



GOVERNOR GREG GIANFORTE
DIRECTOR BRENDAN BEATTY

Memorandum

To: Revenue Interim Committee

From: Eric Dale, Tax Policy and Research
Jared Isom, Tax Policy and Research

Date: November 25, 2024

Subject: Taxable Value Neutral Rates

Section 15-7-111(4) requires the Department of Revenue (Department) to provide the Revenue Interim Committee with a report of tax rates for the upcoming reappraisal cycle that will result in taxable value neutrality for each property class. This is what was presented to this committee on November 18, 2024. To be clear, Montana law requires the Department to calculate these rates; they are not recommendations. Furthermore, the reported rates are based on several assumptions and will likely change before the market values are certified to the counties in August 2025.

The tax rates are set by the Legislature for each property class and are applied to all property in that class across the state. Thus, and in accordance with Montana law, the Department presents these neutral rates calculated on a statewide basis. However, the rates will have very different impacts in each of the 56 counties based on how much of each class of property there is in each county.

It is critical to note three points. First, the taxable value and rate neutrality is not determinative of what an individual property owner's property tax bill will be as the makeup of the types of property in each county differs. Second, the report required is for a statewide calculation of the *taxable value neutrality*, which is the taxable values remain neutral, or unchanged. Third, it represents a very preliminary number in the larger process of determining someone's property tax bill.

Point 1: The taxable value and rate neutrality is not determinative of what an individual property owner's property tax bill will be, as the makeup of the types of property in each county differs.

The tax neutral rate has disparate impacts depending on the county because of the makeup of the property in the county. While a statewide taxable value neutral rate maintains the various classes of property's taxable value across the state, the effect in each of the 56 counties can vary significantly.

Consider, as an example, a hypothetical county with only class 4 residential property. The tax rate in this hypothetical county becomes irrelevant when trying to determine what a property owner's tax bill will be. If the county has a budget of \$10,000,000, it will levy mills sufficient to generate that amount of property tax collections. If the rate is 15%, the mills will float down. If the tax rate is 0.1%, mills will float up. The tax rate has no meaningful effect on the property tax bills that the class 4 residential property owners pay.

It is also critical to understand that adjusting a tax rate does not have a direct impact on a property owner's tax bill. This is true even if the legislature reduced the tax rates to the percentages calculated by the Department. To illustrate, if residential property values grew in a hypothetical county at exactly the state average, and all other classes of property values grew at half of the state average in the same hypothetical county, the residential property owners would see an increase in their property tax bills, even with the decrease to the tax rate. This is because the residential property's share of the total tax base relative to the other classes of property increased.

There is even more variation present as we extend the time frame from one cycle and attempt to calculate rates to maintain taxable value neutrality by class relative to TY 2022. If the tax rates were adopted to move the total taxable values for each class of property back to pre-TY 2023 levels, variations over the 56 counties and the 4-year period would be even greater. Under this scenario, the residential rate would be 0.76% (from 1.35%), the commercial property rate would be 1.35% (from 1.89%), and the agricultural property rate would be 1.85% (from 2.16%).

For example, assume the taxable value neutral rates for residential, commercial, and ag property were passed into law during the 2025 legislative session that would reset the taxable values back to pre-TY 2023 levels. Relative to current law, there would be 43.7% less taxable value associated with class 4 residential property, 28.57% less taxable value associated with commercial property, and 14.35% less taxable value associated with ag property.

The percentage reductions in taxable value above do not correlate to a reduction in taxes levied or collected by a local government. It simply represents a shifting tax base on which mills are levied. With this, here are some examples of what the estimated effect on the taxable values (not the taxes paid) in various counties:

Lake County Example: The effects in Lake County under this scenario, where a large portion of the tax base is residential, would be a 40.87% reduction in the total taxable value in the county: \$52 million from residential, \$3 million from commercial, and \$238,000 from agricultural.

Missoula County Example: Like Lake County, Missoula County's tax base is largely residential. The impact in Missoula County would be a 36.53% reduction in the total taxable value in the county: \$139.9 million from residential, \$25.4 million from commercial, and \$94,000 from agricultural.

Wibaux County Example: The same exercise in Wibaux County results in a 1.66% total taxable value decrease in the county: \$450,000 from residential, \$41,000 from commercial, and \$18,300 from agricultural.

Again, it is important to note that the percentage reductions in taxable value in these examples do not correlate to a reduction in property taxes levied or what a person might see on their own property tax bill.

Explained in other words, the effect of a statewide taxable value neutral rate change has very different impacts on the taxable values across the state that local governments set mill levies against. It is important to also note that this is still just the taxable value being discussed, not the actual property taxes that are levied by a local government. It is not determinative of what a property owner will see on their property tax bill.

In addition to the shifting burden that would result from changing the statutory rates, the state would also collect less in 95 mill revenue to use for school funding. If the Legislature were to adopt tax rates to move the total taxable values for each class of property back to pre-TY 2023 levels, revenue from the 95 mills to fund public schools would fall by an estimated \$165,000,000 per year.

The 95 mills revenue is used for school equalization. With the creation of the SEPTR account, starting in TY 2025, the 95 mills revenue was also used to lower countywide education mills statewide relative to what they would have been otherwise. To that effect, total property taxes levied between TY 2023 and TY 2024 grew by the smallest amounts statewide in over 15 years. That reduced growth was partially due to the SEPTR account and the 95 mills revenue offsetting the countywide education mills.

Point 2: The report required is for a statewide calculation of the *taxable value neutrality*, which is the taxable values remain neutral, or unchanged.

To illustrate this, consider a hypothetical where in 2024, the state had \$1,000,000,000 of commercial market value and a commercial tax rate of 1.5%. This would result in \$15,000,000 of commercial taxable value in the state in 2024. ($\$10\text{M} \times 1.5\% = \$15,000,000$)

To determine the tax neutral rate, the Department uses the estimated 2025 market value of commercial property the state, which, for this example, has increased to \$1,200,000,000. The tax rate that results in taxable value neutrality, or maintenance of that \$15,000,000 of commercial taxable value statewide, would be 1.25%. ($\$12\text{M} \times 1.25\% = \$15,000,000$)

This is what the statute requires to be calculated. This calculation does not provide detail about how the taxable value neutrality rates will affect the taxes in each of the 56 counties, or within any of the school districts, cities, or any of the other taxing jurisdictions with commercial property.

Point 3: The statutorily required report on taxable value neutral rates represents a very preliminary number in the larger process of determining what a person's property tax bill is.

A property's valuation is important to determining its property tax liability, but it is just one of many factors that go into determining a property tax bill. Each taxing jurisdiction sets its own final tax level through a detailed budgeting process. Factors like budgetary adjustments, voted mills, new construction, TIF districts, the number of students and teachers, special fees, and other factors all impact a taxing jurisdiction's the mill levies and tax collections.

Additionally, a property's tax liability depends not only on the property's value but also on its share of the total value in a taxing jurisdiction. For example, if a property represents 1% of the tax base, its liability is 1% of the property tax burden. If that property's value grows faster than other property and becomes 2% of the tax base, its share of the tax burden would increase to 2%, shifting taxes onto that property and away from other property with shrinking shares.

With this, and to provide context to the preliminary changes in market values for reappraisal, the Department also estimated the potential impacts on tax liabilities on a statewide basis for different types of property, which required several assumptions. While these estimated impacts were produced with a lot of data and information, they remain estimates based on preliminary numbers and data available at the time the Department's report to the Revenue Interim Committee was due. Based on a historical comparison of preliminary estimates provided in November and the final appraisal, it is extremely likely that the numbers will change.

To elaborate on how the estimates were produced, we first examined the total market and taxable values for all property in the state in TY 2024. Next, we calculated the total tax liability for each property by multiplying the taxable value by the total mill levies by taxing jurisdiction, which are variable and somewhat unpredictable every year. Then, we summarized the total taxable value for each taxing jurisdiction in the state and calculated the total property tax revenue for each of these taxing jurisdictions.

We then estimated market and taxable values for TY 2025 for all property in the state. Preliminary numbers were calculated with assistance from the Property Assessment Division to estimate growth rates for Class 3 agricultural property, Class 4 residential and commercial property, and Class 10 timber property. Then, the official assumptions used in the revenue estimates for the 2023 Legislature contained in HJR 2 were used to estimate the market values and taxable values for all other types of property. New market and taxable values were estimated for TY 2025 under current law and under the taxable value neutral rates, and the new taxable values were summarized for each of the TY 2024 taxing jurisdictions.

For TY 2025, each taxing jurisdiction's estimated property tax collections (except for the state 95, 6, and 1.5 mills) was assumed to grow by the 10-year average growth rate for county population and inflation. The estimated TY 2025 taxation levels, and the TY 2025 taxable value summaries were then used to project the mill levies for each taxing jurisdiction in the state. The state mills were held constant at the TY 2024 levels.

These new estimated mill levies were then applied to all property in the state, and results were summarized in the memo and presentation to RIC.

If you have any additional questions, please give us a call at (406) 444-3531 or (406) 444-7925.