

# Montana Property Taxes Since Initiative 105 (1996 Update)

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## **Introduction and Legislative History**

In 1986 Montana voters approved Initiative 105 which purported to "freeze" property taxes. Have property taxes in fact remained constant in the ensuing years? Why do property taxes continue to be such a controversial issue in Montana? How have different areas of the state fared? Should property taxes be limited in some fashion, perhaps by basing them on fixed property values in some particular year?

This paper is intended to contribute to public policy discussions of these issues by providing a factual description of how Montana property taxes have actually evolved in recent years. No particular policy proposals are advocated. Rather, the intention is to provide accurate background information that will contribute to greater public understanding of the issues.

The text of Initiative 105 simply called for property taxes to be "capped at the 1986 level." The initiative did not specify whether this cap was to apply to each piece of property individually or to all of the property within a jurisdiction such as a school district or county, nor whether the cap applied to the tax rate or the dollars actually collected, nor what to do about additions, annexations and other issues. Consequently, the 1987 legislature made a number of specific interpretations of Initiative 105:

- The caps would be based on Tax Year 1986 values. These correspond to Fiscal Year 1987, because most property tax payments are made in November of a given tax year and the following May.
- Caps were to apply to all classes of property-commercial, industrial, etc. as well as residential.
- Taxable value rates could not be increased within classes (e.g. residential taxable value is fixed at 3.86 percent of assessed value).

- No increase was to be permitted in the mills levied by each "taxing unit" (e.g. school district or county).
- No increase in the tax liability for individual pieces of property (except for certain cases including improvements and reclassification).

Thus, the legislature seemed to be capping property taxes both for individual residences and other properties, *and* the total mills that could be levied by a governmental unit. However, these limits were eroded by a number of provisions enacted in 1987 and later. First the 1987 legislature specifically excluded from the caps: annexation, new construction, rural improvement districts (RIDs), special improvement district (SIDs), debt service, street maintenance districts, tax increment financing districts and jurisdictions in which taxable value declined by 5 percent or more. The last exclusion proved especially important: by 1994 taxable values had declined at least 5 percent in 34 of Montana's 56 counties. However, these jurisdictions still faced limits on the dollar amount of property taxes.

The limitations of I105 were further eased by the 1989 legislature with the adoption of the "salesassessment ratio" method for annually updating assessed values. Under this system, the assessed values of properties which actually sold were compared with their selling prices, and then the assessed values of all properties were updated on the basis of the results for the properties which sold. Reassessments averaged a modest 3 percent statewide in the first year, but some areas experienced increases of as much as 30 percent in a single year.

After the state's system of financing K-12 education was declared unconstitutional, the legislature reconvened in a 1989 special session. The revamped foundation program increased the mandatory property tax levy for the schools from 45 mills to 95 mills, and specifically excluded school districts from the limitations of I105. The 1993 sessions of the legislature further revamped school funding. One result was to shift the burden of paying for schools back onto local districts which rely heavily on property taxes. Thus while school districts initially lowered their local mill levies as the state assumed a greater funding role in 1991, declines in state support, enrollment growth and inflation have resulted in substantial mill levy increases in recent years.

The 1989 special session also removed oil, natural gas and coal production from the property tax rolls and replaced them with two new taxes (the Local Government Severance Tax and the Coal Gross Proceeds Tax). As [Figure 1](#) indicates, the taxable value of production had already fallen by more than 50 percent before the new taxes were introduced. Thus, communities which had depended on resources were already experiencing fiscal difficulties. The new taxes on resources were at approximately the same effective rates as the old ones, so communities did not experience further losses from the change in taxing methods. However, the change exempted resource production from the increased mill levies that accompanied school finance reform, and thus shifted the burden further onto other forms of property.

The special session also consolidated three classes of business personal property into a single class and reduced their tax rates. Revenue reductions to local governments were to be reimbursed out of the state general fund. The bill reduced statewide taxable value by \$56 million and taxes an estimated \$17 million. Property tax bills received by homeowners in the fall of 1993 were based on the first statewide reassessment of individual properties since 1982. The average reassessment was 7.3 percent, but varied greatly from district to district as well as house to house: Reassessment resulted in *decreases* in value of more than 20 percent for 19 percent of residences and *increases* in value of more than 20 percent for about one quarter of residences. Changes of this magnitude make it easy to understand why many tax payers are concerned about property taxes.

### Taxable Values, Mill Levies and Taxes

This section examines changes in the tax base, mill levies and taxes between fiscal years 1987 and 1996. Property taxes are calculated by a threestep process:

1. The assessed value of a property is determined. All property (except agricultural land) is in principle assessed at market value-the value at which an informed buyer and seller would agree to an exchange. Taxpayers who believe their property is incorrectly assessed have the right to appeal.
2. The assessed value is multiplied by a **taxable value rate** to obtain **taxable value**. Residential and commercial properties have a taxable value rate of 3.86 percent. Thus, a home with an assessed value of \$100,000 would have a taxable value of \$100,000 x 3.86% = \$3,860. The taxable value rate for residential and commercial property has been constant since 1986.
3. The property tax bill for a property is obtained by multiplying the taxable value by the **mill rate** and dividing by 1000. For example, a home with a taxable value of \$3,860 that was located in a jurisdiction with the statewide average mill rate of 385 mills would receive a bill for:

$$\$3,860 \times 385/1000 = \$1,486.10.$$

**Table 1** reports statewide taxable values, mill rates and taxes levied for each year from 1987 through 1996. Taxable value declined by \$470 million or 20 percent over the period. As **Figure 1** indicates, the decrease is primarily attributable to the decline in natural resource production and subsequent elimination from the tax rolls. The taxable value of resources declined by almost \$700 million during this period.

**Table 1: Taxable Values, Mill Rates, and Taxes Levied Statewide**

Fiscal Year	Taxable Value (Millions of \$)	Mill Rate (Average)	Taxes Levied (Millions of \$)
1987	2308	242	559
1988	2001	265	531
1989	1943	256	498
1990	1907	281	535
1991	1573	327	514
1992	1593	338	539
1993	1633	344	561
1994	1732	363	628
1995	1787	378	675
1996	1838	385	708
<b>Change: 1987 to 1996</b>	<b>-470</b>	<b>143</b>	<b>149</b>

The combined mill levy of state and local governments and schools increased steadily. By 1996 the average mill levy had increased 59 percent over its 1987 level. As Table 2 illustrates, mill levies tended to increase the most in counties in which taxable values had declined the most. The correlation between percentage changes in taxable value and percentage changes in mills levied is 0.82.

Another way of examining the impact of the decline in resource production is to calculate what mill rates would have been in 1994 if the decline had not occurred. (The 1995 legislature further modified natural resource taxes, so that a comparison using 1996 data is not possible.) If the taxable value of natural resource production had maintained its 1987 value (\$705 million), then 1994 property taxes (\$628 million) plus the new resource taxes (local government severance tax + coal gross proceeds tax = \$40.8 million) could have been levied with a mill rate of only 275 mills. That is, if natural resources had not declined, the statewide average mill levy would have risen a more modest 33 mills or 13 percent rather than the 50 percent it actually rose.

Total taxes levied initially decreased by about 11 percent after the passage of I105, but then increased with especially large jumps in the last few years. The increase over the entire 1987-1996 period was \$149 million or 24 percent. Consumer prices increased 39 percent over these years, so the purchasing power of property taxes actually fell by about 15 percent. The increase in property taxes was also moderate in relation to income growth, which was 71 percent. In fact, total property taxes declined from 5.7 percent of income in 1987 to 4.4 percent in 1996. If one includes the local government severance tax and the coal gross proceeds tax in the 1994 figures, taxes rose \$109 million or 20 percent—still less than inflation and income growth.

## Tax Breakdowns by Level of Government

Figure 2 and Table 3 (below) display taxes levied by level of government. Schools are the largest beneficiaries of property taxes, accounting for more than 60 percent of the total. Counties receive about 20 percent of all property taxes, cities and towns about 8 percent and the remaining 10 percent goes for all other uses—including the university 6 mill levy, state assumption of welfare and fire and miscellaneous districts. See Table 6 for a county by county breakdown.

The "state" component of school taxes is the amount that counties or the state were required to levy. In 1987 each county was required to levy 45 mills, and in 1996 every county was required to levy 55 mills and the state levied an additional 40 mills for a total of 95 "state" mills. School taxes levied at local discretion declined by \$71 million between 1987 and the introduction of the new foundation program in 1991. This was partially offset by a 46 million dollar increase in the "state" levies. Since 1991, both the "state" and local taxes for schools have increased so that over the entire 1987-1996 period the total increase was \$117 million or 34 percent. K-12 enrollment rose 8 percent. Thus with inflation of 39 percent, property taxes per pupil fell about 15 percent relative to prices.

County taxes rose \$4 million while municipal taxes increased about \$8 million. The "other" category increased by \$20 million. Thus, about 80 percent of the increase in property taxes in this period is the result of increases for elementary and secondary education.

### Table 3: Montana Property Taxes by Level of Government (\$Millions)

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	Fiscal 1987		Fiscal 1996		Change: FY 87 to 96	
	Taxes	% Total	Taxes	% Total	Dollars	% Change
Schools-Local	235	42	281	40	46	20
Schools-State	104	19	176	25	72	69
Schools-Total	340	61	457	65	117	34
County	125	22	129	18	4	3
Municipal	45	8	53	7	8	18
Other	49	9	69	10	20	41
Total	559	100	708	100	149	27

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## Residential Property Taxes

While the rise in total property taxes was moderate in comparison with inflation and income growth, this was not necessarily true for taxes on individual pieces or classes of property. In particular, the decline in the taxable value of natural resources meant that higher mill rates would have to be levied on other forms of property just to maintain existing revenue levels. At the same time, homeowners received widely varying reassessments of their properties depending mostly on where they lived.

**Table 4** displays residential property tax data for each county. County averages do not reflect differences within counties that stem from residence in or out of a city or town, the specific school district, or (housetohouse) variations in reassessments. Thus, most individuals experienced greater or lesser changes in their property taxes.

Statewide average mills levied on residential property increased from 310 to 391, or 26 percent. Average mill rates on residential property exceed average mill rates for all property because residential property is more likely to be located in cities or towns which have higher mill rates. Residential mill rates include taxes for state, counties, municipalities and schools-fire, miscellaneous and special improvement districts are excluded.

The cumulative effect of all reassessments in the 1987-96 period was an average increase of 11 percent statewide. Combining reassessments and mill rate changes, a typical residence saw an increase of 40 percent in property taxes. This is an increase of 1 percent after inflation is accounted for, and about 10 percent less than the growth in per capita income (51 percent). Thus residential property taxes declined as a fraction of income.

Perhaps the most striking finding is the diversity of results across counties. **Table 5 County Rankings** ranks counties in a number of ways to address this issue. The first ranking is by the percentage change in property taxes on a typical residence. These range from an increase of 133 percent in Powder River to a decline of 17 percent in Carter County. (Note that these two counties are



adjacent. An important difference is that Carter had no natural resource base.) Increases exceeded the statewide average of 40 percent in 24 of the counties and were below average in 31 counties.

The second set of rankings display the extent to which each county depended on natural resources (Class 1 and Class 2 property) in 1987. It is clear that nine of the 10 counties with the largest increases in residential taxes all depended heavily on natural resources. As these sources of funds dried up, more of the property tax burden was shifted to residential and other forms of property.

Perhaps surprisingly, the current level of tax rates in these 10 counties is just average. The third set of rankings displays the average number of mills levied in 1996. The 10 counties which experienced the largest percentage increases in taxes have an (unweighted) average mill rate of 391-equal to the state average. Most of these counties had extraordinarily low mill rates in 1987, because much of the burden was borne by natural resources.

In Fallon County, for example, resources were 90 percent of the tax base in 1987. Because of the large resource base, mills levied (Table 4) were only 135-less than half of the statewide average. By 1996 mill rates had increased by 139 percent which, when combined with a 23 percent decline in residential values, resulted in a 84 percent increase in the property taxes on a typical residence. Still, in 1996 the average mill rate in Fallon County was 322-well below the statewide average. Thus the dramatic increases in residential property taxes in the resource counties have been mostly a "catchingup" with the rest of the state.

Even with this gap closing, dramatic differences in property tax rates remain. Custer County has the highest average rate (487 mills) while Rosebud has the lowest (179). This means that a typical residence in Custer County is assessed more than two and a half times as much in property taxes as a residence of equal value in Rosebud County. Some of this difference represents the additional or higher cost services (e.g. a paid fire department) provided in the urbanized areas of Custer County but most of the difference arises because Rosebud County obtains a great deal of revenue from the Colstrip power plants and thus is able to levy relatively low mill rates.

The final set of rankings in Table 5 sorts counties by the percentage reassessment of residential property. Rising property values also contributed to tax increases in some areas of the state-most notably in western Montana. The five counties in which average reassessments were 29 percent or higher experienced tax increases averaging 61 percent. On the other hand, declining property values did not necessarily translate into declining taxes, because value declines often occurred in the eastern Montana counties which lost their natural resource tax bases and increased mill rates in order to compensate.

## **Proposals for Reform**

Do these findings suggest a need or strategy for property tax reform? First, residential property taxes do not appear to be high in Montana in comparison with other states. The statewide average mill rate of 391 combined with a taxable value rate of 3.86 percent means that property taxes average about 1.51 percent of market value. This is very close to the national average of 1.46 percent reported by the Advisory Commission on Intergovernmental Relations for 1991. (This calculation assumes that assessed values approximate market values. If assessed values are generally lower than market, Montana tax rates are below the national average.) Second, residential property taxes have actually declined relative to per capita income in the last decade. Thus neither the level nor rate of growth of statewide residential property taxes seems to be a cause for major reform.

However, statewide averages conceal a great deal of variability across areas of the state and individual properties. Should tax increases be mitigated where they have been the largest? Perhaps. The largest increases occurred in the natural resource counties which previously had extraordinarily low tax rates, and their rates are now about average. It is hard to make the case that tax payers in the rest of the state should shoulder a portion of the burden that residents of these counties had previously been fortunate enough to avoid. On the other hand, these counties have experienced very real adjustment problems.

Another source of tax increases has been upward reassessments of property values. There are three possibilities. If the increased value does not reflect market value, then Montana law states that it should be reversed. Adequate provisions for appeals of assessed values would appear to exist. A second possibility is that the reassessment does reflect market value, because the property was previously underassessed, and thus the owner paid fewer taxes than his or her neighbors who owned properties of equal value. If this is the case, there would appear little reason to continue this particular favoritism. Indeed, it is unconstitutional.

Finally, an upward reassessment could occur because a property has in fact increased in market value. In this case the wealth of the owner has also increased, but perhaps not the owner's ability to generate cash flow with which to make tax payments. Recall that property taxes average about 1.5 percent of market value. Thus for each dollar increase in wealth through appreciation of a property, an owner must be able to find about 1.5 cents in additional cash flow. This is, without doubt, a serious problem in a certain number of cases, although it is not clear how many.

Montana law already contains several provisions designed to mitigate the impact of property taxes on low income and elderly residents who may be most vulnerable to reappraisals. A low income provision reduces taxable values, and an elderly homeowner/renter credit provides tax relief based on income level. Participation in these programs is not very high, although the 1995 legislature expanded eligibility and benefit levels. The 1995 legislature also provided relief specifically to residential property owners whose assessed values increased by 15 percent or more in the 1993 reappraisals. Senior citizen homeowners may also enter into "reverse annuity" agreements, which provide monthly payments to help cover taxes and other expenses.

One alternative to periodic reappraisals is to change assessed values only when a property is sold. If property taxes are thus based on acquisition value rather than market value, the burden of taxes is redistributed and a "lockin" effect is created. Redistribution occurs because, for a given level of revenues, lower taxes on longtime owners must be offset by higher taxes on newer owners, including the young who may face increased difficulty in purchasing a first property. Owners may become "locked in" to their properties after living in them for some time, because moving to a different property—even one with a lower market value—would result in higher taxes. For example, older homeowners may hold on to larger houses than they need after their children have moved on, thus making it still more difficult for younger families to acquire suitable housing.

The 1995-96 Tax Policy Task Force has proposed a major revision of I105. Basically, the new proposal would limit the property taxes levied by any jurisdiction to those levied in tax year 1996 (fiscal year 1997), except for increases stemming from new construction, subdivision, reclassification, etc. Effectively, the proposal would require jurisdictions to lower their mill levies so as to offset increases in appraised values. Jurisdictions could still adopt higher taxes, but only if they are approved by a vote of the people.

The Task Force's proposal would succeed in partially offsetting the "automatic" tax increases which accompany rising property values, but they would not protect owners of individual properties whose

reappraisals exceed the average. In particular, adjustments in the 101 statewide mills will not fully protect tax payers in areas where properties have appreciated especially rapidly. For example, suppose that half of the property in the state appreciated 50 percent while the other half had essentially no change in value. Then the statewide tax base would have increased about 25 percent, and the 101 mills would have to be reduced to about 80 to keep revenues constant. Thus taxes will rise about 20 percent where values are rising, while taxes will be reduced about 20 percent on the properties whose values were constant. Also, any reductions in mill levies at the state or local levels will apply to all types of property including commercial, agricultural, business equipment and utilities, as well as residential, so the burden of property taxes will continue to be shifted onto residential property that is appreciating in value.

The Montana Association of Counties has proposed a more radical restructuring of property taxes. That proposal would remove the state's 101 mills as well as most local mill levies for K-12 education, eliminate property taxes on business equipment and livestock, and exempt 65 percent of the first \$50,000 of value of each residence. To pay for all of this, the association proposes a 4 percent sales tax (with income tax credits to offset regressivity) and increases in the electrical energy and telephone license taxes. The entire package is designed to be revenue neutral. Thus the thrust of MACO's proposal is to provide relief from property taxes by increasing other taxes, with the bulk of the revenue coming from a sales tax.

Each of these proposals is likely to be widely discussed in the course of the fall campaign and the next legislative session.

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