montana business quarterly

AUTUMN 1977

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AUTUMN 1977 VOLUME 15 NUMBER 4

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Graphic Design: JACOBSON ADVERTISING AGENCY

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Second-class postage paid at Missoula, MT 59812.

The Montana Business Quarterly is available on Microfilm from University Microfilms, 300 N. Zeeb Rd., Ann Arbor, MI 48106.

The subscription rates for the Quarterly are $6.00 per year, $11.00 for two years, $16.00 for three years, and $2.00 per single issue.

Reprints of the articles are not available but additional copies of the Quarterly may be secured at $2.00 per copy.

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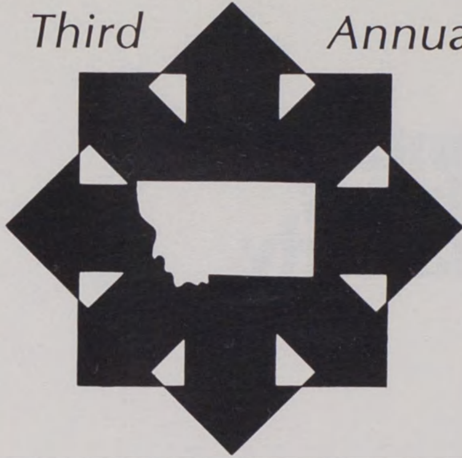

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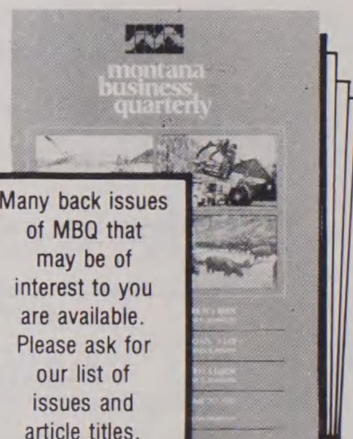

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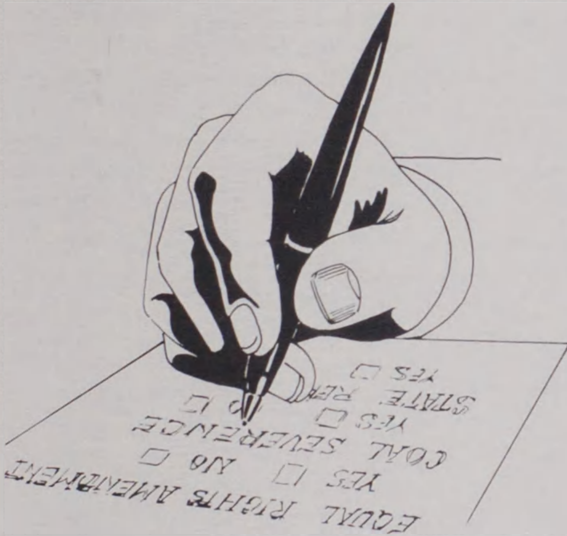
CITIZEN PREFERENCES AND LEGISLATIVE CHOICE:

An Examination of the Montana Legislature's 45th Session



JERRY W. CALVERT

Jerry W. Calvert is Assistant Professor in the Department of Political Science, Montana State University, Bozeman.

The 1977 edition of the Montana Legislature has come and gone. The Legislature sat, pondered, debated, enacted some new laws, did not enact many others, and finally went home to its biennial slumber.

Retrospective examinations of what representative institutions are supposed to do and what they do in fact are useful but sometimes painful. Representative institutions, we have been told, exist to carry out the public will and realize the public interest. The Montana Constitution unequivocally states: "All political power is invested in and derived from the people. All government of right originates with people, is founded upon their will only, and is instituted solely for the good of the whole." The belief that representative bodies exist primarily to realize the public will is further encouraged by the means by which members are selected — elections — and no doubt by the rhetoric of office seekers who ritually promise to be "responsive," and to "listen." This study will examine one aspect of the larger relationship of representation. To what extent do legislators in their actions reflect the opinions of the people who elect them?

Here representation is being defined in *instrumental* terms. Representatives are defined by their activity, by what they *do*, or fail to do with reference to specific issues. However, there is often a considerable gap between the choices made by state legislators and their constituents. The gap is affected significantly by partisan cleavages within the Legislature and an endemic citizen indifference to and lack of knowledge about the process from without. In order to study the relationship between citizen preference and legislative choice in Montana, a public opinion survey was completed under a modest grant provided by the Research Administration of Montana State University.

How constituents were surveyed

Shortly after the 1977 Legislature ended, 2,066 voters were randomly selected from the voting lists of 54 precincts, which also had been randomly selected. The precincts were located in 27 counties. These counties comprised 31 Senate and 41 House districts. Each of the 2,066 voters was sent a six-page questionnaire. Of these, 1,863 actually received it (the rest having moved, left no forwarding address, etc.), and 1,179 replied, a response rate of 63 percent. The rate of response was very high and represents the results of careful design and persistent follow-up for non-response. Consequently, in demographic terms the sample approximates the population from which it was

drawn, based upon what is known nationally about those who register and vote and those who do neither. The demographic characteristics of the sample and its relationship to the population as a whole are found in table 1.

Registration and voting are related to social class and status among the eligible adult population. Those with better education, higher income, white collar occupations, and those who are self-employed register and vote in higher proportions than those of modest education, low income, and blue collar occupations. In addition, participation is related to age. Young people (24 and under) fail to register and vote in large numbers (less than half reported doing so in 1974) while a high percentage of those in the middle years (45-54) do so. Among blue collar workers, slightly more than half will be registered to vote; among ranchers and farmers, as many as three-quarters will be registered.[1] Thus the underrepresentation of certain categories of people among respondents is not only expected, but unavoidable.

In order to compare constituent preferences with public choices made by their representatives, constituents were asked about specific issues actually considered by the Legislature. They were asked whether they "favored" or "opposed" the substance of a bill or resolution, or were presented with policy alternatives and asked which of the alternatives they agreed with most. Assertive statements which tend to unduly influence the result, such as "America is the best place in the world to raise children, (agree or disagree?)" were not used. Rather constituents were asked, "Do you favor or oppose legislation that would permit the sale of wine in grocery stores?" And, "With regard to the recall of public officials, which of the following statements do you agree with more? Only elected state officials should be subject to recall and only for specific statutory cause, or any public official whether elected or appointed should be subject to recall for any reason the voters think fit." Constituent responses were then compared to the roll call votes cast by their representatives on the issues studied, the vote being seen as an expression of the legislator's judgment on the issue.

The roll call votes used in this study and a

[1]U.S. Bureau of the Census, "Voting and Registration in the Election of November, 1974." *Current Population Reports*, series P-20, No. 293 (Washington, D.C.: U.S. Government Printing Office, 1976) and *idem*, "Voting and Registration in the Election of November, 1972," *Current Population Reports*, series P-20, No. 253 (Washington, D.C.: U.S. Government Printing Office, 1973).

Table 1

Characteristics of Survey Respondents and Montana's Adult Population

Characteristics	Sample (Percent)	Montana Adult Population[a] (Percent)
Sex		
Men	50.2	49.4
Women	49.8	50.6
Age		
18-24	10.6	18.9
25-44	38.8	36.3
45-64	33.4	30.1
65 or over	17.2	14.7
Race		
White	98.0	96.7
Non-white	2.0	3.3
Marital status		
Married	80.1	63.5
Single	12.4	25.7
Widowed or divorced	7.5	10.8
Education		
8th grade or less	8.8	25.2
Some high school	6.4	15.7
High school graduate	46.2	34.0
Some college	17.4	14.0
College graduate	21.1	11.0
Occupation		
Professional and technical	17.8	14.5
Business and management	20.3	10.3
Clerical and sales	19.6	21.1
Blue collar workers	28.0	42.3
Ranchers and farmers	14.3	11.8
Place of residence[b]		
Urban (places of 2,500 or more)	64.1	53.4
Rural (places less than 2,500 in population)	35.9	46.6
Income[c]		
$5,000 or less	18.5	
$5,000-$9,999	22.6	
$10,000-$14,999	27.4	
$15,000-$24,999	24.6	
$25,000 or more	6.9	

[a]Data obtained from the U.S. Bureau of the Census, *Census of Population: 1970, General Social and Economic Characteristics, Montana*, PC(1)-C23 (Washington, D.C.: U.S. Government Printing Office, 1971) and *idem*, "Population Estimates and Projections of the Population of Voting Age for States: November 1976," *Current Population Reports*, Series P.25, No. 626 (Washington, D.C.: U.S. Government Printing Office, 1976).

[b]Based on location of the voting precinct rather than each respondent identifying the type of locale. As such, residents probably underestimated in the above statistics are rural residents who live adjacent to urban areas.

[c]No recent income figures are available for the state.

summary description of each piece of legislation are listed in Appendix A. Twenty-four issues were examined. They were selected because of their significance to the state, the publicity they received in the media, or the controversy they generated. The issues used here include the much disputed Equal Rights Amendment, gambling, subdivision regulation, strip mining, energy policy, taxes, regulation of lobbying activities, annual sessions, Indian-white relations, and others. To be sure, there is necessarily disagreement concerning what is an "important" issue, and the issues contained here should be viewed as primarily an illustrative cross-section of policy options used to examine how representative institutions work.

Constituents and legislators: the comparison

The basic comparison between constituent preferences and public choices is shown in the next two tables. Table 2 compares the constituents' opinions with the votes of state senators who represent them. Table 3 compares constituents' opinions with the votes of their state representatives. In the first column is the percentage of those constituents supporting the bill or resolution in question; in the second column, the proportion of their senators or representatives supporting the bill or resolution. The third shows the degree of difference between the two groups expressed in percentage points. The degree of statistical significance in the differences (if any) is reported also.

In examining these two tables two things should be noted, first, whether the constituent majority was supported by a Senate or House majority, and second, the difference between constituents and legislators on each issue. It must be stressed that the comparison is between constituents and their state legislators rather than between a sample of citizens and the Legislature as a whole. Hence the percentages reported for senators and representatives in the tables refer only to those members who coincidentally happened to represent the people in the precincts which had been previously selected at random.

The most cursory glance at tables 2 and 3 will reveal that there is often a considerable difference of opinion between legislators and constituents on the issues; consequently, majority sentiment is oftentimes not reflected in legislative choice. In the Senate, on only five of eighteen issues (28 percent) under consideration did the legislative majority reflect the sentiments of the constituent majority. In the House the legislative majority did somewhat better, concurring with the constituent majority on eleven out of twenty issues, or 55 percent. The mean difference between legislators and constituents, which describes the *quality* of the representative relationship, is best demonstrated by percentage points. The average or mean difference of opinion for all issues between senators and constituents was 31.8 percent; between representatives and constituents, 25.2 percent.

Examining the differences more closely, it is clear that senators and their constituents were in sharp disagreement over environmental issues. While a very large majority of our respondents endorsed the banning of the nonreturnable beverage container, only a minority of their senators supported the so-called "bottle bill." A majority of constituents supported existing legislation requiring local government review of subdivision applications and retention of reclamation requirements of the existing strip mine reclamation law enacted in 1973. A majority of their senators, however, supported bills which, if they had been approved by both houses, would have eliminated public involvement as a consideration in subdivision regulation, and seriously altered the reclamation requirements governing strip mines. By way of contrast, the differences between constituents and House members were significantly smaller.

"There tended to be broad areas of agreement among constituents. Differences based on partisan identification and rural-urban cleavages were relatively slight."

Both chambers of the Legislature were found to be in strong disagreement with constituents on issues concerning the structure and process of politics itself. While only a thin majority of those willing to take a stand supported the concept of annual legislative sessions, an extremely large majority (96.7 percent) of constituents gave affirmative replies to the question: "Would you favor or oppose legislation which would require lobbyists to report the amount of money they spend trying to influence legislation?" Legislation designed to do just that was rejected by both chambers. Constituents also favored legislation

which would limit the volume of legislation introduced. Two bills intending to impose such a limit were rejected.

A surprising finding of this survey is that constituents did not agree with their legislators on the question of recall elections. In the 1976 general election an initiative measure was sponsored by conservative groups in the state. Entitled the Recall and Advisory Recall Act, it was approved by the voters by a margin of 57 percent in favor and 43 percent opposed.

The initiative approved by Montana voters was broad in scope. No distinction was made between elected and appointed officials, and the rationale for recall was sweepingly defined as "any reason causing the electorate dissatisfaction . . notwithstanding good faith attempts" on the part of the affected official to do his or her duty. Approval of the initiative required the Legislature to enact laws to legally implement its intent.

What the Legislature subsequently enacted was clearly and self-consciously more modest, limiting recall to elected officials only, and then only for specific statutory cause, such as physical or mental impairment or violation of criminal law. As illustrated in the example given earlier, constituents were offered the two alternatives — the substance of the initiative itself or the substance

Table 2

State Senators' Choices and Constituent Opinion
1977

	Percent Favoring the Legislation		Difference in Percentage Points
	Constituents	Senators	
Structure and Process Issues:			
1. Annual sessions	53.6	24.1	–29.5
2. Lobbyist expense reporting requirements	96.7	33.3	–63.4**
3. Limiting bills	71.1	10.0	–61.1**
4. Recall of officials (modest version)	20.2	53.6	+33.4**
Environment and Land Use Regulation Issues:			
5. Limit corporate farming	48.9	31.0	–17.9
6. Ban throwaway bottles	81.2	32.3	–48.9**
7. Regulate subdivisions	79.9	36.7	–43.2**
8. Strip mine reclamation[a]	61.7	36.7	–25.0*
9. Water reservations on the Yellowstone[b]	39.7	96.5	+56.8**
Taxes:			
10. Coal severance tax[c]	61.0	77.4	+16.4
11. Property tax replacement act	54.2	41.4	–12.8
12. Homestead Tax Relief	78.9	70.0	– 8.9
Other			
13. Keno	55.6	22.6	–33.0*
14. Equal Rights Amendment	53.9	54.8	+ 0.9
15. Wine in stores	66.1	51.6	–14.5
16. State jurisdiction on reservations	76.9	96.3	+19.4*
17. Study Indian-white jurisdiction problems	85.3	14.8	–70.5**
18. Forbidding strikes by public employees	61.9	44.8	–17.1

+ = more supportive than constituents.
– = less supportive than constituents.
*Difference statistically significant at the .05 level or below.
**Difference statistically significant at the .001 level or below. The larger the difference the closer to statistical significance. At the .05 level the probability of a difference of the observed magnitude occurring by chance is only 5 out of 100 times; at .001 level, 1 in 1,000. Statistically significant differences may not necessarily mean substantive significance. Our assumption is that in a democratic system differences between representatives and constituents can occur and do, but they cannot also be endemic. The gap between constituents and legislative action should not be consistently large. Majority public sentiment should not be regularly unreflected in legislative choice. Differences reported here and for the 1975 Legislature demand explanations, however tentative they may be.

[a]Percentage refers to support for the 1973 Montana Strip Mine Reclamation Act.

[b]The Senate bill in question would have established the following priority list for future reservations: domestic, agricultural, industrial, and fish and wildlife uses. Herein constituents were scored as favoring the bill if they placed industrial users ahead of or equal to fish and wildlife claims. Those placing fish and wildlife ahead of industrial claims were scored as opposed to SB359.

[c]Percentage refers to those supporting the present tax rate on coal.

of the legislation subsequently enacted. A large majority selected the former, thus placing the Legislature in a position of doing less than what the public apparently wanted, and in direct contradiction to the spirit of the initiative which had been approved.

Members of both chambers were much closer to constituents on questions of taxes, on what to do about Indian-white conflicts of jurisdiction on reservations, and on the question of lease or purchase of agricultural land by foreign corporations. House members were very close to constituents in retaining bingo and keno as legal games of chance, as were the senators in their reaction to the Equal Rights Amendment. Finally, the House, in rejecting two bills which would have involved the state in promoting new energy technologies, was clearly out of step with constituent sentiment, as was the Senate in its rejection of a bill establishing a state study of Indian-white relations.

In general, there tended to be broad areas of agreement among constituents. Differences based on partisan identification and rural-urban cleavages were relatively slight. The mean difference of opinion between Republican and Democratic voters was only 12.9 percentage points for all issues; between urban and rural residents, a slight 2.8 percentage points. To be sure there was significant disagreement on some issues. Rural and urban voters divided most sharply on the issue of public access (18.7 percentage points), and between Republicans and Democrats on the issue of annual sessions (56 percentage points). In defining rural and urban, we have followed the U.S. Census classification: rural residents live on farms or in places of 2,500 or fewer inhabitants, and urban residents live in places with more than 2,500 residents.

The relative lack of partisan and regional differentiation among voters is not mirrored by the behavior of their representatives. Legislators

Table 3

State Representatives' Choices and Constituent Opinion 1977

	Percent Favoring the Legislation		Difference in Percentage Points
	Constituents	Representatives	
Structure and Process Issues:			
1. Annual sessions	53.6	60.0	+ 6.4
2. Lobbyist expense reporting requirements	96.7	30.0	–66.7**
3. Limiting bills	71.1	25.6	–45.5**
4. Recall of officials (modest version)	20.2	97.1	+76.9**
Environmental and Land Use Regulation Issues:			
5. Limit corporate farming	48.9	60.0	+11.1
6. Regulate subdivisions	79.9	65.0	–14.9*
7. Strip mine reclamation[a]	61.7	82.5	+20.8*
8. Water reservations on the Yellowstone[b]	39.7	18.4	–21.3*
Taxes:			
9. Coal severance tax[c]	61.0	51.2	– 9.8
10. Property tax replacement act	54.2	65.9	+11.7
11. Homestead Tax Relief	78.9	73.2	– 5.7
Other			
12. Bingo	85.2	87.5	+ 2.3
13. Keno	55.6	53.7	– 1.9
14. State lottery	57.3	18.9	–38.4**
15. Slot machines	35.4	15.4	–20.0*
16. Renewable energy resources	85.6	18.4	–67.2**
17. Coal gasification	72.6	40.0	–32.6**
18. State jurisdiction on Indian reservations	76.9	75.0	– 1.9
19. Study Indian-white jurisdiction problems	85.3	70.0	–15.3*
20. Permitting public access to state land	54.2	20.0	–34.2**

+ = more supportive than constituents.
– = less supportive than constituents.
*Difference statistically significant at the .05 level or below.
**Difference statistically significant at the .001 level or below.

divided sharply on partisan lines though somewhat less so on a rural-urban basis. The mean difference of opinion for Republican and Democratic legislators for all issues was 33.8 percentage points; between rural and urban legislators, 20.5 percentage points. The sharpest partisan cleavages occurred on the issues of annual sessions (68.7 percentage points), nonagricultural and foreign corporations in the agricultural business (68.4 percentage points), appropriating money to study Indian-white conflicts (55.5 percentage points), and the "bottle bill" (53.7 percentage points). Between rural and urban legislators annual sessions proved also to be the most divisive (44.4 percentage points) followed by the state subdivision law (43.4 percentage points) and the Equal Rights Amendment (41.4 percentage points).

Ironically, the study showed the difference between urban and rural voters on the Equal Rights Amendment to be miniscule, a mere 1.3 percentage points difference. It cannot be said, therefore, that the differences among legislators are a reflection of similar differences in the electorate. Dissimilarity between constituents and legislators is most apparent when the two are compared on the partisan dimension.

"Legislators divide sharply on partisan lines and somewhat less so on a rural-urban basis."

The distance between constituent preferences and legislative choices is shaped to a significant degree by the partisan affiliation of the legislators themselves. In a word, Republican legislators were less accurate in reflecting constituent opinion on the issues than Democrats. The mean difference of opinion between Republican legislators and their constituents was 37.1 percentage points; between Democrats and constituents, 24.1 percentage points. As table 4 demonstrates, the relationship holds regardless of the partisan affiliation of the constituents as well. Not surprisingly, the greatest difference of opinion was between Democratic constituents and the Republican legislators who represent them, but the distance is almost as great for independents. Most interesting was that Democratic legislators did a slightly better job of reflecting the preferences of Republican constituents in their districts than did Republican legislators in their districts.

Other factors which might affect the quality of representation presented here, such as region,

Table 4

Mean Difference of Opinion Between Legislators and Constituents (In Percentage Points)

	Republican Legislators	Democratic Legislators
Republican constituents	*32.6*	*28.4*
Democratic constituents	*40.0*	*25.4*
Independent constituents	*38.7*	*23.3*

degree of interparty competition, and the number of terms served by legislators, did not begin to approach the differences associated with the partisan affiliation of legislators. For example, the mean difference of opinion between urban representatives and their constituents was 25.8 percentage points; between rural representatives and their constituents, 28.1 percentage points.

The greater distance between Republican legislators and constituents appears to be a function of ideology. Republican legislators in their voting behavior tend to take the conservative position on both economic and social questions, but constituents in Montana are not as consistent or predictable. Constituents are willing to endorse more liberal solutions on certain issues. Specifically, constituents are willing to accept the use of government power and government regulation if protection of the environment or development and conservation of energy is the issue. In this study constituents were decidedly more favorable toward banning throwaway beverage containers, accepting state involvement in developing new energy technologies, keeping the public interest requirement in the Montana subdivision law, retaining the reclamation requirements of the state strip mine law, and placing lesser importance on industrial claims for Yellowstone River water than were Republican legislators. Less disagreement between the more liberal Democratic legislators and constituents on such issues in turn contributed to the figures illustrated in table 4.

That political party affiliation is a strong determinant of legislative choice is given little legitimacy by constituents themselves. In table 5 we see that constituents *expect* their legislators to pay a great deal of attention to district opinion when they make policy, while few are willing to assign such weight to the advice of party leaders, the Governor, and interest group spokesmen.[2] Constituents expect their representatives to adopt the delegate role or style of representation. This role assumes that the legislator's primary responsibility is to reflect the "will" of the district in his or her policy making, even to the extent of subordinating the dictates of personal judgment to district opinion.

Unfortunately, constituent expectations are not reinforced by constituent behavior. If constituents expect legislators to pay a great deal of attention to the opinions of the people in the district, then constituents must have the minimal knowledge required to communicate effectively, and they must do so. Perhaps the most sobering data gleaned from this survey is the sheer lack of citizen involvement in the legislative process. Such lack of involvement partially explains the differences in constituent preference and legislative choice; a legislator can hardly follow closely the dictates of constituents who fail to communicate their views.

At the very least, citizens should know their legislators' names. It should be easy; under the single member district form of election adopted in 1974 each voter is represented by a single senator and single representative. Yet when asked to recall the name of their legislators, only 35.6 percent were able to correctly identify their senator, and 37.1 percent their state representative.[3]

In addition there seems to be only minimal willingness to evaluate legislative performance with reference to any standard. Of those citizens able to identify one of their legislators or both, a clear majority (60 percent) did not respond to the question: "Is there anything in particular that you liked or disliked about the job your state legislators did during the 1977 session of the Legislature?" Of those who did respond, more than half made reference to the presumed personal characteristics of the legislators, while less than one in four responded by making reference to the perceived public policy positions taken by the legislators.

Table 5

Constituent Perception of Expected Legislative Behavior

(In Percentage Points)

Question: "In general, how much attention do you expect your state legislators to give to each of the following when they vote on bills and resolutions?"

	A Great Deal of Attention	Some Attention	Little Attention
The opinions of the people in the district	85.1	10.6	4.3
The advice of interest groups	17.5	59.0	23.5
The legislator's own best judgment	34.2	51.0	14.8
The advice of party leaders	10.3	39.2	50.5
The position taken by the Governor	8.1	44.7	47.2

In addition to discovering that only a minority of those surveyed can even identify their representatives, the survey found that most citizens play a passive role in the policy process. For most citizens, the infrequent act of voting and talking about political subjects appears to exhaust their utilization of the democratic process. As table 6 shows, initiating contact with a legislator to express opinions, as opposed to merely discussing politics, is an adventure upon which only a few embark.

Those few who directly participated in the legislative effort, as shown in table 6, were not

Table 6

Political Participation: Percent Reporting Having Engaged in Each Participatory Activity

Activity	Percent
Visited the Legislature	6.8
Attended a committee hearing	7.5
Contacted the legislator(s) to express opinions	18.8
Belonged to a group that was actively trying to influence legislation	24.2
Attended a meeting at which legislative issues were discussed	27.2
Talked with friends and relatives about the issues	84.2

[2]A similar question was used in a survey conducted on behalf of Governor Judge in early 1977. The response was similar to that reported here. See *Montana Futures, a Survey of Citizen Choices* (Helena: Office of the Governor, 1977), pp. 17-18.

[3]This represents a small decline in name recognition reported in this journal for the 1975 Legislature. See "Representation, Reform, and Accountability: a look at the Montana Legislature," *Montana Business Quarterly* (Missoula: University of Montana, 1976).

Table 7

Social Composition of the Montana Legislature by Occupation 1965-1977

(Mean Percent Serving)*

	Senate	House
Farmers and ranchers	41.5	36.6
Business	28.5	28.5
Professional and technical	22.0	18.0
Clerical and sales workers	1.3	4.1
Manual workers	1.9	7.0
Housewives	0.5	2.0
Retired	3.6	7.9
Other	1.6	3.8

*Percentages, when added, do not equal 100 due to averaging.

evenly distributed among population groups. On one extreme are the people we will lable the apathetics, who engaged in none of the activities reported above, and who comprise about 13 percent of the respondents. At the other extreme are the activists. These individuals reported contacting a legislator and having engaged in at least two other participatory activities. They comprised slightly less than 9 percent of the sample. Between the two extremes is the large and relatively passive majority—those who discussed issues, attended a meeting, or belonged to a group.

Participation is directly associated with social class. Apathetics tended to have a high school education or less, were blue collar workers if employed, and were lower-middle and lower income. The activists tended to be the apathetics' social opposites. Activism was associated with having a college education, being a rancher-farmer, business or professional person, and having an above average income.

Social class is also directly associated with the tendency to seek legislative office. Since 1965, legislators have been drawn from the same social groups from which the citizen activists tend to originate (see table 7). Farmers and ranchers are the most overrepresented social group in comparison to their distribution in the population, while blue collar workers tend to be significantly underrepresented.[4]

While the relationship between social class and political participation is clear and is usually accounted for by inequality of education and

income, the relationship between participation and public policy remains ambiguous. First, the survey data here tend to contradict recent findings by political scientists Sidney Verba and Norman Nie, who argue that public policy is conservative in part because high participant groups are also more conservative than non-participant groups.[5] Here there is no evidence of a consistent relationship between tendency to participate and particular issue positions. For example, the activists were most supportive of annual legislative sessions (generally considered a liberal position), and were least supportive of ratification of the Equal Rights Amendment (also considered to be a liberal measure). Activists supported the existing public review of subdivisions and were the least supportive of state involvement in development of renewable energy resources. In short, activists, like the more numerous non-participatory citizens, were found to be neither consistently liberal nor conservative, but rather leaned one way and then the other, depending on the issue.

Further, the data neither confirm nor deny one of the most cherished assumptions of the democratic process, that participation counts. In light of this assumption it was hypothesized that activist citizens more closely agree with legislators on issues than

[4]The dominance of rancher-farmers in state legislatures is pronounced in the Rocky Mountain states and the agricultural plains states to their east. See *Occupational Profile of State Legislators, 1976* (New York: Insurance Institute of America, 1977).

[5]Sidney Verba and Norman Nie, *Participation in America, Political Democracy and Social Equality* (New York: Harper & Row, 1972).

do non-activist citizens. After studying the mean difference of opinion between legislators and constituents it was found that there is no apparent relationship between levels of participation and the quality of representation. The mean difference of opinion between activist citizens and legislators was 25.2 percentage points; between less active citizens and legislators, 24.3 percentage points.[6]

"Republican legislators in their voting behavior tend to take the conservative position in both economic and social questions, but constituents in Montana are not as consistent or predictable."

This finding, though disturbing, is highly tentative at this point and must be qualified. Activist citizens may achieve some or all of the goals they seek because of their activity on the issues that interest them, issues which may not only be specific, but of interest to only a few. In addition, the findings do not imply that citizen representation by special interest groups and political parties should be minimized. Almost one-quarter of our respondents indicated that they belonged to a group that was actively involved in influencing legislation. The effect political parties have on the representative relationship has already been shown.

Nonetheless, elected officials exercise a great deal of independence. This is shown by the gap between constituent preferences and legislative performance, and is encouraged by the general lack of citizen attention and knowledge already described.

Public inattention is not a constant, however, and the discretion exercised by elected representatives is certainly not without limits. Periodic elections, opportunities for citizens to inform themselves and gain access to the process, and the intense interest shown toward some issues mark the outer limits of legislative discretion. A legislator who acquires a reputation for indifference to his or her constituents does so at great peril. Data in this study notwithstanding, representatives will continue to act as they always have done, to act as if the district were watching on at least some issues. Casting the wrong vote on one issue out of several hundred can spell electoral defeat. Someone may be watching. □

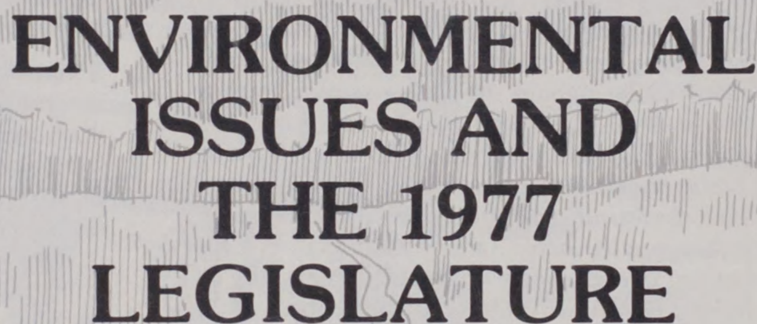
[6]*Ibid.* The data contradict the finding of Verba and Nie here as well. They suggested participation did count in influencing public policy. But their measure was different than that used here.

APPENDIX A
Bills and Resolutions Used in the Study

Issue		Disposition[a]	
1	A bill to put the question of annual legislative sessions before the people in the form of referendum.	rejected by Senate approved by House	13-32 54-30
2	Two bills designed to require lobbyists to report expenses incurred in lobbying efforts.	rejected by Senate rejected by House	13-35 26-60
3	Senate bill would have required legislators to get together when sponsoring similar bills, and work on creating a single bill. House bill would have required any legislator who introduces any bill in excess of five to have it approved by a special screening committee.	rejected by Senate rejected by House	8-41 25-63
4	Legislation calling for the recall of elected officials on the basis of defined statutory cause. No provision for the advisory recall of judges.	approved by Senate approved by House	31-17 75-6
5	Family Farm Act calling for the prohibiting of nonagricultural corporations from buying or leasing agricultural land.	rejected by Senate approved by House	17-32 55-37
6	A bill to ban throwaway beverage containers.	rejected by Senate	15-34
7	A bill to remove the public interest criteria contained in the Montana Subdivision and Platting Act.	approved by Senate rejected by House	31-18 29-62
8	A bill permitting a strip miner to reclaim land to meet any future use, significantly altering the mine reclamation law which requires the land to be restored to its original condition.	approved by Senate rejected by House	33-16 21-75
9	A bill establishing an order of preference for water use on the Yellowstone.	approved by Senate rejected by House	43-3 25-66
10	Two bills to modify the tax rate on coal. Senate bill would have raised the tax on lignite from 20% to 30% of market value. House bill would have lowered the tax on high sulphur coal, which had been processed to burn cleaner, from 30% to 20% of market value.	rejected by Senate rejected by House	8-39 46-54
11	The Property Tax Replacement Act would have replaced the homeowner's property tax with a tax on gross personal income.	rejected by Senate approved by House	19-29 72-28
12	A bill appropriating money from the state's general fund surplus and using it to lower the property tax rates for homeowners.	approved by Senate approved by House	37-13 71-28
13	Amendment to a Senate bill calling for the outlawing of bingo.	rejected by House	10-84
14	A bill outlawing keno.	approved by Senate rejected by House	32-18 43-57
15	A bill providing for a state lottery.	rejected by House	19-74
16	A bill legalizing slot machines.	rejected by House	17-76
17	A resolution calling for rescinding the 1974 ratification of the ERA by the state legislature.	rejected by Senate[b]	25-25
18	A bill permitting the sale of wine in grocery stores.	rejected by Senate	22-27
19	A bill calling for the creation of a state commission to encourage research into renewable energy technologies.	rejected by House	18-76
20	A bill creating within the Dept. of Natural Resources and Conservation a new agency to conduct research into coal gasification as an energy source.	rejected by House	40-59
21	A resolution calling on Congress to give the state jurisdiction over non-Indians living on Indian reservations.	approved by Senate approved by House	42-2 62-29
22	A bill appropriating money for a state investigation of Indian-white relations.	rejected by Senate approved by House	7-38 69-24
23	A bill prohibiting strikes by public employees.	rejected by Senate	18-29
24	A bill providing that preference be given bidders for leases of state land who agree to permit public access to the land in question.	rejected by House	20-75

[a]All votes are second reading votes unless otherwise noted. On second reading the bill is reported out of committee. It is usually the critical vote. Failure to win approval here means the bill dies.

[b]Third reading vote. On second reading the Senate approved SJR9 by a margin of one vote. On third reading the vote was a tie. In the case of a tie the bill is killed. Hence in those instances where legislators change their mind third reading becomes critical.



ENVIRONMENTAL ISSUES AND THE 1977 LEGISLATURE

DOROTHY BRADLEY

Dorothy Bradley is a fourth term representative from Bozeman and served as majority whip in the last legislative session.

In a variety of ways, the 1970s have been politically exhilarating for environmentalists. For reasons that are not exactly clear, Montana appears to be leading the nation in the pursuit and enactment of environmental legislation. Although many surrounding states face similar environmental problems and pressures, their citizens do not appear to have approached the problems with quite the same fervor.

Environmental Legislation: The Beginning

The demand for environmental legislation began in 1970, led by students and national political leaders who established "Earth Day" at campuses across the country. In the Montana Legislature, the action began with the passage of state representative George Darrow's Montana Environmental Policy Act (MEPA). Legislators decided that Montanans deserved advance economic and environmental assessment of planned industrial developments as well as the opportunity to offer suggestions concerning them.

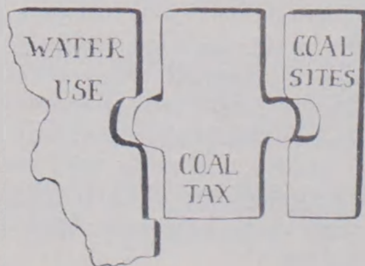
On the heels of MEPA came approval of the Strip Mine Reclamation Act, the Water Use Act, Major Facilities Siting Act, the Subdivision Act, and many others. These efforts perhaps culminated in 1975 with the passage of the 30 percent tax on coal and the establishment of the Coal Trust Fund.

The 1977 Session

Fewer environment-related laws were passed during the 1977 session than in preceding sessions. Although the Legislature did not retreat, it was clearly a time of retrenching. Many legislators recognized that debate simply is not over once a bill is passed. Laws will work only if every subsequent legislature continues to support them and if citizens prod their implementation between sessions. Environmental legislation usually creates periodic controversy, and Montana is no exception; consequently, there was a rehashing of much existing environmental legislation. As a result, victories for environmentalists during the 1977 session consisted mostly of holding the line.

Legislative action concerning energy policy has elicited both praise and criticism. Clearly, the Legislature is not likely to pass a comprehensive energy policy, particularly when it meets a scant ninety days every two years, during which all action must be completed on all issues. Nevertheless, an energy policy of sorts does exist in the state, a piecemeal policy created by a number of separate laws which deal with different aspects of environmental issues. Following is a description of action taken by the 1977 Legislature on many of these issues.

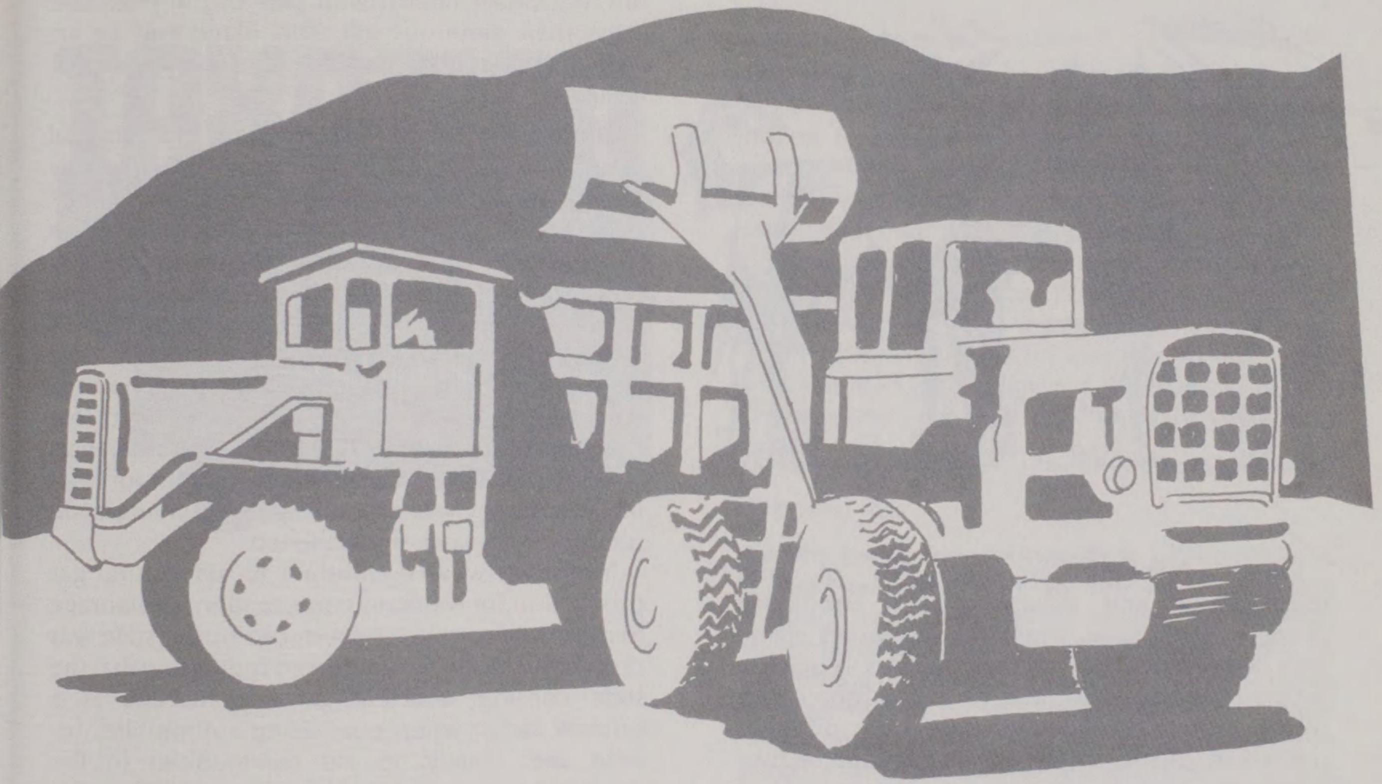
Coal taxes. The first modifications proposed in 1977 concerned Montana's 30 percent coal tax. A bill before the House proposed to decrease the tax on "noncompliance" coal (coal with a high sulphur content) if the coal was to be subjected to a process called "beneficiation." Beneficiation supposedly would clean up this so-called "dirty" coal. This raised some interesting questions. It was difficult to determine whether any successful beneficiation process existed. Could the term, for example, simply mean mixing low-sulphur coal with "dirty" coal? Where would beneficiation take place, and what authority would Montana have to ensure that such coal would be processed if exported? Since much of Montana's coal reserve is noncompliance, would the tax reduction cause a serious loss of revenue? Some supporters of the bill believed that it might decrease air pollution and improve the economy by providing an incentive to mine more coal. Nevertheless, the unanswered questions raised significant doubts, and the measure was killed.



Water use. Another bill proposed a state water use preference system. The idea behind this was that some users, such as municipal and agricultural, should have higher priorities in low water years than other users, such as recreational. This bill raised many problems. One was that it seemed impossible to design a system which could encompass the state's widely varying geographic conditions. Some legislators objected to the bill's lack of water quality standards. It also appeared that the legislation could create problems in an emergency. High priority Montana users, for example, might be forced into litigation during low water years to exert their priority over other state users. The bill was ultimately defeated, but the question of water use preference will persist.

Reclamation. Montana's strip mine reclamation law also generated controversy this past session. One proposal would have allowed coal companies to reclaim strip mined land with nonnative grasses, with the consent of the surface owner. One aim of this proposal was to ensure that ranchers and farmers would have more control over land use when stripping is completed. During debate, it was discovered that of all the privately owned stripped land, 96 percent is owned by mining companies and the Burlington Northern and the remaining 4 percent, amounting to 400 acres, is owned by one rancher. This disclosure implied that most decisions in accordance with the legislation would be made by corporate rather than individual landowners. The bill was killed.

Several individuals endeavored to take the offensive on the strip mine issue, by proposing greater protection for river valleys than presently is provided. The reasoning was that these highly productive agricultural areas deserve special attention and only amount to 3 percent of the strippable area. Although this measure failed in Montana, it is receiving much attention and debate at the federal level.



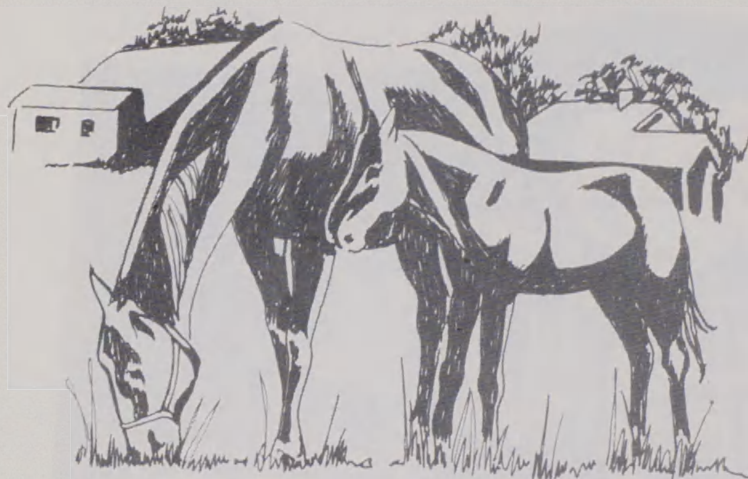
Siting. Efforts were also made to change the Major Facilities Siting Act. Major criticism leveled at the existing law concerned the cost and time involved in its enforcement. For example, it took three years, 100 days of hearings, 117,000 pages of testimony, and $1.5 million of taxpayers' money for the state to reach a decision on Colstrip Units 3 and 4. However, those who opposed shortening the process feared that its abbreviation might eliminate procedures essential to the Act.

One Senate bill would have modified the existing law in a number of ways. It would have completely exempted the Burlington Northern Railroad from the review process for its proposed Circle West ammonia fertilizer plant near Circle in McCone County. The House substantially amended the bill but failed by a few votes to kill it entirely. Other provisions of the bill reduced citizen participation in the hearing process by requiring persons to register to testify sixty days in advance of the hearing. This seemed inadvisable to some legislators, who felt that citizens should never be discouraged from participating in the hearing process, regardless of the moment at which they decided that they wished to contribute.

Governor Thomas Judge eventually vetoed this bill as being contrary "to the spirit of Montana's constitution and laws."[1] The Governor pointed out that in the 100 days of hearings on Colstrip, fewer than three days were taken up by persons other than the major parties involved. Part of the expressed purpose of the original Siting Act was to promote citizen participation and comment; the Governor felt it would indeed be unfortunate to pass laws which would inhibit such participation.

Additional efforts were made in the House to change the Siting Act in other ways. One proposed amendment would have extended the provisions of the Act to cover new facilities such as smelters, refineries, and pipelines. Another proposed amendment attempted to clarify the provision which stipulates that new facilities may be built only if definite need can be demonstrated. Both amendments were defeated.

[1]Governor Thomas L. Judge, Veto Message for Senate Bill 324 (Helena, Montana), May 13, 1977.



Land subdivision. In the area of land development and subdivision, no substantial changes were made. Montana developers claim, with legitimacy, that present statutes require a lengthy, cumbersome, and expensive process to review planned subdivisions. In spite of these restrictions, however, the law has been ineffective. Before the session, the Montana Department of Community Affairs examined land development throughout the state. It estimated that of the state's total subdivided acreage, 93 percent received no advance public review.[2] Most surprising is the indication that of those subdivisions dividing land into lots of twenty or fewer acres, 70 percent escaped review. Exceptions in the law, such as the "occasional sale," which allows one unreviewed sale per year, also contribute to its ineffectiveness. Another problem is that no review for major shopping centers is required.

Perhaps the most serious deficiency in the law is that it is misunderstood. Many Montanans believe that subdivision review is actually a prohibition of development and a means to harass developers. The intent of the Legislature, on the other hand, was to facilitate community planning and reduce the loss of agricultural land. This unresolved issue will surely remain controversial, and the next legislative session will undoubtedly attempt to facilitate further revisions.

Wild Horse Island. The 1977 Legislature allocated the funds necessary for the acquisition of Wild Horse Island, 23,000 acres of undeveloped land in Flathead Lake. The state was offered the island by the McDonald family, with part of the purchase price their generous gift. This island will be an outstanding addition to the state's recreational facilities.

Other proposals. Approximately 100 additional proposals dealing directly or indirectly with energy and the environment were introduced in the 1977 session. Those that passed included the delegation of energy emergency powers to the Governor and the establishment of a state energy office under the Lieutenant Governor. Also, to encourage both individual homeowners and businesses to conserve energy and develop alternative sources, income tax credits and deductions were established for renewable energy installations and conservation expenditures. The winterization program for low-income homes was expanded, and building code requirements were strengthened.

Incentives were established to aid natural gas production for Montana consumption, and storage here of nuclear wastes produced out of state was prohibited. A resolution passed requesting that the state consider efficient gasoline mileage as a primary factor when purchasing automobiles for state use. Finally, to aid communities in the development of sewage treatment facilities, the Legislature outlined a solid waste management plan.

Bills which failed to pass include prohibition of the use of natural gas and propane for outdoor decorative lighting and enabling legislation for local alternative energy districts. A cost analysis which would require estimates of the total costs, including maintenance and possible modifications, for state-constructed buildings was rejected, as was a bill which would coordinate Montana's railway regulations with federal statutes. And, an increase in the penalty for highway speeding was voted down.

Future Considerations

And so the Legislature met, debated, acted on some proposals, and didn't act on others. Overall, I would say that the session generated outstanding debates, which indicated that major issues are being considered even if there is no agreement yet on possible solutions. However, I have continuing hope and conviction that the Legislature will be able to cope, and cope intelligently, with the environmental issues which are among Montana's major problems. □

[2]Montana Department of Community Affairs, *Land Division in Montana: The Subdivision and Platting Act in Practice (Helena, 1977).*

TAXATION AND THE 45th LEGISLATURE

ALAN DAVIS

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Tax reform was a key issue during the Montana Legislature's 45th Session. While many legislators hoped to implement major tax reforms, public sentiment was more concerned with halting tax increases. As always, special interest groups lobbied for their own tax advantages. However, few concessions were granted, and, in general, changes in tax laws were minor. While legislative hopes were frustrated, most taxpayers presumably were satisfied, for no significant increases in taxes were implemented. Following is a brief description of the noteworthy changes enacted by the Legislature in 1977.

Income Tax

Credits for energy conservation. Changes in the income tax laws made by the 1977 Legislature included tax incentives for energy conservation investments and alternative energy systems. In computing net income, a deduction is now allowed for specified investments in energy conservation. This deduction may be used in computing net income for either the individual income tax or the corporation license tax. In order to qualify, an investment must reduce the waste or dissipation of energy or reduce the amount of energy required to accomplish a given quantity of work. For example, installation of storm windows or triple-glazed windows would qualify. The amount of the deduction depends on whether the investment is in a residence or business; in both cases it is based on the actual costs, which may include installation costs, less the value of any grants received.

ENERGY CONSERVATION DEDUCTION

Residence	Business
100% of first $1,000 expended	100% of first $2,000 expended
50% of next $1,000 expended	50% of next $2,000 expended
20% of next $1,000 expended	20% of next $2,000 expended
10% of next $1,000 expended	10% of next $2,000 expended

A tax credit toward individual tax liability also is allowed for actual costs of a system which is a recognized nonfossil energy generation system. A solar water system for heating a house is such a system. The system must be installed in a taxpayer's primary residence in order to qualify. The amount of the credit is equal to 10 percent of the first $1,000 expended and 5 percent of the next $3,000 expended. If the credit exceeds the tax liability in

any given year, the excess may be credited against future tax liabilities for a maximum of four years. Thus the total credit available is $250 ($100 plus 5 percent of $3,000, or $150) and any excess credit over tax liability may be used in as many as five successive years until the taxpayer's accumulated state income tax liability exceeds that amount.

Investment tax credit. The Legislature enacted an investment tax credit for individuals and small business corporations. The credit is equal to one-fifth the amount of the federal investment credit and can be applied to either individual income tax or corporation license tax. In order to qualify for the credit, a corporation must qualify as a small business corporation as defined in the Revised Codes of Montana 84-1501.1, which basically states that the corporation must have no more than ten resident stockholders, none of which are other corporations, and no more than one class of stock. Taxpayers are not allowed to carry excess credit back to tax years beginning before January 1, 1977. They may, however, carry excess credit forward to subsequent tax years. This law applies only to investments made in 1977 or later years.

Other changes. Montana uses the federally defined tax base for income tax purposes. Often the federal government makes changes that may put Montana's laws in conflict with federal statutes. The state tax codes pertaining to deductions for political contributions were repealed because they were in conflict with federal statutes. The deduction for child care expenditures allowed by the federal government for tax year 1974 was enacted into the Montana statutes. The federal deduction was subsequently changed to a tax credit in 1976. However, the Montana Legislature, wishing to keep a deduction rather than a credit, specifically enacted the deduction, which may be claimed only by those who file joint returns. The maximum deduction allowed for dependent care expenditures is $400 per month for those whose joint annual incomes are less than $18,000; the maximum deduction gradually declines for those with annual incomes above $18,000, finally reaching zero for joint annual incomes exceeding $27,600.

Other minor changes in income tax laws were made by the 1977 Legislature. Parents of children who are 50 percent or more disabled, as attested to in writing by a physician, are allowed a double exemption for the handicapped child; this double exemption applies even after the child reaches legal age, as long as the child remains a dependent. The maximum income that an individual can earn without filing a return was increased from $665 to $720 for single or married persons filing separately, and from $1,330 to $1,445 for married couples filing jointly. The increment for each additional exemption was increased from $600 to $650. Thus a married couple with one child must have income exceeding $2,090, if filing separately, or $2,095, if filing jointly, before they are required to file a tax return.

Finally, taxpayers in business for themselves should be happy to learn that even though they are required to pay estimated tax, the Legislature removed the penalty for failure to comply.

Corporation License Tax

Small business corporations which elect to pay individual income taxes rather than corporation license taxes may utilize the changes in income taxes already noted. Of special interest are the investment tax credit and the deduction for investments in energy conservation, both of which can be used to reduce the corporation license tax liability.

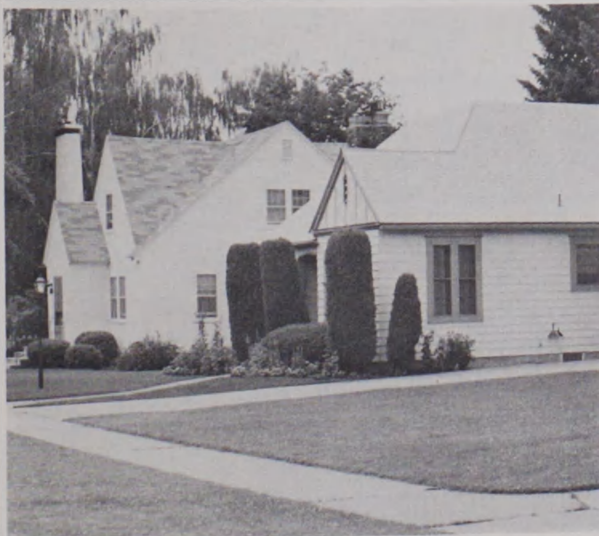
In computing gross income for the corporation license tax an exemption is allowed for interest paid on loans held by out-of-state financial institutions, regardless of where the collateral is located. The loans must originate from an instate business, be assigned out of state, and the out-of-state lender's only action can be periodic inspection of the property. Additionally, recent changes in federal statutes pertaining to Subchapter S corporations (primarily small businesses or family corporations) were incorporated in Montana's statutes. These changes are technical in nature and are related to the treatment of trusts and estates as stockholders in small business and family corporations.

Property Tax

New methods of computing taxable value. As a result of an interim study of property taxation, property tax procedures were revised in 1977 by House Bill (H.B.) 70. This was one of the most substantive changes in taxation the legislature has made in several sessions. The change simplified the property tax system by eliminating a step used in computing taxable value. In the past, assessed value was a percentage of market value, and taxable value was a percentage of assessed value. Tax bills were computed by multiplying the taxable value of property by the local mill levy. Under H.B. 70, assessed value is now defined as market value (except for agricultural land which is valued on its productive capacity). Taxable value is a percentage of market value and tax bills still equal taxable value multiplied by the local mill levy.

The thrust of the change was to compute taxable value from market value rather than from assessed value. The ratios of taxable value to market value were changed so the effect of the change on taxes would be neutral. More classes of property were added to the system. Property owners should now have more information on their tax bills than before, making it easier to understand how their property tax liability was calculated.

Homestead Relief Act. In November 1976 the voters of Montana overwhelmingly approved the Homestead Relief Act. This Act placed an added burden on the Legislature, for it had to decide the politically volatile issue of funding the measure. The Act itself allowed general fund monies to be spent in reducing the local property taxes paid by individuals. The Legislature, after prolonged debate, finally funded the bill.



MELDA. The Montana Economic Land Development Act (MELDA) was literally put to rest by the 45th Legislature. The concept of the bill was to reward certain types of land use with tax breaks and penalize other types of land use with increased taxes. Some called the law a hodgepodge of special interest legislation, while others called it progressive. The new version of the law applies only to cities with a population of 5,000 or more and may be implemented only by affirmative vote in a citywide referendum.

Mining. The valuation of metal mines for property taxation was converted from net proceeds of the mine to gross proceeds. Under the old law, net proceeds were taxed at 100 percent of value after deductions were allowed for costs incurred in the mining process. No deductions are allowed in computing gross proceeds, which are taxed at the lower rate of 3 percent under the revised property tax system. Over the long run it is expected that property tax revenue from metal mines will average about the same as before the change, but there should be less variation between consecutive years. For example, in the past, the tax base in Silver Bow County has varied by millions of dollars from year to year depending on net proceeds reported by the Anaconda Company. This, in turn, led to wide variations in mill levies and an uncertain distribution of the burden among the other taxpayers of the county.

New requirements for inventory reporting. A standard method of reporting business inventories for property taxation has been enacted into law. Before the change, businesses could use several methods of valuing business inventories for property tax purposes. H.B. 551 requires that the value of inventories used for federal income tax returns be reported as the value for property tax purposes. This change will make compliance much easier because a duplicate of the federal inventory computation will suffice for reporting business inventories. If a business feels the inventory value for federal tax purposes does not truly reflect the value of its inventories, H.B. 591 allows business inventories to be assessed at cost or present value, whichever is lower.

Other changes. Additional changes in property taxation included lowering the taxable valuation of livestock. H.B. 70, discussed above, had specified that cattle should be taxed at 13 percent of assessed market value, but H.B. 85 reduced the percentage to 8 percent. Irrigated farm land must be taxed as nonirrigated land for three years after an irrigation system is installed. Finally, banks will now be

allowed to deduct a portion of federal obligations they hold in computing their bank shares tax.

Miscellaneous Business Taxes

The biggest change among the other taxes levied on Montana business was the change in the tax base for the electrical energy producers' tax. The tax was originally 1.438 percent of the gross sales of electricity but, in order to avoid violating legal prohibitions against restraint of interstate commerce, only sales inside Montana could be taxed. The Legislature modified the tax to $0.0002 per kilowatt hour produced. The electricity needed to operate the power plant is exempt from taxation. This new tax base will allow all electricity produced in Montana to be taxed, regardless of its final destination.

The oil and gas producers' severance tax was altered slightly. Originally the tax was 2.1 percent of the gross value for the first 450 barrels per well from a lease area and 2.65 percent of the gross value of all barrels in excess of this 450 barrels. The new tax is still 2.1 percent, but it is on the first $6,000 of gross value. The gross value of oil over $6,000 per well from a lease area is taxed at 2.65 percent.

Both the cement and gypsum producers' and dealers' license taxes were changed from a rate of $0.04 per 350-pound barrel to $0.22 per ton. Also, the telegraph license tax was repealed. In recent years, revenue from this tax had been less than $500.

Inheritance Tax

Senate Bill (S.B.) 31 was the culmination of an interim study of inheritance taxes by the Legislature. Several changes in the taxation of estates were enacted as a result of this study.

Joint tenancy estates will now be taxed at 100 percent of their value rather than the previous system of varying percentages. A surviving spouse, however, receives a 50 percent reduction, which is subtracted from the gross value of the estate. After deductions are made for outstanding debts, the surviving spouse is allowed an additional 50 percent exclusion.

Inheritance tax rates in Montana are progressive; that is, rates go up as the value of an estate increases. Before S.B. 31 was passed, the allowable exemption for a beneficiary was subtracted from the first $25,000 bequeathed, which was taxed at the most favorable rate. However, the net result was that the entire estate was taxed at higher rates. Now the exemption is the first item subtracted. The effect of this change is a potential lowering of the marginal tax rate levied on the estate.

Exemptions allowed for inheritance tax purposes were increased. The exemption for a surviving spouse was raised from $25,000 to $40,000, and from $5,000 to $15,000 for minors. The exemptions for adult beneficiaries was raised from $2,000 to $7,000, and from $500 to $1,000 for other beneficiaries.

For illustrative purposes, the simplified example

Table 1
Sample Calculation of Montana Inheritance Tax Computed on a Joint Tenancy Estate

Estate value		$200,000
Less: Joint tenancy reduction for surviving spouse (50 percent of $200,000)	$100,000	
Expenses	10,000	
		110,000
		$ 90,000
Surviving spouse exclusion (50 percent of $90,000)	45,000	
Surviving spouse exemption	40,000	
		85,000
Taxable value of the estate		$ 5,000
Inheritance tax (2 percent of $5,000)		$ 100

in table 1 shows the order in which the inheritance tax would be computed on a joint tenancy estate worth $200,000 left to the surviving spouse. Note the $10,000 subtracted to cover debts outstanding against the estate. The surviving spouse exclusion and increased exemption contribute to a significant tax savings.

Motor Fuels and Liquor

The slight increases in motor fuel taxes will be used to pay for highway maintenance. The tax on diesel and special fuels was increased from $0.0975 per gallon to $0.10 per gallon. The tax on gasoline was increased from $0.0775 per gallon to $0.08 per gallon.

Consumers may have noticed slight increases in the cost of alcoholic beverages. Part of this increase is due to increased liquor and beer taxes. The tax on beer was increased from $3.25 to $4.00 per 31-gallon barrel. The excise tax on liquor and wine was increased from 5 percent of the retail price to 10 percent. These increases are earmarked to fund alcohol treatment centers. □

Montana Business Yesterday

COLLINS LAND COMPANY: Dealer in Public Land Scrip

DALE L. JOHNSON

In the first two decades of this century, the buying and selling of public land scrip was a lucrative nationwide business. Land scrip, the right to claim as one's own a portion of the public domain, was as old as the nation. Revolutionary War soldiers were awarded land scrip as a part of their compensation for aiding the emerging nation in its time of need; free land was really an early form of the "G.I. Bill." Union Civil War veterans, too, providing they met certain requirements of service, received land scrip. This scrip was used by the veteran in locating land or was sold on the market.

Scrip was also used to adjust land problems. Railroad land grants often included lands already homesteaded. Thus, the railroad received scrip in lieu of these previously claimed lands. The railroad could then claim an equivalent portion of the public domain elsewhere or sell the scrip on the market. Similarly, when forest reserves were established in the closing years of the last century, established settlers whose lands were within a designated reserve could, if they wished, trade the land back to the government in exchange for scrip, which entitled them to land of similar size and value in another area of the public domain. The names of some other types of scrip included Isaac Crow, Porterfield, Santa Fe, Alabama, Recertified Soldiers' Additional, Approved Soldiers' Additional, Unapproved Soldiers' Additional, Settlers' Rights, Adjudicated Sioux Half-Breed, and Valentine.

Since scrip could be bought and sold on the market, an excellent opportunity existed for an individual in an area with extensive public domain lands to do business bringing the scrip holder, scrip buyer, and available public domain lands together. Additionally, by 1900 the lands available for scrip claim and settlement were becoming scarce, and the opportunity for profit as a dealer in land scrip was great.

Jeremiah Collins, a native of Ireland, came to

DO YOU WANT LANDS?

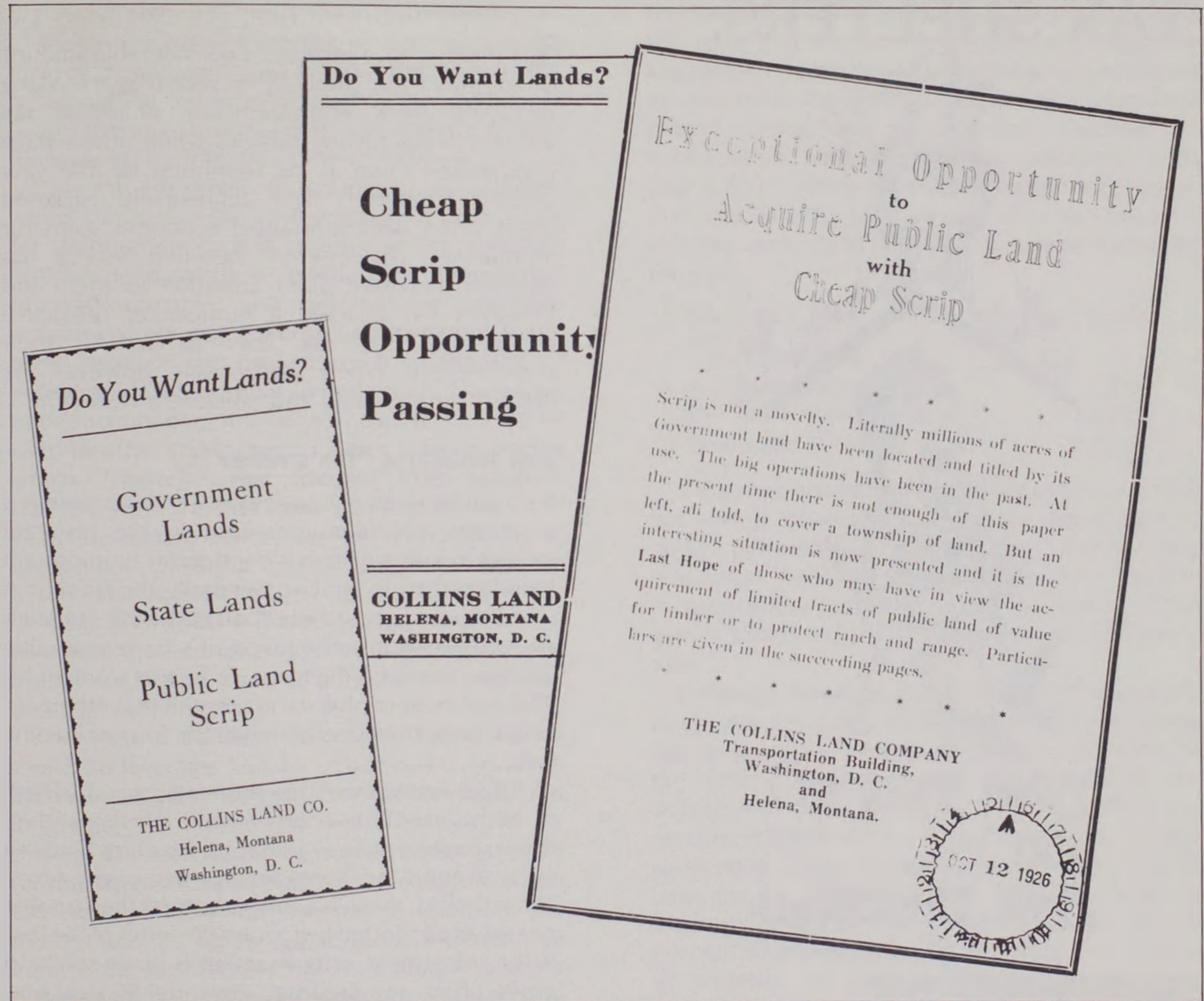
The Collins Land Company.

HELENA, MONTANA, June 7, 1900.

DEAR SIR:--On June 6, Congress enacted that from and after October 1, 1900, UNSURVEYED lands could not be selected by means of FOREST RESERVE SCRIP. This means that after that date, UNSURVEYED lands can be located only through the medium of Valentine, Girard, Ware, Porterfield and other very high-priced scrips, costimg from $25 to $100 per acre. If you desire to secure unsurveyed lands, it is necessary that you act promptly. Forest Reserve scrip will be held at higher figures from now until the first day of October, and it is so scarce that many who need these lands will find themselves powerless to secure the same.

GET YOUR ORDER IN; THE EARLIER THE BETTER.

THE COLLINS LAND COMPANY.



Montana Territory in 1881 as editor of the *Fort Benton River Press.* In 1887 he moved to Great Falls where he published the *Great Falls Tribune* until 1894. He was then appointed by President Cleveland to be Receiver of the United States Land Office at Helena. Upon the expiration of his term of office in 1899, Collins had come to recognize the business opportunity available in the land scrip business, and he established and incorporated the Collins Land Co.

Business was so profitable the first two years that the company opened a branch office in Washington, D.C., both to expand its market and to facilitate client representation before the Department of the Interior. The establishment of the Washington office, and an office in Portland, enlarged the company's business to such an extent that it furnished scrip for clients who used it to claim lands in every public land state in the country.

It was not unusual for the company to purchase scrip in blocks of 10,000 to 30,000 acres, which it sold to clients. The Collins Land Company became the largest land scrip dealer in the nation, a position it enjoyed for many years.

The public domain available for land scrip redemption steadily decreased. The Collins Land Company had also expanded to include an insurance business in Helena, and by the 1930s the company's profits came increasingly from that portion of its business. Trade in land scrip did continue until 1957 when it was finally invalidated by an act of Congress. After that, the company dealt only with insurance. Its corporate charter expired in 1974, and what had been the largest land scrip dealer in the nation ceased to exist. □

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TAX SHELTERS:

What They Are and How They Work

RANDLE V. WHITE

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Tax shelters have received a considerable amount of attention and publicity in recent years. Many taxpayers have enthusiastically endorsed tax shelters as tax saving miracles while others have condemned them as tax loopholes for the very wealthy. Promoters have aggressively marketed them, often with substantial economic gains for themselves. The Internal Revenue Service has directed increased audit attention to them and Congress has enacted a number of restrictive changes in the tax laws to reduce their attractiveness. When used wisely, however, tax shelters can be a safe and efficient investment.

Just what is a "tax shelter"?

A tax shelter is an investment in which tax savings is a primary consideration. That is, the resultant savings in income taxes is considered an important benefit of the investment. Generally, the tax savings comes about because all or part of the investment is deductible against the taxpayer's current taxable income. In effect, the taxpayer invests some of his after-tax income plus some amount that otherwise would go to the government in the form of income taxes.

If, at first glance, this sounds immoral, illegal, or both, relax! The courts have firmly established the taxpayer's right to minimize his taxes by using every avenue the law grants for decreasing taxes. Nevertheless, there is a limit to how far the taxpayer can go, even though he follows the letter of the law. If the investment or transaction is made solely to avoid taxes, the Internal Revenue Service may legally disallow any benefit from the investment. Therefore, a tax shelter must have a rational economic or business basis, other than tax avoidance, in order to pass the scrutiny of the Internal Revenue Service.

How do tax shelters work?

Tax shelters utilize several concepts to produce tax benefits to the investors; these concepts vary from shelter to shelter in the type and number utilized. The prevailing tax law greatly influences how the concepts are put to use in a given shelter. The Tax Reform Act of 1976, which we will discuss later, places several important restrictions on the operation of tax shelters.

The most common concept employed in tax shelters is that of **deferral.** The payment of income taxes is deferred to future years by accelerating deductions or transferring them to the early years

of the investment. In effect, the investor receives an "interest free loan" from the government, in the form of tax savings, to use as he wishes. This "loan" is "repaid" in the form of taxes as the investment begins to show a profit or when the investor sells, or disposes of, his interest in the investment.

Deferrals are usually found in business activities which can utilize the cash method of accounting for tax purposes such as farming, where inventory buildup need not be included in the computation of taxable income. Also, deferrals are created in activities where expenses can be accelerated in the early years of the project, such as the use of accelerated depreciation in real estate. The excess of deductions over income in the early years can be used to offset the investor's other taxable income which "shelters" that income from taxation. However, the income taxes avoided in the early years are usually shifted to later years when the investment shows a profit and the offsetting deductions have been used up. The advantage of deferral is, of course, the economic use of the tax savings in the interim period. By investing in a new shelter each year, theoretically the tax could be deferred indefinitely.

The second concept commonly found in tax shelters is **leverage.** The use of borrowed money to increase one's financial capacity, or "leverage," has long been an investment tool. The twist in tax shelters has been to use the borrowed funds to pay for the expenses taken as accelerated deductions in the early years of the venture. In addition, the interest on the borrowed funds is a deductible item. Most tax shelters utilize leverage to some extent, with the borrowed funds often accounting for 50 percent or more of the total capital structure of the venture. In such cases it has been possible to claim first year losses which exceed the amounts invested.

A third concept found in some tax shelters is the **conversion** of ordinary income into capital gains. As the reader is probably aware, long-term gains on capital assets receive preferential tax treatment. The Internal Revenue Code definition of capital assets includes most types of nonbusiness property such as stocks, bonds and personal residences. Land and depreciable property used in a business are not included in the capital assets category but, in most cases, gains on the disposition of these assets can be treated as capital gains.[1]

The conversion of ordinary income to capital gains comes about when the taxpayer depreciates a business asset, which reduces his ordinary income that year on a dollar for dollar basis, and later sells the asset and the gain is treated as a long term capital gain. For example, a businessman purchases an asset for $1,000 and depreciates it over a ten-year period using the straight-line method of depreciation. The depreciation deduction each year is $100, which lowers his taxable income for that year by $100. Let's say that after two years he sells the asset for $1,100. Here is how we compute the gain:

Sales price		$1,100
Less: cost	$1,000	
Less: depreciation	200	
Depreciated value of the asset		800
Gain on sale of the asset		$ 300
Taxable gain (½ of $300)		$ 150

If the asset is treated as a capital asset, only half of the gain is taxable as a long-term capital gain — $150. Therefore, taking the depreciation deduction reduced the businessman's taxable income, dollar for dollar, but only one-half of the gain is added to his taxable income at the time of sale.

Congress, however, has tightened this loophole for most types of depreciable property by requiring the taxpayer to "recapture" the depreciation, to the extent that the sales price exceeds the depreciated value of the assets, and to treat the recaptured depreciation as ordinary income. In the previous example, the $200 of depreciation would have to be recaptured and taxed as ordinary income, leaving $100 of long-term capital gain, 50 percent of which is taxable. However, some types of property are not covered by the recapture provisions, for example, depreciable real estate, to the extent that accelerated methods of depreciation are not used. This is one reason why rental real estate is an attractive investment to many taxpayers.

If it still seems strange that one can make money by first making a loss, then perhaps looking at an example of how a particular tax shelter operates will help to illustrate the point.

Tax shelters have been marketed in a variety of areas such as real estate, motion pictures, oil and gas drilling, farming, and equipment leasing. However, an example of a typical cattle feeding shelter will illustrate how most tax shelters work, and how the Tax Reform Act of 1976 has reduced their attractiveness by limiting the allowable deductions to the investor. The following example describes how a cattle feeding tax shelter would have operated prior to 1976. Later we will discuss the effects of the Tax Reform Act of 1976.

[1]Internal Revenue Code Section 1231.

The cattle feeding tax shelter is basically a vehicle for deferring income taxes, that is, for claiming deductions in the current year and recognizing income in future years. Most cattle feeding ventures are organized as limited partnerships which consist of one or more general partners (usually a commercial feedlot operator or a promoter) and one or more limited partners (usually several investors) whose liability in the venture is limited to the amount of their investment. The use of the limited partnership, therefore, limits the liability of the investors but still allows income and losses of the partnership to flow through to the partners.

Typically, a cattle feeding shelter is formed in November or December. The promoter forms the partnership, sells the limited partnership interests to investors, leverages the invested capital by borrowing, and begins operation. Immature cattle are purchased, usually weighing 400-700 pounds, and fed a special weight-gaining diet until they weigh about 1,000 pounds. This usually takes about 5 or 6 months, which places the sale of the animals to packing houses in the subsequent tax year.

As cattle feeding shelters used to work, the general partner would prepay the interest on the borrowed funds and purchase enough feed for the cattle for six months to provide tax deductions for the limited partners in the first year. Because the Internal Revenue Code allowed all cash basis farmers (including partnerships) to deduct their expenses when they paid their bills, the full amount of the cash expenditures for feed and interest was passed through to the partners in the first year. For tax purposes, all of the partners were considered farmers by virtue of their investment in the partnership.

For example, in November 1974, John Taxpayer realized that his income for the year was going to be quite high so he purchased a limited partnership interest in a cattle feeding operation in the hopes of deferring some of his income tax bill to a later year. Mr. Taxpayer invested $10,000 in the partnership on December 1st and signed a nonrecourse note along with the other partners in which his share was $50,000. (A nonrecourse note made by a partnership is one in which the partnership assets are subject to liability but the individual partners are not liable for the loan.) Mr. Taxpayer's equity and borrowed funds were then used by the general partner to buy cattle and feed, and prepay interest on the note and the general partner's management fees. Therefore, on December 31, 1974, John Taxpayer found himself in the following situation:

1974
(First Year)

Investment in partnership:		
Cash investment		$10,000
Borrowed funds (nonrecourse)		50,000
Tax basis of investment		$60,000
Use of funds:		
Cattle purchased (not deductible) (200 head @ $200)		$40,000
Deductible expenses:		
Feed	$15,000	
Interest	2,500	
Management fee	2,500	
Total deductible expenses		20,000
Total funds expended		$60,000
Taxes deferred: 50% of $20,000		$10,000
Cash flow:		
Investment		$10,000
Less: taxes deferred		10,000
Net cash flow		$ -0-

Mr. Taxpayer had invested $10,000 and now had $20,000 to deduct from his other taxable income for that year. If his marginal tax rate was 50 percent, the taxes deferred for the first year would have been $10,000, so he had, in effect, made his investment with funds that would have otherwise gone to the government in the form of taxes.[2]

But what happened five months later when the cattle were sold? Let's assume at that time the animals were worth $310 a head because of their increased weight and there had been no death losses. The gain is computed as follows:

1975
(Second Year)

Computation of gain:		
Sales price on cattle (200 head @ $310)		$62,000
Less cost of the cattle		40,000
Ordinary gain (taxable)		$22,000
Cash flow:		
Cattle sale proceeds		$62,000
Less: note repayment	$50,000	
Income tax on gain (50% of $22,000)	11,000	61,000
After tax cash		$1,000

This may seem like a lot of work, just to make $1,000, but we also have to take into consideration the time value of money Mr. Taxpayer received from deferring $10,000 in taxes for one year. For example if Mr. Taxpayer invested the $10,000 in deferred taxes in a tax-free municipal bond yielding 7 percent, the interest income from April

[2]Considering both the Federal and Montana State Income Taxes, a married couple filing jointly with a gross income of $35,000 can have a marginal tax rate of 50 percent. A single person with a gross income of $25,000 can also reach the 50 percent bracket when the Federal and Montana rates are added together.

15, 1975 to April 15, 1976, would have been $700. Even if the cattle investment just broke even, the effective average annual rate of return on Mr. Taxpayer's cash investment would have been about 19 percent, considering that his cash investment was only $10,000 from December 1, 1974 to April 15, 1975.

If Mr. Taxpayer's income had been higher in 1974 and his marginal tax rate had been 70 percent, the tax deferral from investing the $10,000 would have been $14,000, resulting in an even higher net return. Conversely, if his marginal tax rate had been only 20 percent, the deferred taxes would have been $4,000. It is obvious that tax shelters are much more effective investments for high income taxpayers.

Also, if Mr. Taxpayer's income had been much higher in 1974 than in 1975, he would have enjoyed an additional benefit of sheltering income in one tax bracket (in our example, 50 percent) and paying tax on that income one year later in a lower tax bracket (for example at the 38 percent tax rate). Thus, tax shelters can be used to advantage by persons with fluctuating incomes.

How has the Tax Reform Act of 1976 affected tax shelters?

As part of the Tax Reform Act of 1976 (TRA), Congress moved decisively to restrict the benefits accruing to taxpayers with tax-sheltered investments. The specific changes in the tax laws are voluminous and far beyond the scope of this article. However, a discussion of the major changes for farming tax shelters can be related to our cattle feeding shelter outlined above and give the reader a feel for Congress's intent to restrict tax shelter "loopholes."

The cattle feeding tax shelter described above was based on the following features: limited partnership, cash basis tax accounting, nonrecourse borrowing, and deductions for prepaid interest, feed, and management fees. The TRA attacked the tax benefits of all of these features to some extent.

The major limitation on tax shelters imposed by the TRA is referred to as the "at risk" rule.[3] The "at risk" rule limits the deductions a taxpayer may claim from specific activities to the amount the taxpayer has "at risk" in the venture as of the end of the year. The amount at risk is defined as the amount of money and the depreciated value of any property contributed to the venture by the taxpayer plus the amount of any liabilities for which he is personally liable for repayment. Thus the use of nonrecourse financing is effectively stopped and the risks associated with tax shelters are substantially increased. The activities to which the "at risk" rule applies include farming, oil and gas exploration, motion picture production and distribution, and equipment leasing. Also, the "at risk" rule is applied to partnerships which are engaged in other areas with the exception of real estate investment.

The effect of this rule on Mr. Taxpayer's cattle feeding tax shelter would be to limit his maximum first year deduction to $10,000 — the amount of his cash investment. Since the note he signed was a nonrecourse note, he is not personally liable for its repayment and therefore the $50,000 is not at risk.

As we observed earlier, using the cash basis of tax accounting provides considerable leeway for the timing of income and expense transactions for the benefit of the taxpayer. The TRA tightened the rules for corporations, other than certain small, or family type, corporations, by requiring farming corporations to use the accrual method of accounting.[4] Although this change in the law doesn't affect our cattle feeding partnership, other changes were directed at what are called farming syndicates or partnerships.

As a result of the TRA, farming syndicates (partnerships) now are required to capitalize the cost of feed, seed, fertilizer and other farm supplies and claim deductions for them in the taxable year in which they are actually used.[5] A similar change was enacted to restrict deductions for prepaid interest. The new rule allows cash basis taxpayers to deduct only the interest cost applicable to the use of money in the current taxable year. Any interest prepaid for future periods must be capitalized and deducted in subsequent periods.[6]

These changes prevent Mr. Taxpayer from deducting the full amounts expended for prepaid interest and cattle feed in the first year. In our example his deductions would be about one-sixth of the total feed bill and interest payment in the first year, and five-sixths in the second year.

The deduction of prepaid fees to management for organizational expenses has been contested by the Internal Revenue Service for many years. The TRA has strengthened the Internal Revenue Service position by requiring that no automatic deductions be allowed to a partnership for organizational expenses; instead they must be capitalized by the

[3]Internal Revenue Code Section 465.

[4]Internal Revenue Code Section 447.
[5]Internal Revenue Code Section 464.
[6]Internal Revenue Code Section 461(g).

partnership and deducted over a period of time (usually at least 60 months).[7]

If John Taxpayer had invested in his cattle feeding partnership in December 1976, the tax consequences would be much different than we previously outlined:

1976
(First Year)

"At risk" basis in partnership:		
Cash investment		$10,000
Nonrecourse borrowing		50,000
Funds available		$60,000
Use of funds:		
Cattle purchased (not deductible)		$40,000
Deductible expenses[8]		
Feed (1/6 of $15,000)	$ 2,500	
Interest (1/6 of $2,500)	417	
Management fee (1/60 of $2,500)	42	
Total deductible expenses		2,959
Nondeductible expenses		
Feed (5/6 of $15,000)	12,500	
Interest (5/6 of $2,500)	2,083	
Management fee (59/60 of $2,500)	2,458	
Total nondeductible expenses		17,041
Total funds expended		$60,000
Taxes deferred: 50% of $2,959		$ 1,480
Cash flow:		
Investment		$10,000
Less: taxes deferred		1,480
Net cash outflow		$ 8,520

1977
(Second Year)

Computation of gain:		
Sales price of cattle		$62,000
Less: cost of cattle	$40,000	
Feed (5/6 of $15,000)	12,500	
Interest (5/6 of $2,500)	2,083	
Management fee (remainder)	2,458	57,041
Ordinary gain (taxable)		$ 4,959
Cash flow:		
Cattle sale proceeds		$62,000
Less: note repayment	$50,000	
Income tax on gain (50% of $4,959)	2,480	52,480
After tax cash		$ 9,520

Prorating the interest, feed, and management expenses over the six months of the venture reduces Mr. Taxpayer's first year deduction from $20,000 to $2,959 and therefore cuts the tax deferral from $10,000 to $1,480. Even though he still has an overall gain of $1,000, his out-of-pocket investment the first year has increased from $0 to $8,520.

[7]Internal Revenue Code Section 709.
[8]Even though $20,000 was spent for feed, interest, and management fees, only a prorated portion would be deductible in 1976.

Clearly, much of the glamour of cattle feeding shelters is gone.

Are tax shelters dead?

Though the comparison between the above illustrations might indicate otherwise, tax shelters are not dead. Many tax shelters received near fatal blows from the Tax Reform Act of 1976, but while it appears that all tax shelters have been affected by the act to some degree, not all have been affected equally. Variations of real estate tax shelters have been very popular this year primarily because the "at risk" limitation does not apply to real estate investments. Also, the liberal tax incentives for investment in government-subsidized low income housing still exist.

Shelters, in general, are becoming more and more complex and the tax advantages smaller and smaller each year. Also, the TRA strengthened the minimum tax on certain types of tax preferred income, so some taxpayers will pay tax penalties for excessive tax shelter investment. These trends are increasing the risks of tax sheltered investments, particularly to middle income taxpayers. On the other hand, they force more emphasis to be placed on analyzing the economic soundness of the venture; such analysis might have prevented many past shelter failures.

Do I need a tax shelter?

More than likely what you need is **tax planning.** A professional review of your financial situation will probably suggest several alternatives, such as deferred compensation, tax free investments, or charitable contributions which can save you tax dollars. One of those alternatives may be investment in a tax shelter. Tax shelters have received a great deal of publicity, but they are, by no means, the only way to save taxes.

A primary point to remember is that tax planning can't be left to the last minute. Deciding in December that you need a tax shelter to cut down your income taxes will not be very effective. The earlier in the year you begin your tax planning the more options you have available. Also, adequate time must be taken for a careful review of the tax shelter's prospectus and the promoter's record. Remember that famous phrase—*caveat emptor*—buyer beware. □

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