A BRIEF HISTORY OF CYCLICAL REAPPRAISAL OF PROPERTY IN MONTANA

Prepared for the House Bill No. 488 Subcommittee of the Revenue and Transportation Interim Committee

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Like the policeman in the *Pirates of Penzance*, taking one consideration with another, the DOR's [and the Legislature's] lot in property tax appraisal is not a happy one--Justice John C. Sheehy, Montana Supreme Court

INTRODUCTION

Before the 1972 Montana Constitution became effective July 1, 1973, the appraisal, assessment, and taxation of real property in Montana was generally the responsibility of county officials subject to supervision, appeal, and equalization of the state Board of Equalization.[1] Article VIII, section 3, of the new constitution required the state to "appraise, assess, and equalize the valuation of all property which is to be taxed in the manner provided by law."[2]

The change to the state's constitution regarding the valuation of property for tax purposes was not made lightly, given the way property had been assessed. Local elected county assessors appraised property at something less than full cash value. County assessors established fractional assessments for valuation of all types of property, and these assessments varied from county to county.[3] The State Board of Equalization, established by Article XII, section 15, of the 1889 Montana Constitution, was an assessing, administrative, and quasi-judicial agency. The Board often adopted its own tax policy by rule, circumventing legislative intent. The Legislature had little authority to meddle in the affairs of the Board because Montana Supreme Court decisions held that the Legislature had limited control over the Board.[4]

The tax appeals process under the 1889 Constitution presented its own problems. County tax appeal boards and the Board of Equalization ruled on taxpayers' appeals to valuations that were determined by their staff.[5] Article VIII, section 7, of the 1972 Constitution provided for "independent appeal procedures for taxpayer grievances about appraisals, assessments, equalization, and taxes." The absence of uniform and equalized property assessments and a tax

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[1] Greg Petesch and Lee Heiman, Memo to the Joint Meeting of the Tax Reform Study Committee and Property Tax Reappraisal Study Committee, (Montana Legislative Services Division, Legal Services Office, January 12, 2004), p. 6.

[2] Article VIII, section 4, of the constitution requires that all taxing jurisdiction use the assessed valuation of property established by the state.

[3] Connie Erickson, "House Joint Resolution No. 48: Property Revaluation Procedures in the Property Tax Laws", Property Taxation and other Issues Before the Revenue Oversight Committee, (Montana Legislative Council, December 1988), p. 6.

[4] *Ibid., p. 6.*

[5] *Ibid.*, p. 6.

appeals process that was clearly tilted in favor of government were impetuses to make the constitutional changes.

Since the state has taken over the valuation of taxable property, the Montana Legislature has provided for six reappraisal cycles of various durations for agricultural land, residential and commercial land and improvements, and forest land.[6]

THE FIRST CYCLE BEGINS

In 1975, the Montana Legislature directed the Department of Revenue to administer and supervise a program for the revaluation of all taxable property within the state every 5 years (Ch. 294, L. 1975). At least 20% of the property in each county had to be revalued each year, with property that had gone the longest since appraisal to be appraised first. The Department of Revenue was required to promulgate a written plan to implement the program. In separate legislation, the Legislature provided that land and improvements be assessed at 40% of full cash value (Ch. 209, L. 1975) to correspond with existing practices. Since the statutory tax rate on residential and commercial land and improvements was 30%, the effective tax rate on these properties was 12%.

In April 1975, a group of taxpayers filed action in District Court in Missoula County against the new reappraisal plan. The action challenged "the constitutionality and legality of the Montana Appraisal Plan, its implementing legislation and the property appraisal program in Missoula County." The District Court judge ruled that the appraisal plan was never legally adopted and that the reappraisal program violated the taxpayers' right to uniformity of taxation and denied them due process and equal protection under the laws of the state and federal constitutions. Similar actions were filed in other district courts in the state with varied results. Because of the uncertainty occasioned by the various decisions, the governor directed the Department of Revenue to use tax year 1974 values for tax year 1975.[7]

The Montana Supreme Court ruled that the appraisal plan and the implementing legislation were constitutional, noting that although the scheme produced temporary inequities it did not violate equal protection and uniformity requirements. However, the Supreme Court agreed with the District Court that the Department's reappraisal plan was not legally adopted under the Montana Administrative Procedure Act. At the public hearing for adopting the plan, taxpayers raised many objections, including:

- a 3-year plan would reduce the inherent inequities of the plan;
- maintaining the same order of reappraisal would perpetuate the inequities;
- the mandatory state levies would increase taxes on those properties that were first reappraised;
- the effects of higher valuations should be delayed until the Legislature had the

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[6]Forest land is valued on its productivity (Ch. 783, L. 1991). Before 1991, the value of timberland was the appraised value of standing timber and the grazing productivity of the land.

[7]Erickson, *Op. cit.,* p. 13.

opportunity to adjust mill levies;
- the plan was implemented before it was adopted;
- the plan was so ambiguous that it would be difficult to know whether the plan or the law was being followed.

The Administrative Procedure Act requires that a state agency respond in writing to the various comments made at the public hearing. The Department had concluded that the comments were irrelevant to the plan and adopted the plan without change. The Court determined that revaluations made under the plan could not be placed on the tax rolls. Patterson v. Department of Revenue, 171 Mont. 168, 557 P.2d 798 (1976).

In 1975, the Legislature also enacted the Realty Transfer Act (Ch. 528, L. 1975). The purpose of the legislation was:

> to obtain sales price data necessary to the determination of statewide levels and uniformity of real estate assessments by the most efficient, economical, and reliable method.

The use of price information obtained from a realty transfer certificate allowed the Department of Revenue to develop a market value approach to appraising property. This method could be used in conjunction with the cost approach for appraising residential property.

RECLASSIFICATION, REVALUATION, AND STRATIFICATION

In 1977, the Legislature revised the classification and taxation of property (Ch. 566, L. 1977). It reclassified taxable property and established tax rates by property class that corresponded to tax rates applied to fractionally assessed property.[8] It required the Department of Revenue to assess all taxable property at 100% of market value[9] (with exceptions). The Legislature required that the Department of Revenue certify to the Governor by June 30, 1978, the percentage increase in the market value of residential and commercial land and improvements (class twelve property at the time) as of January 1, 1977, as the result of reappraisal. The Legislature established a schedule whereby the tax rate applied to class twelve property would be determined by the percentage increase in market value of that property. The market value of residential and commercial property increased by 47% and the tax rate, according to the schedule, was reduced from 12% to 8.55% in tax year 1978.

The next reappraisal cycle began in 1979, with new values expected to go on the tax rolls by January 1, 1984. Because the Department of Revenue had to train staff for the new reappraisal and lacked a computer-assisted mass appraisal system, only 5% of all property had been

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[8] See Teresa Olcott Cohea, Montana's Property Taxes: Assessment and Classification, Subcommittee on Taxation (Montana Legislative Council, Helena, December 1976).

[9] Market value is the value at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.

reappraised by 1981.[10] (The Department of Revenue was still required to revalue 20% of all property within a county each year.) Because of these problems, the Legislature extended the reappraisal cycle by 2 years, ending December 31, 1985 (Ch. 350, L. 1981).

The value of residential property increased by 121% statewide because of reappraisal,[11] so the Legislature reduced the tax rate on industrial and commercial property from 8.55% to 3.86% (Ch. 427, Laws of 1987).[12] The Legislature also delayed for 1 year the placement of new values on the tax rolls and required a taxpayer who disagreed with the taxpayer's new value to appeal the new value in the year before the value was placed on the tax roll.

Also in 1987, the Legislature directed the Department of Revenue to conduct statistically valid annual sales assessment ratio studies of all residential and commercial land and improvements (including agricultural improvements and home sites). The counties of the state were divided into 13 areas for the purpose of conducting the studies, with Billings, Great Falls, and Missoula assigned to their own areas. The purpose of these studies was to revalue residential and commercial property each year during the reappraisal cycle so that changes in market value would be implemented incrementally rather than fully at the end of the reappraisal cycle.

In 1989, the Legislature revised the stratified sales assessment ratio procedures (Ch. 636, L. 1989). The Department of Revenue was directed to partition the state into as many as 100 areas for residential property and as many as 20 areas for commercial property. The areas had to be as economically and demographically homogeneous as possible. The studies had to be completed by November 1 of each year to be used for determining appraisals for the next tax year. Taxable property was considered revalued for each tax year, based on the results of the study. The legislation also provided that increases in property valuations pursuant to the ratio studies in order to equalize property values annually were not subject to the 1986 property tax limits.

The sales assessment ratio studies seemed like a good idea. However, in 1990, a taxpayer in Great Falls disputed the reappraisal of her property that resulted from the sales assessment ratio study. The Department of Revenue increased the valuation of Patricia Barron's home from $28,019 to $40,325. Barron appealed to the Cascade County Tax Appeal Board challenging the constitutionality of the adjustment.[13] The County Tax Appeal Board denied the appeal on the grounds that the Department of Revenue had found an error in the appraisal and would correct the valuation. Barron appealed to the State Tax Appeal Board. The State Board determined that Barron's property should be assessed at $75,000 (the purchase price) and that the Department of Revenue had failed to equalize values in the area in which Barron's property was located. The

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[10]Erickson, *Op. cit.*, p. 14.

[11]*Ibid.*, p. 14.

[12]In 1985, the Legislature provided for the calculation of the tax rate on agricultural land (Ch. 739, L. 1985) and on timberland (Ch. 681, L. 1985) to account for changes in valuation because of reappraisal.

[13]Petesch and Heiman, *Op. cit.*, p. 6.

State Board also noted that the District Court would find the sales assessment ratio study unconstitutional. The Department of Revenue brought an original proceeding to the Montana Supreme Court, challenging the State Tax Appeals Board decision.[14] The Court held that the Department's use of "stratified sales assessment ratio study" to increase appraisals in given area by 30% required taxpayers in area whose properties were appraised at or above their market values to bear disproportionate share of tax burden, in violation of equal protection and due process requirements of the Constitution and tax equalization statutes. Department of Revenue v. Barron, 245 Mont. 100, 799 P.2d 533 (1990).

The Court's order applied prospectively to December 31, 1990, to allow collection of 1990 property taxes.[15]

In order to respond to the Barron decision, the Legislature in 1991 made another try to refine the stratified sales assessment ratio study approach (Ch. 680, L. 1991). The legislation required the Department of Revenue to reappraise residential property in a given area if certain criteria were not met under the sales assessment ratio study. It also provided a taxpayer appeal process of adjusted values and for shorter reappraisal cycles (from 5 to 3 years). The new law was challenged and the Montana Supreme Court held that to use specific stratified sales ratio study to adjust property values in a given district during an appraisal cycle violated equal protection by causing disparity of treatment of taxpayers within a specified area.

The Court noted in its decision that the same disparities existed under the revised approach as those that occurred under Barron. Additionally, the Court was not persuaded by the Department's argument that the appeal process saved the entire statute. Department of Revenue v. Sheehy, 262 Mont. 104, 862 P.2d 1181 (1993).

FOURTH TIME A CHARM?

The third reappraisal cycle was completed on December 31, 1992. Because new market values increased by only 7%,[16] the tax rate for residential and commercial property remained at 3.86%. In the July 1992 Special Session, the Legislature temporarily extended the reappraisal cycle to 4 years. Property had to be revalued by December 31, 1996 (Ch. 13, Sp. L. July 1992). The legislation also extended the reappraisal of agricultural land to December 31, 1993.

The reappraisal cycle that began January 1, 1993, and ended January 1, 1996, resulted in a 40%

[14] *Ibid.*, p. 7.

[15] *Ibid.*, p. 7.

[16] Montana Department of Revenue, "Timeline of Reappraisal", Exhibit 4, in Minutes, Revenue and Transportation Interim Committee meeting, June 21, 2007.

increase in the market value.[17] To deal with this relatively large increase in market value, the Legislature phased in the effects of reappraisal for agricultural land, residential and commercial property, and forest land (Ch. 463, L. 1997). The legislation reduced the tax rate applied to class four residential and commercial property (and class three agricultural property) by 0.022% a year for 50 years. In addition, the amount of change in valuation (increases and decreases) for agricultural land, residential and commercial property, and forest land was phased in each year at 2% of the total change in valuation and provided the next reappraisal cycle would begin January 1, 2007.

Like Snoopy impersonating a mountain lion, a lawsuit was waiting to pounce. In 1997, Theodore Roosevelt IV appealed the Department of Revenue's 1997 valuation of his property in Fergus County to the County Tax Appeal Board. The Department's appraised value of the property in 1997 ($701,890) was less than the appraised value in 1996 ($890,850). In determining the 1997 value of the property, the County Tax Appeal Board reduced Roosevelt's 1996 value to $820,597 and his 1997 value to $658,840. However, because of the 2% phasein provision contained in 15-7-111, MCA, the "taxable market value" of his property was $817,363. The County Board upheld the calculation of the 1997 phasein value. Following proceedings in the State Tax Appeal Board and in District Court, the matter came before the Montana Supreme Court. The Court concluded that taxing some property in excess of its market value while taxing other property at less than market value is not rationally related to the state interest in reducing reliance on property taxes and avoiding property tax increases. The Court held that the phasein scheme as it applied to property that declined in value violated the equal protection clause of the Montana Constitution because certain taxpayers pay a disproportionate share of the state's property taxes. Roosevelt v. Department of Revenue, 293 Mont. 240, 975 P.2d 295 (1999).

In 1999, the Legislature significantly revised the state's property tax system (Ch. 584, L. 1999). In order to mitigate the effects of the last reappraisal cycle and to respond to Roosevelt, the Legislature incrementally reduced the tax rate applied to residential and commercial property, agricultural land, and forest land, incrementally increased market value exemptions for residential and commercial property, and phased in remaining valuation increases (the phasein of valuation decreases were eliminated) for the three classes of property over a 4-year period. The table below summarizes the changes made for residential and commercial property.

[17] *Ibid.*

Table 1: Mitigation of Property Value Increases Beginning in Tax Year 1999				
Tax Year	Tax Rate	Residential Market Value Exemption	Commercial Market Value Exemption	Market Value Increase Phasein Percentage
1999	3.71%	16%	6.5%	25%
2000	3.63%	23%	9%	25%
2001	3.54%	27.5%	11%	25%
2002	3.46%	31%	13%	25%

The legislation also provided a land value cap at the greater of 75% of the improvement value on the land, or 75% of the statewide average improvement value. The purpose of the cap was to mitigate large increases in land values in certain parts of the state.[18]

The legislation also extended the reappraisal cycles to 6 years, revised property tax limitations (initiated by I-105 in 1986) and the procedures for calculating mill levies related to the revised limitations, and provided reimbursements to local governments associated with reducing tax rates on business equipment, telecommunications property, and electric generation property and with revising the taxation of oil and natural gas production. It also created an interim local government funding and structure committee[19] and an interim court funding and structure committee.[20]

IN A ROUTINE?

New values of property subject to periodic reappraisal went into effect January 1, 2003. Statewide, the market value of residential property increased by 20.2% because of reappraisal.[21] The 2003 Legislature took a similar tack as in 1999 to mitigate the effects of the periodic property reappraisal (Ch. 606, L. 2003). The Legislature incrementally reduced the tax rate applied to residential and commercial property and agricultural land,[22] incrementally increased market value exemptions for residential and commercial property, and phased in valuation increases for the three classes of property over a 6-year period. The table below summarizes the changes made for residential and commercial property.

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[18]During the May 2000 Special Session, the Legislature eliminated the land value cap effective January 1, 2002 (Ch. 11, Sp. L. May 2000).

[19]The result of the local government funding and structure committee was the enactment of House Bill No. 124 (Ch. 574, L. 2001) to revise the collection and allocation of state and local revenue. The legislation also included a provision for voter approval of mill levy increases.

[20]*Mirabile dictu*, the legislation did not suffer from any legal challenges.

[21]Montana Department of Revenue, *Op. cit.*

[22]The legislation did not change the tax rate applied to forest land. Forest land is taxed at 0.35% of its forest productivity value.

Table 2: Mitigation of Property Value Increases Beginning in Tax Year 2003				
Tax Year	Tax Rate	Residential Market Value Exemption	Commercial Market Value Exemption	Market Value Increase Phasein Percentage
2003	3.40%	31.0%	13.0%	16.66%
2004	3.30%	31.4%	13.3%	16.66%
2005	3.22%	32.0%	13.8%	16.66%
2006	3.14%	32.6%	14.2%	16.66%
2007	3.07%	33.2%	14.6%	16.66%
2008	3.01%	34.0%	15.0%	16.66%

The legislation also dealt with "extraordinary market value increases during the revaluation cycle that ended December 31, 2002," by implementing the so-called "extended property tax assistance" program. The program provided a cap for residential dwellings and appurtenant land not exceeding 5 acres that had a taxable value increase of 24% or more because of reappraisal. The legislation required that certain conditions be met in order to qualify for the cap. First, the property tax liability of the property would have to increase by $250 or more by the end of the reappraisal cycle as measured against tax liability in tax year 2002. The increase was calculated by multiplying 2002 mill levies times the value of the property at the end of the reappraisal cycle. Second, only taxpayers whose annual gross household income was $75,000 or less would qualify for the program. For taxpayers with gross household income of $25,000 or less, the taxable value of the property would be phased in at 4% a year to a total cap of 24%. For taxpayers with gross household income up to $50,000, the taxable value of the property would be phased in at 5% a year to a total cap of 30%. For taxpayers with gross household income up to $75,000, the taxable value of the property would be phased in at 6% a year to a total cap of 36%.

The legislation also established a property reappraisal study committee and a tax reform study committee.

ENGAGED IN EMPLOYMENT

The periodic reappraisal of property in Montana has had a long and tumultuous history. Improved techniques and technologies of reappraisal have improved the accuracy of reappraisal and the ability to analyze its effects. These improvements, however, do not necessarily make the Legislature's lot any easier. It will still have to weigh conflicting views on how best to deal with funding local governments and schools and protecting property taxpayers.

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