

HB 598. Conform net operating loss (NOL) provisions to federal code

Hearing: March 10, 2010
House Taxation Committee
Statement of the Montana Telecommunications Association

Thank Rep. Knudsen for bringing this legislation forward.

As Rep. Knudsen mentioned, this is a jobs, investment and revenue bill. HB 598 allows companies to apply losses to grow their current businesses, create new enterprises, invest in new facilities, and employ more Montana citizens. And in so doing, businesses, by taking advantage of the opportunities presented by HB 598, will expand the tax base which results in additional revenues for State and local governments.

Here are two examples of how this bill, if it had been enacted, could have helped specific, real companies in Montana.

The first example involves a company that not only provides high quality telecommunications services and products to its business and residential consumers, but it often launches new enterprises in a continual effort to meet market demand for telecommunications services. These new start-up enterprises by definition don't have prior tax years in which to apply any NOL look back provisions. Moreover, it often takes start-ups years to earn a profit. So, they benefit from NOL carry-forward provisions. In fact, one could argue that it is precisely this sort of enterprise we want to encourage, and NOL provisions enable such start-up enterprises to save money which otherwise could pay for growing the business.

With a 7-year carry forward, as in current Montana law, one start-up spawned by the company in this example, just started finally to earn a profit at about the same time that it lost its ability to benefit from Montana's NOL provisions. Thus, the

NOLs were of little use—directly contrary to the intent of NOL provisions, which is to give struggling or start up enterprises a tax break while they are heavily investing in their business’ survival.

As is the case with any enterprise that is able to keep money, the enterprise could have invested more of its resources in new facilities, better services, and jobs. To the extent that the company could have been invested in more plant, it would have expanded the property tax base on which it pays taxes. To the extent it could have invested in jobs, it obviously would employ Montanans, who in turn would expand Montana’s income tax base. In this example, the company actually identified two new positions it would have been able to create if it had been able to apply a 20-year NOL carry-forward provision.

The second example involves the merger provisions of HB 598, in which a company acquired a struggling Montana enterprise. If the merger provisions of HB 598 were in effect, the acquiring company could have benefited by acquiring the struggling firm’s NOLs. The acquiring company could have had additional revenues to invest in turning the newly acquired company around, investing in more plant and employing more Montanans. In addition, the NOLs of the struggling company could have “discounted” the acquisition price of the acquired company, making it more attractive in the market for acquisition.

In the case of mergers or acquisitions, the ability to acquire NOLs makes struggling firms more attractive. Moreover, allowing acquiring companies to inherit the NOLs of a struggling company can make the difference between saving a company and its employees and letting the struggling company go out of business, causing job loss as well as permanent state and local revenue loss.

In fact, in this example, the acquiring company was advised by nationally respected accounting firms that the acquisition price *could* be discounted by the acquired company’s NOLs. It was only after the acquisition that the acquiring

company and its accountants discovered that Montana law does not conform to federal law. It was an oversight that cost hundreds of thousands of dollars—dollars that could have been put to much better use.

So an additional benefit of HB 598 is to eliminate confusion that can be caused when state law does not conform to federal law.

As Rep. Knudsen stated, the Fiscal Note accompanying HB 598 completely misses the point about how NOL deductions stimulate business activity and job growth. Instead, the Fiscal Note assumes there will be lost revenues, without taking into account the positive effects of job and investment growth.

Moreover, the Fiscal note says on the one hand that “many corporations use up all or most of their NOL in one or two years of carry-backs.” It does not address start-ups at all. It notes that long term effects are even less predictable, assuming again that the bill would result in revenue loss, rather than revenue gain from a broadened tax base. The Fiscal Note merely says that “the amount of reduction will vary greatly from year to year depending on whether corporation[s] with losses carried forward for more than 7 years have income to offset in the 8th through 20th year.”

Another interesting point about the Fiscal Note: when a very similar bill to HB 598 was analyzed by the Department of Revenue in 2007, the Department estimated a revenue loss of about \$200,000 a year, not the millions that the Department now estimates.

In summary, HB 598 will reduce confusion and complexity caused when Montana law fails to conform to federal law. It will promote investment in new facilities. It will encourage job growth. It will help rescue failing companies from bankruptcy, thereby saving jobs and maintaining—if not growing—state and local government revenues.

I urge the Committee to give HB 598 a Do Pass.

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