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Revenue and Transportation Interim Committee

60th Montana Legislature

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TO: House Bill No. 488 Subcommittee

FROM: Jeff Martin, Legislative Research Analyst

RE: Overview of Proposal to Revise the Property Taxation of Agricultural Land and Residential and Commercial Land and Improvements

At the April 17, 2008, meeting of the House Bill No. 488 Subcommittee, a property taxpayer discussed a proposal to mitigate the effects of the reappraisal cycle. The proposal would significantly revise the property taxation of agricultural land (class three property) and residential and commercial land and improvements (class four property). The proposal may also indirectly affect the taxation of other classes of property, including the taxation of railroads and airlines.

Under the proposal, the taxation of class four property would move from a market-value standard to one based primarily on taxable value. For the tax year beginning immediately following a reappraisal cycle, a maximum taxable value would be determined for each property. For property that increases in market value because of reappraisal, increases in taxable value would be limited to 3% a year during the reappraisal cycle up to the property's maximum taxable value. Similarly, the taxation of class three property would move from a productivity basis to one based primarily on the taxable value of the property. The proposal would also limit property tax revenue from these two classes of property to the amount collected in the prior tax year. The proposal would also provide for reductions in statewide and local mill levies commensurate with increases in taxable value of class three property and class four property to maintain revenue neutrality for these classes of property.

The purpose of this memorandum is to highlight some of the salient features of the proposal and to discuss some of the changes in law, including constitutional changes, that would be required to implement the proposal.

BACKGROUND

During the last two reappraisal cycles, the Montana Legislature mitigated the effects of increases in the reappraisal value of class four property residential and commercial land and improvements (15-6-134, MCA) by phasing in valuation increases (valuation decreases were not phased in), phasing in market value exemptions, and phasing in reductions of property tax rates.[1] The productivity value of class three agricultural land (15-6-133, MCA) and the forest productivity value of class ten forest land (15-6-143, MCA) have also been phased in. The tax rates under 15-6-134, MCA, apply to agricultural land and other types of land classified as class three property, while the tax rates applied to forest land were incrementally reduced from 0.79% to 0.35%. The tax rate applied to forest land has been 0.35% since tax year 2002.

In addition, the Legislature has limited property tax increases under Title 15, chapter 10, part 4. Section 15-10-420, MCA, provides that a governmental entity may impose a mill levy sufficient to generate the amount of property taxes actually assessed in the prior year plus one-half of the average rate of inflation for the prior 3 years. The maximum number of mills that a governmental entity may impose is established by calculating the number of mills required to generate the amount of property tax actually assessed in the governmental unit in the prior year based on the current year taxable value, less the current year's value of newly taxable property, plus one-half of the average rate of inflation for the prior 3 years. The levy calculated under these provisions, plus additional levies authorized by the voters under 15-10-425, MCA, apply to newly taxable property in the current year.

The property reappraisal mitigation proposal under consideration here would change the way in which agricultural land and residential and commercial land and improvements are taxed. The discussion that follows focuses on residential property, but the analysis would apply to commercial property and, to a lesser extent, agricultural property.

MAXIMUM TAXABLE VALUE

The proposal would maintain the current 6-year reappraisal cycle, but it would provide that residential and commercial land and improvements would be taxed on the lesser of taxable value or maximum taxable value. For property tax years beginning after December 31, 2008, the Department of Revenue would determine the maximum taxable value of existing residential and commercial property by subtracting the 2008 market value exemption percentage for class four property (34% of market value for residential property and 15% of market value for commercial property) from the new reappraisal market value and multiplying that amount by the tax year 2008 property class four tax rate (3.01%). For tax year 2009, the maximum taxable value of a piece of property with a market value of $200,000 would be calculated as follows:

Residential property: ($200,000 - ($200,000 x 0.34)) x 0.0301 = $3,973

Commercial property: ($200,000 - ($200,000 x 0.15)) x 0.0301 = $5,117

Taxable value from the previous tax year would increase by 3% a year until the taxable value of the property is equal to the property's maximum taxable value. Once the property reaches its maximum taxable value, no further increases in taxable value would occur until the next

[1] See Jeff Martin, "Brief History of Cyclical Reappraisal of Property in Montana", prepared for the House Bill No. 488 Subcommittee of the Revenue and Transportation Committee, February 2008.

reappraisal cycle. However, the year in which maximum taxable value of particular property would be reached would depend on the percentage increase in the market value due to reappraisal. For example, under the current reappraisal cycle (2003-2008), residential property that increased by 10% from the last reappraisal cycle would reach its maximum taxable value in the fourth year of the new reappraisal cycle, while residential property that increased by 19.5% would reach its maximum taxable value in the last year of the reappraisal cycle. Residential property that increased by higher percentages would not reach maximum taxable value during the reappraisal cycle.

The tables attached to this memorandum compare current law taxable values under various scenarios with taxable values of the proposal for tax years 2002-2008. In general, taxable values under the proposal would be higher than current law. However, lower state and local mill levies would be applied to property under the proposal than are applied under current law.

The taxable value and maximum taxable value of property that did not increase in market value because of reappraisal would be the same as the taxable value of the property in the last year of the reappraisal cycle. The maximum taxable value of a property that decreased in market value would be determined in the year that the reappraisal went into effect. The proposal envisions that the taxable value of property that had a decrease in market value could still increase by 3% a year until the new maximum taxable value was attained.

Under the proposal, new property and improvements or additions to existing property would be taxed on the maximum taxable value determined for the property, as would property that is transferred to a new owner. However, primary residential property transferred to a family member would continue to be taxed on the current taxable value of the property. In addition, a taxpayer 65 years of age or older would be allowed to transfer the taxable value of the taxpayer's primary residence to a new primary residence of equal or lesser market value.

PROPERTY TAXATION

In the first year of the new reappraisal cycle, property tax collections from class three property and class four property subject to taxation in the last year of the reappraisal cycle would be the amount collected in that year. In each succeeding year of the reappraisal cycle, property tax collections from class three property and class four property would be limited to the amount collected in the prior year. As such, local and state mills would be reduced to offset increases in taxable value due to reappraisal. There would be growth in revenue attributable to new construction, as is the case under current law. There would be two mill levy schedules, one that applied to class three property and class four property and one that applied to all other classes of property.

POLICY CONSIDERATIONS

If the House Bill No. 488 Subcommittee is interested in considering this proposal or similar proposals that do not tax property uniformly, it should keep in mind several factors.

Article VIII, section 3, of the Montana Constitution requires that "[t]he state shall appraise, assess, and equalize the valuation of all property which is to be taxed in the manner provided by law". Under this proposal, the taxation of residential and commercial land and improvements would be on the basis of taxable value and only remotely connected to market value.

Without a constitutional amendment, the proposal would violate equal protection in several ways. First, properties with equal market value could be subject to different levels of taxation. For example, a property that had no change in market value because of reappraisal (e.g., $200,000 in market value before and after reappraisal) would have a higher taxable value than a property that had a new market value of $200,000 because of reappraisal (e.g., increasing from $150,000 in market value to $200,000 in market value). Properties with different market values may incur the same amount of taxes. Finally, other classes of property would continue to be taxed on a market-value standard. Agricultural land and forest land are taxed on the basis of productivity value of the land; under the proposal, these classes of property would be taxed differently.

As noted above, a significant feature of the proposal is to ensure that the amount of taxes levied on class three property and class four property do not exceed the amounts levied on those classes of property in the prior tax year. That would entail reducing the mill levies on these classes of property to accomplish that goal.

The property tax limitation part of the proposal is somewhat similar to Initiative No. 105, approved by the electorate in November 1986. The initiative provided that the amount of taxes levied on certain classes of property (agricultural land, residential and commercial property, livestock, certain personal property, mobile homes, and improvements on agricultural land) may not exceed the amounts levied on those classes of property for the 1986 tax year. During the 1987 legislative session, the Legislature expanded the limitation to include all classes of property. Section 15-10-411, MCA (now repealed), provided in part:

> (1) In order to avoid constitutional challenges based on discriminatory treatment of taxpayers in tax classes not enumerated [in the initiative], the limitation to 1986 levels is extended to apply to all classes of property described in Title 15, chapter 6, part 1.

In a memorandum to the Revenue and Transportation Interim Committee dealing with the question of whether the state may establish a statewide school equalization district to levy taxes in a nonuniform manner on property subject to taxation within the district, Lee Heiman, Committee staff attorney, concluded that ". . . different levels of levies for the same purpose within a jurisdiction would appear to violate equal protection".[2] He noted that "[a] constitutional

[2] Memorandum (Levying Different Property Tax Mills Against Different Classes of Property) from Lee Heiman, Staff Attorney, to the Revenue and Transportation Interim Committee, in Minutes, December 7, 2007, EXHIBIT #4. Available on the Internet at http://leg.mt.gov/css/committees/interim/2007_2008/rev_trans/meeting_documents/materials.asp

amendment . . . would be required to levy different mills against different classes of property within the jurisdiction of a taxing entity".[3]

A constitutional amendment to effect the proposal could not be considered by the voters until the general election held in November 2010. Article VIII of the Montana Constitution (Revenue and Finance) would have to be amended to allow for nonuniformity in the valuation of class three property and class four property and to limit property taxes on class three property and class four property by allowing separate mill levies depending on the class of property. It is arguable whether the constitutional changes could be considered as one amendment or whether two amendments would be required. If the House Bill No. 488 Subcommittee wants to pursue this proposal, staff would provide a legal analysis on how best to proceed with amending the constitution.

The Legislature could not implement the constitutional changes until 2011. A number of sections under Title 15, MCA, dealing with property classification (chapter 6); appraisal (chapter 7); assessment procedures (chapter 8); and property tax levies (chapter 10), including the university levy, limitations on property taxes, and voted levies may have to be amended. School finance laws under Title 20, MCA, may also have to be amended. Again, if the Subcommittee wants to pursue this proposal, staff would inventory the sections of the MCA that may have to be amended.

Finally, the effects of the proposal on the several classes of property and on taxing jurisdictions, including the state, would have to analyzed.

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

Comparison of Taxable Values of the Proposal With Current Law Taxable Values

Scenario 1: No increase in market value

Tax year	2002 Value Before Reappraisal	2003 Value After Reappraisal	2004	2005	2006	2007	2008
Proposal							
Market value	$ 200,000	$ 200,000	$200,000	$200,000	$200,000	$200,000	$200,000
Taxable market value	138,000	138,000	138,000	138,000	138,000	138,000	138,000
Taxable value & maximum taxable value	4,775	4,775	4,775	4,775	4,775	4,775	4,775
Current Law							
Market value	$ 200,000	$ 200,000	$200,000	$200,000	$200,000	$200,000	$200,000
Taxable market value	138,000	138,000	137,200	136,000	134,800	133,600	132,000
Taxable value (16.8% decrease-2002-08)	4,775	4,692	4,528	4,379	4,233	4,102	3,973

Scenario 2: 10% increase in market value

Tax year	2002 Value Before Reappraisal	2003 Value After Reappraisal	2004	2005	2006	2007	2008
Proposal							
Market value	$ 200,000	$ 220,000	$220,000	$220,000	$220,000	$220,000	$220,000
Taxable market value	138,000	151,800	151,800	151,800	151,800	151,800	151,800
Taxable value (10% increase--2002-08)	4,775	4,918	5,066	5,218	**5,252**	**5,252**	**5,252**
Maximum taxable value		5,252					
Current law							
Phased-in market value	$ 200,000	$ 203,334	$206,668	$210,002	$213,336	$216,670	$220,004
Taxable market value	138,000	135,134	137,588	139,602	141,616	143,630	145,204
Taxable value (8.5% decrease-2002-08)	4,775	4,595	4,540	4,495	4,447	4,409	4,371

Scenario 3: 19.5% increase in market value

Tax year	2002 Value Before Reappraisal	2003 Value After Reappraisal	2004	2005	2006	2007	2008
Proposal							
Market value	$ 200,000	$ 239,000	$239,000	$239,000	$239,000	$239,000	$239,000
Taxable market value	138,000	164,910	164,910	164,910	164,910	164,910	164,910
Taxable value (19.4% increase-2002-08)	4,775	4,918	5,066	5,218	5,374	5,535	**5,701**
Maximum taxable value		5,706					
Current law							
Phased-in market value	$ 200,000	$ 206,501	$213,002	$219,503	$226,004	$232,505	$239,006
Taxable market value	138,000	132,411	137,956	143,023	148,090	153,157	157,746
Taxable value (no change 2002-08)	4,775	4,502	4,553	4,605	4,650	4,702	4,748

Scenario 4: 33.33% increase in market value

Tax year	2002 Value Before Reappraisal	2003 Value After Reappraisal	2004	2005	2006	2007	2008
Proposal							
Market value	$ 200,000	$ 266,660	$266,660	$266,660	$266,660	$266,660	$266,660
Taxable market value	138,000	183,995	183,995	183,995	183,995	183,995	183,995
Taxable value (19.4% increase-2002-08)	4,775	4,918	5,066	5,218	5,374	5,535	5,701
Maximum taxable value		6,366					
Current Law							
Phased-in market value	$ 200,000	$ 211,102	$222,204	$233,306	$244,408	$255,510	$266,612
Taxable market value	138,000	128,437	138,473	147,975	157,477	166,979	175,948
Taxable value (10.9% increase-2002-08)	4,775	4,367	4,570	4,765	4,945	5,126	5,296

Under the proposal, the property would reach maximum taxable value in 10 years

Scenario 5: 50% increase in market value

Tax year	2002 Value Before Reappraisal	2003 Value After Reappraisal	2004	2005	2006	2007	2008
Proposal							
Market value	$ 200,000	$ 300,000	$300,000	$300,000	$300,000	$300,000	$300,000
Taxable market value	138,000	207,000	207,000	207,000	207,000	207,000	207,000
Taxable value (19.4% increase-2002-08)	4,775	4,918	5,066	5,218	5,374	5,535	5,701
Maximum taxable value		7,162					
Current Law							
Phased-in market value	$ 200,000	$ 216,670	$233,340	$250,010	$266,680	$283,350	$300,020
Taxable market value	138,000	123,670	139,140	154,010	168,880	183,750	198,020
Taxable value (25% increase-2002-08)	4,775	4,205	4,592	4,959	5,303	5,641	5,960

Under the proposal, the property would reach maximum taxable value in 14 years

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