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Revenue Interim Committee

69th Montana Legislature

TO: Revenue Interim Committee
FROM: Jaret Coles, Staff Attorney
RE: Legal Analysis of Property Tax Classes and Rates
DATE: February 20, 2026

During the January 5, 2026, Revenue Interim Committee meeting, members requested a legal memorandum that analyzes the ability of the Legislature to classify property with different tax rates based on specific factors such as duration of occupancy, rental property status, and valuation. Ultimately, the question pertains to the substance of Senate Bill No. 542 from the 2025 legislative session. This legislation is currently being challenged in court. Generally, the policy of the Legislative Services Division is to not to provide opinions on the outcome of pending litigation. As such, staff presents the legal framework for analyzing the Legislature's ability to classify property, but this memorandum does not make a legal conclusion on the constitutionality of Senate Bill No. 542.

LEGAL FRAMEWORK ON CLASSIFICATION

After property is assessed, the Department of Revenue ("Department") determines the rate of the tax levied by classifying the property according to statutory definitions. *See* Title 15, ch. 6, part 1. Historically, the Legislature had broad authority over classification of property under the 1889 Constitution. *See Hilger v. Moor*e, 56 Mont. 146, 163, 182 P. 477, 479 (1919). Yet, the delegates of the 1972 Constitutional Convention drafted provisions that gave the state even broader authority and more flexibility regarding tax policy. In *Kottel v. State*, 2002 MT 278, ¶ 38, 312 Mont. 387, 60 P.3d 403, the Montana Supreme Court cited the Convention history regarding this flexibility:

> *See e.g.* II Mont. Const. Conv., Committee, Intro. 579-80 ("For 80 years, the Constitution required taxation of all property. That mandate was difficult to live up to. . . . ***The legislature shall decide what property to tax and how to tax it***."); II Mont. Const. Conv., Committee Proposal Comments, 591 (regarding Article VIII, Section 5 that now allows the Legislature to exempt any class of property: "The proposed provisions . . . leave the scope and nature of taxation programs up to the Legislature."); V Mont. Const. Conv., Verbatim Transcript, 1376-78 ("The

> committee felt that [the tax article] should be flexible enough so that future Legislatures would not be restricted for many years to come. . . . ***So our thinking now is that the Legislature is now free to tax whatever form or class of property it so desires and they can define it at the time they make the law.***"); V Mont. Const. Conv., Verbatim Transcript, 1378 ("You can have a tax on a special subject, but it has to be broadly based across the state."). (emphasis added).

Section 15-7-103(2), MCA provides that all lands must be classified according to their use or uses. When a statute does not give an indication of how a property is to be classified, the Montana Supreme Court has held that the Department had the authority to classify property to an appropriate class. *See Bresnan Communications, LLC v. State,* 2013 MT 357, ¶ 40, 373 Mont. 29, 315 P.3d 921. However, when the plain language of a statute provides for classification within a specific class, the Department does not have broad discretion, and the intent of the Legislature must be followed. *Hiland Crude, LLC v. Dep't of Revenue*, 2018 MT 159, ¶ 17, 392 Mont. 44, 421 P.3d 275. Ultimately, classification becomes important because the rate of tax varies depending on how the property is classified.

Numerous Montana Supreme Court have analyzed classification. In 1919, the Montana Supreme Court upheld an act of the Legislature that divided property into seven different classifications, each taxed at a different rate, against a challenge that the Legislature was "without authority to classify property for purposes of taxation." *Hilger,* 56 Mont. at 163, 182 P. at 479. The Legislature may properly go even to the extent of placing identical articles in the hands of different owners in different classes, because different uses result in different productivity. A classification will be upheld if it has a reasonable relation to some permitted end of governmental action. *Wheir v. Dye*, 105 Mont. 347, 73 P.2d 209 (1937). However, where a classification results in discrimination, it is an unconstitutional exercise of the legislative function to classify property for taxation. *Victor Chemical Works v. Silver Bow County*, 130 Mont. 308, 301 P.2d 730 (1956).

In *Montana Stockgrowers Association v. State*, 238 Mont. 113, 777 P.2d 285 (1989), the Montana Supreme Court reversed a lower court decision that held that taxing livestock while exempting business inventories was unconstitutional in that the law denied certain individuals equal protection under the federal and state constitutions. The Court ruled that the proper test was a rational basis test to determine if there was a basis for treating inventory and livestock differently. The Court explained further that to survive scrutiny under the rational basis test, classifications must be reasonable, not arbitrary, and they must bear a fair and substantial relation to the object of the legislation, so that all persons similarly circumstanced shall be treated alike. *Id.* at 117-118 (citing *Eisenstadt v. Baird* 405 U.S. 438, 447, (1972)). Under the rational basis test, it was clear that the Legislature had acted rationally in applying different classifications, and historically the two properties had been treated differently.

In *Powder River County v. State.*, 2002 MT 259, 312 Mont. 198, 60 P.3d 357, certain counties and individual taxpayers argued that statutes enacted to tax coal, oil, and natural gas while at the same time exempting those properties from a statewide mill levy for education were invalid because the statutes did not classify those properties and, in addition, created a partial exemption from school funding instead of creating a total exemption. The Supreme Court held that the Legislature is not constitutionally limited to a classification system and that the Legislature is not constitutionally limited to providing tax exemptions for property exclusively within a classification system.

In *Department of Revenue v. PPL Montana, LLC*, 2007 MT 310, 340 Mont. 124, 172 P.3d 1241 (2007), a defendant utility company appealed a District Court decision regarding the equality of the state's tax assessments, claiming that the state deprived the utility of equal protection by failing to properly equalize defendant's property tax burden with other comparable electric generation facilities in Montana. The Department explained that the relatively higher appraisal values of defendant's properties arose from the fact that the different companies had different total market values as a unit, so their individual properties also had different market values even though the individual properties might be physically similar. The Court held that there is nothing constitutionally significant in the bare fact that the Department appraises the fair market value of the same electric generation assets differently when those assets are owned by different utilities. The basic rule of equal protection is that persons that are similarly situated with respect to a legitimate governmental purpose of law must receive like treatment. The first prerequisite of a meritorious equal protection claim is that the state had adopted a classification that affects two or more similarly situated groups in an unequal manner. Here, the District Court's determination that defendant failed to establish that the state's use of the unit method of valuation deprived defendant of equal protection was affirmed.

In *Department of Revenue v. Heidecker*, 2013 MT 171, 370 Mont. 464, 304 P.3d 726, the defendant purchased 230 acres of agricultural property and subdivided 30 acres subject to restrictive covenants providing that the subdivided lots could be used only for residential purposes. Although the defendant did not sell any of the lots and continued to use the lots for agricultural purposes, the Department reclassified the land as residential tract land based on the restrictive covenants. The Supreme Court affirmed the District Court's finding that the defendant's continued use of the land for agricultural purposes belied any claim that the covenants effectively prohibited agricultural purposes and that upon sale of any of the lots the Department of Revenue could then reevaluate whether the covenants effectively prohibit agriculture.

ANALYSIS

A. Homestead Reduced Rate and Long-Term Rental Reduced Rate

In the event of a Constitutional challenge regarding a state law that provides for a higher rate of tax when a property owner does not meet specific occupancy or long-term rental criteria, the courts would most likely analyze the framework provided for in this memorandum.

The courts could look at the actual use of the property. *See* section 15-7-103(2), MCA. Use of the property is a predominant factor, as identical property can be classified and taxed differently based on use. When looking at use, a court would most likely apply a rational basis test to determine if the classifications is reasonable, not arbitrary, and whether the classification bears a fair and substantial relation to the object of the legislation, so that all similarly situated taxpayers are treated alike. *See Montana Stockgrowers Association v. State*, 238 Mont. 113, 777 P.2d 285 (1989).

As applied here, Senate Bill No. 542 (2025) revised section 15-6-134, MCA, to provide reduced graduated rates for property that qualifies for a homestead reduced rate, or the long-term rental property reduced tax rate. Section 15-6-134(3)(b)(i), MCA. The application criteria for obtaining the homestead reduced rate is provided for in section 15-6-405, MCA, and ultimately the property needs satisfy the definition of a "principal residence" in section 15-6-402, MCA. Likewise, the application criteria for obtaining the rental property reduced tax rate is provided for in section 15-6-411, MCA, and ultimately the property needs satisfy the definition of a "long-term rental" in section 15-6-402, MCA. The impact is that if an owner of residential property is not using it as a principal residence or a long-term rental, it will typically be subject to the highest rate of tax in the graduated rate table. *See* section 15-6-134(3)(a), MCA.

Among the criteria in the definition for a "principal residence", one of the requirements is that the "owner can demonstrate the owner owned and lived for at least 7 months of the year for which the homestead reduced tax rate for a principal residence is claimed". Section 15-6-402(4), MCA. Likewise, among the criteria in the definition for a "long-term rental", one of the requirements is that an owner can demonstrate the property was "rented for periods of 28 days or more for at least 7 months in each tax year for which the rental property reduced tax rate is claimed" and the property "is occupied by tenants who use the dwelling as a residence during the year in which the reduced tax rate is claimed". Section 15-6-402(2), MCA. Both definitions have a use test, which has been recognized as a proper way to classify and therefore tax identical property differently. *See Wheir v. Dye*, 105 Mont. 347, 354-355, 73 P.2d 209 (1937).

The relevant question on the homestead reduced rate is whether a property owner using a property as a principal residence and a property owner using the property as a second home are similarly situated. Likewise, the relevant question on the long-term rental reduced rate is whether a property owner that rents property on a short-term basis or keeps it vacant is similarly situated to an owner that has a long-term rental. In applying these tests, the courts will look for any

differences, however slight between the two categories in determining if the owners are similarly situated. *See Montana Stockgrowers Association v. State*, 238 Mont. 113, 118, 777 P.2d 285 (1989) (citing existing precedent that "[w]hen there is a difference between various properties, it need not be great or conspicuous in order to warrant classification"). Using a rational basis test, there are a variety of differences that could be put forward in the legislative record for the disparate treatment. Given the pending litigation in this matter, this memorandum does not apply these arguments.

B. Multiple Rates in the Same Statutory Classification

In the event of a Constitutional challenge regarding a state law that provides graduated tax rates in the same statutory class, the courts could also turn to the framework provided for in this memorandum. A primary question could be whether subclassifications of property within a statutory classification are allowable. The Montana Supreme Court has previously held that Legislature is not constitutionally limited to a classification system. *Powder River County v. State.*, 2002 MT 259, 312 Mont. 198, 60 P.3d 357. Using this reasoning, the state could argue that different classifications within a statutory classification is allowable. The Legislature has broad authority in this area, so long as there is no discrimination among similarly situated taxpayers using a rational basis test.

It is also noteworthy that the Legislature has set different rates based on the value of property that have stood the test of time. For example, class eight business equipment property has graduated rates based on market value starting at 0% for the first $1 million in market value, then 1.5% for the next $6 million in market value, and finally 3% for all remaining market value. *See* 15-6-138(3), MCA. Additionally, before the 2025 legislative session, there was a higher rate of tax for residential homes that exceeded $1.5 million in market value. *See* 15-6-134(3)(b) (2023), MCA (providing that "the market value of a single-family residential dwelling in excess of $1.5 million is the residential property tax rate [of 1.35%] multiplied by 1.4"); section 7(3)(b), Chapter 361, Laws of 2015, enacting the $1.5 million property tax rate increase in Senate Bill No. 157 (2015)). Using a rational basis test, the state would need to show that the rate difference is reasonable, not arbitrary, and bears a fair and substantial relation to the object of the legislation, so that all similarly situated taxpayers are treated alike. Again, given the pending litigation in this matter, this memorandum does not apply the arguments that could be raised.

In closing, I hope that I adequately addressed your question, and I look forward to providing further guidance to the committee.