BEFORE THE DEPARTMENT OF REVENUE
OF THE STATE OF MONTANA

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| In the matter of the adoption of New Rules I through III pertaining to apportionment and allocation of income for financial institutions | ) ) ) ) | NOTICE OF ADOPTION |

TO: All Concerned Persons

1. On October 13, 2017, the Department of Revenue published MAR Notice No. 42-2-986 pertaining to the public hearing on the proposed adoption of the above-stated rules at page 1844 of the 2017 Montana Administrative Register, Issue Number 19.

2. On November 2, 2017, a public hearing was held to consider the proposed adoption. Bob Story, Montana Taxpayers Association, appeared and testified at the hearing. Other members of the public attended the hearing but did not testify. Written comments were received from Steve Turkiewicz, Montana Bankers Association.

3. The department adopts New Rule II (42.26.1302) and New Rule III (42.26.1303) as proposed, effective January 1, 2018.

4. As presented at the public hearing, the department is removing the language originally proposed for New Rule I(8)(g) and (h) that references credit unions. Therefore, the department adopts New Rule I (42.26.1301) as proposed, effective January 1, 2018, but with the following changes from the original proposal, new matter underlined, deleted matter interlined:

NEW RULE I (42.26.1301) DEFINITIONS The following definitions apply to terms used in this subchapter.

(1) through (7) remain as proposed.

(8) "Financial institution" means:

(a) through (f) remain as proposed.

~~(g) a state credit union the loan assets of which exceed $50,000,000 as of the first day of its taxable year;~~

~~(h) a production credit association organized under the Federal Farm Credit Act of 1933, all of whose stock held by the Federal Production Credit Corporation has been retired;~~

~~(i)~~(g) any corporation whose voting stock is more than fifty percent owned, directly or indirectly, by any person or business entity described in ~~subsections~~ (a) through ~~(h)~~(f) above other than an insurance company;

(j) remains as proposed, but is renumbered (h).

~~(k)~~(i) any other person or business entity, other than an insurance company, a real estate broker, or a securities dealer which derives more than fifty percent of its gross income from activities that a person described in (b), (g), ~~and~~ or (h) ~~through (j)~~ above.

(9) through (18) remain as proposed.

5. The department has thoroughly considered the comments received. A summary of the comments and the department's responses are as follows:

COMMENT 1: Regarding proposed New Rule II, Mr. Story commented that the rule references statutes that were changed with the adoption of House Bill 511, L. 2017, which amended the apportionment laws by referencing the Multi-State Tax Commission compact contained in 15-1- 601, MCA. However, when a person is directed in the new rule to Title 15, chapter 31, part 3, they will have to go to 15-1-601, MCA, to find out what the law really means. There should be a better way to reference this.

RESPONSE 1: Referencing the compact in Title 15, chapter 31, part 3, MCA, was discussed at length within the department during the legislative session. It was ultimately decided, and recommended to the legislature, that it is best to keep the compact intact in its current location and also retain the statutes in Title 31, chapter 31, part 3, MCA. When drafting these administrative rules, the issue arose again in references within the rules. Although taxpayers will be directed to chapter 31, and then on to the compact, the department believes it is important to keep the references within the administrative rules to chapter 31. The legislature did not repeal the statutes in chapter 31, so changes may be made in future legislative sessions. If references are made directly to the compact, taxpayers may miss changes that affect them that are addressed in chapter 31.

COMMENT 2: Regarding proposed New Rule III, Mr. Story commented that keeping the numbers included in the receipts factor tied to original collateral seems to be attempting to keep in place a formula that should change with the situation. If, for example, a borrower did have in-state property securing the original loan, but the loan is modified over time rather than being reissued and the collateral is now all out of state, why should that receipt still be taxable?

He also asked why receipts cannot be less than zero. If net gains can be taxed, why can net losses not be deducted?

Mr. Story further commented on the language pertaining to how merchant discounts are reported, and asked if there are similar rules for surcharges such as those that counties charge when a credit card is used to pay taxes.

RESPONSE 2: The language in New Rule III(2)(b) is for ease of administration for both the taxpayer and the department. Tracking the subsequent substitutions of collateral would likely not be material enough to merit the additional tracking effort.

Losses can be used to offset gains, but only to a net zero. To go below zero when offsetting gains by losses could result in a negative sales factor which would not be reflective of the entity's activity in the state. This treatment is not new. This language has been part of ARM 42.26.259 for many years.

New Rule III(7)(c) is intended to serve as a catchall for how to source other fees that are not specifically addressed in the rule.

COMMENT 3: Mr. Turkiewicz commented that while New Rule III is long and details various receipt types based on Section 3 of the MTC model rules, it does not include MTC Section 3, subparagraph (o), regarding all other receipts, which reads "the numerator of the receipts factor includes all other receipts pursuant to the rules set forth (insert your state's regular situsing rules for the receipts not covered in this section)."

Since this important subparagraph was not included in the rule, the taxpayer must go to 15-1-601(17), MCA, to determine the "other receipts" to include in the receipts factor numerator for financial institutions. He commented that he understands there are style and construction limitations that the department must follow and that the "all other receipts" language was not included for this reason, but without the Section 3, subparagraph (o) language included the taxpayer must review several sections of the Montana Code Annotated and the Montana Administrative Rules to determine the full extent of the receipts that may be included in the receipts numerator factor. There should be a better way for the taxpayer to comply with the rules without having to pour over statutes and rules when calculating the taxpayer's Montana income using the apportionment factors in the proposed new rules for financial institutions.

RESPONSE 3: The language included in subparagraph (o) of the MTC model regulations is included in New Rule II. As detailed in the reasonable necessity provided in the proposal notice, New Rule II directs taxpayers to Title 15, chapter 31, part 3, MCA, and the supporting administrative rules in ARM Title 42, chapter 26, for apportionment and allocation issues not specifically addressed in this subchapter. This is consistent with the way the other industry specific administrative rules read and is done to prevent the duplication of general apportionment and allocation rules that apply to all entities.

COMMENT 4: Mr. Turkiewicz commented that as he reads the proposed language in New Rule III(11)(a), net gains on trading assets are to be included in the apportionment factor for sales of trading assets for financial institutions, which appears to be different than the treatment of "assets" for non-financial industries. Sales of trading assets of financial institutions should have equivalent treatment as sales made by manufacturers and retailers; thus, the gross selling price of trading assets should be included in the receipts just as the gross selling price of widget sold by manufacturers and retailers are included the receipts factor. Assets maintained for sale in the inventory of a financial institution are equivalent to assets maintained for sale in the inventory of manufacturers and retailers.

Therefore, the Montana Bankers Association respectfully requests that the department include "gross receipts," not "net gains," in the apportionment factor for sales of trading assets.

RESPONSE 4: The decision to use net gains instead of gross receipts for the sales of trading assets was thoroughly discussed by the states and industry during the MTC model regulation drafting. To allow the inclusion of gross receipts for trading assets and net gains for all other items of revenue associated with a financial institution would distort the sales factor and would not provide a fair reflection of the financial institutions' business activity in all states. The department believes that it is proper to include only net gains from the sale of trading assets in the sales numerator and denominator.

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| /s/ Laurie Logan | /s/ Mike Kadas |
| Laurie Logan | Mike Kadas |
| Rule Reviewer | Director of Revenue |

Certified to the Secretary of State November 27, 2017.