

**PROPOSED STUDY PLAN FOR AN INTERIM STUDY TO ANALYZE THE
PROPERTY TAX VALUATION OF CENTRALLY ASSESSED PROPERTY AND
INDUSTRIAL PROPERTY**

Prepared by Jeff Martin, Legislative Research Analyst
Montana Legislative Services Division
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INTRODUCTION

Senate Joint Resolution No. 17, passed by the 62nd Legislature, requests that an appropriate interim committee study the system of valuing centrally assessed properties and industrial companies assessed annually by the Department of Revenue. The preamble of the resolution describes the rationale for the study:

- the Legislature has heard concerns about centrally assessed property and large industrial facility taxation; and
- predictability and stability of property valuation will improve the business investment climate for Montana businesses.

The body of the resolution directs the appropriate interim committee to:

1. review the statutory authority identifying the type of properties that should be assessed by the central office of the department of revenue and not by local county employees of the department. The following must be reviewed:
 - a. the history and changes in the industry for properties that are currently designated as being centrally assessed; and
 - b. the statutory authority regarding assessment of large industrial properties, properties that may involve characteristics or complexity that require specialized assessment but are not classic unitary businesses, and other types of property that different taxing jurisdictions have considered appropriate for being assessed centrally and locally;
2. analyze whether there should be a relationship between a property's tax classification and the method used for assessment of that property;
3. analyze whether property owned by a particular type of business should be centrally or locally assessed;
4. analyze whether assessment directly by the state or local assessment should be based on separate types of property being assessed;

5. analyze whether methods used in determining market value should differ based upon whether the assessment is determined centrally or locally;
6. analyze how exempt intangible personal property can and should be removed from a centrally assessed unitary valuation;
7. review the appropriateness of the percentages to deduct intangible personal property from the cost, income, and market indicators of value specified in the Administrative Rules of Montana; and
8. any other matter relating to central assessment, including equalization with other classes of property, that the committee considers appropriate.

The Legislative Council assigned the study to the Revenue and Transportation Interim Committee.

BACKGROUND

Montana and Maryland are the only two states in which the state Department of Revenue assesses all property in the state for property tax purposes. In common parlance, property in Montana is locally assessed by local Department appraisers or is centrally assessed by appraisers located in Helena.

Locally assessed property typically includes residential and commercial property, business equipment, and certain other types of property. Centrally assessed property includes, among other types of property, electrical and natural gas utilities, telecommunications services, rural electric cooperatives and rural telephone cooperatives, oil and natural gas pipelines, airlines and railroads, net proceeds of mines, and coal gross proceeds (see 15-23-101, MCA). Industrial property, classified as class four property (land and improvements) and as class eight property (business equipment), is also assessed by appraisers located in Helena.

In Montana, the unit value method is used for valuing most centrally assessed property. This method is used for property that is operated as a single and continuous property operated in more than one county of the state or more than one state. The rationale for using this method of valuation is that the property would have no value, over and above its salvage value, except as integral parts of the business in which they operate.

The unit value method uses companywide information regardless of location of assets or customer base to determine the market value of the entire business entity and allocates a proportionate share of the total value to the state and to political subdivisions within the state. There are three indicators to determine the market value of the entity: cost, market, and income.

Ideally, each of these approaches should yield about the same value of the entity being assessed. In practice, however, these approaches often produce widely disparate results. To resolve the differences, the appraiser will weight each approach in order to produce a final unit value.

Weighting of the indicators is called "correlation" and may involve significant judgment on the part of the appraiser. The particular weighting method may cause disputes between the appraiser, who may put the highest weight on the highest value, and the taxpayer, who wants more weight given to the lowest indicator of value.¹

The classification of property is a separate matter from the valuation of property. In Montana, property is classified according to its use and is taxed at different percentages of market value or assessed value. Before 1999, most centrally assessed property, except for railroad and airline property and rural cooperative property, was classified as class nine property and taxed at 12 percent of market value. Legislative enactments since then have put centrally assessed property in several different property tax classifications.

In 1997, the Montana Legislature restructured the electric utility industry with the enactment of Senate Bill No. 390 (Ch. 505, L. 1997), the Electric Utility Industry Restructuring and Consumer Choice Act, and the natural gas utility industry with the enactment of Senate Bill No. 396 (Ch. 506, L. 1997), the Natural Gas Utility Restructuring and Customer Choice Act. Both pieces of legislation directed the then-Revenue Oversight Committee to "analyze the amount of state and local tax revenue derived from previously regulated [electricity suppliers and natural gas suppliers] that will enter the competitive market . . ." and to "recommend legislative changes, if any, to address the establishment of comparable state and local taxation burdens on all market participants in the supply of [electricity and natural gas]".

In the course of adopting the study plans for the tax analyses of electrical utilities and natural gas suppliers, the Committee decided during the 1997-98 interim to combine the studies and expand the scope of the study to include telecommunications property. The study focused on property tax rates in the context of restructuring and competition and included the impact of any changes to the taxation of centrally assessed property on class twelve property (railroad and airline property²).

The Committee's recommendations were introduced in 1999 as House Bill No. 174 (Ch. 556, L. 1999) and House Bill No. 128 (Ch. 426, L. 1999). In its final version, HB 174 reclassified most generation property from class nine property to a new class thirteen property, taxed at 6 percent of market value, and imposed a wholesale energy transaction tax to offset a portion of lost property tax revenue associated with the rate reduction. House Bill 124 reclassified most telecommunications property as class thirteen property and replaced the telephone company tax with a retail telecommunications excise tax.

¹Lawrence C. Walters and Gary C. Cornia, "Electric Utility Deregulation and the Property Tax in the United States", in Impacts of Electric Utility Deregulation on Property Taxation, edited by Philip Burling (Lincoln Land Institute of Land Policy: 2000), p. 49.

²The tax rate applied to class twelve property is based on the tax rate of commercial and industrial property.

The Revenue Oversight Committee also introduced Senate Bill No. 111 (Ch. 583, L. 1999) to exempt intangible property from taxation.

Classification procedures and valuation methods may cause continual skirmishes between taxpayers and the Department of Revenue.

In late 1999, Montana Power Company sold most of its generation facilities to Pennsylvania Power & Light Global Resources. PPL Montana, the operating entity of the facilities in Montana appealed the valuation of its property in the state on the basis, in part, that the Department of Revenue improperly assessed the generation facilities as centrally assessed property and that the valuation of the facilities "is higher than the valuation of similar and identical properties owned by Montana taxpayers in violation of the principles of Montana law and the United States Constitution requiring fair, just and equitable valuation of taxable property. . .".³

The Montana Supreme Court upheld the Department's authority to centrally assess PPL Montana's property and affirmed a State Tax Appeal Board ruling to lower the Department's valuation of the property.⁴

Omimex Canada, Ltd., is a natural gas production company that operates in several counties in Montana. Omimex produces natural gas (and some oil) and transports in its pipelines its own natural gas, third-party gas, and gas of which it owns a working interest. In tax year 2004, Omimex reported its personal property for local assessment to the counties in which it operates.⁵ The Department of Revenue determined that the property should be centrally assessed, classified as class nine property, and taxed at 12% of its market value rather than as class eight personal property at 3% of market value.

Omimex appealed to the Montana Supreme Court a District Court ruling that determined that the Department had properly centrally assessed Omimex's property under 15-23-101, MCA, and had properly classified the property as class nine property under 15-6-141(1)(c).⁶

The Supreme Court reversed the District Court decision. The Court concluded that "centrally assessed companies allocations" did not apply to Omimex's property because the "specific description of 'centrally assessed natural gas companies having a major distribution system in this state' in 15-6-141(1)(c), MCA, prevails over the general catch-all provision". The Supreme Court pointed out that the Legislature could have included other natural gas companies in the

³PPL Montana, LLC v. Montana Department of Revenue, State Tax Appeals Board, Case No. SPT-02-6.

⁴State of Montana, Department v. PPL Montana, LLC, Montana Supreme Court, 2007 MT 310, December 4, 2007.

⁵Omimex did not dispute the valuation of its property for tax year 2004. It disputed the valuation and taxation of its property for subsequent tax years.

⁶Omimex Canada, LTD v. State of Montana, Department of Revenue, Montana First Judicial District, Cause No. BDV-2004-288 (Findings of Fact, Conclusions of Law and Order), February 2, 2007.

description of class nine property if it had intended to do so. The Supreme Court determined that Omimex's personal property must be classified in 15-6-138, MCA. Because Omimex's property had been improperly classified, the Supreme Court did not find it necessary to deal with the central assessment of the property because "where the property is assessed does not make any difference for its classification." Likewise the court did not deal with Omimex's due process and equal protection arguments.⁷

The 2009 Legislature responded to the Supreme Court decision with the enactment of Senate Bill No. 489 (Ch. 487, L. 2009). The legislation clarified the taxation of oil and natural gas pipelines and flow lines and gathering lines. But certain disputes of classification remain.

Verizon Wireless is a wireless communications company operating in Montana and other states. Prior to 2007, Verizon's real property was classified as class four property and its personal property was classified as class eight property. In tax year 2007, the Department of Revenue determined that all of Verizon's property should be centrally assessed and classified as class thirteen property. The State Tax Appeal Board affirmed the Department's decision. On May 4, 2011, a District Court upheld the STAB ruling.⁸

Based on concerns raised by certain centrally assessed property owners, Dan Bucks, director of the Department of Revenue, agreed at the September 15, 2010, meeting of Revenue and Transportation Interim Committee, to conduct an economic impact statement on proposed rules regarding appraisal methods and standards for centrally assessed property. A proposed rule provided for the adoption of the 2009 WSATA-CCAP (Western States Association of Tax Administrators – Committee on Centrally Assessed Properties) appraisal handbook as the reference and overall appraisal guide and the NCUVS (National Conference of Unit Valuation States) standards. An amended rule dealt with intangible property. Director Bucks told the Committee that the rules would formalize the Department's existing practices.

Although complaints were raised about the proposed rules at the Committee's November 16, 2010 meeting, a motion to formally object to the rules failed on a tie vote.

The Department adopted the 2009 WSATA-CCAP as the reference and overall appraisal guide for conducting unit valuations of centrally assessed properties in Montana and the NCUVS standards when conducting unit valuations of centrally assessed properties (ARM 42.22.109). These rules, along with the change in the definition of intangible property (ARM 42.22.110), were adopted December 24, 2010.

⁷Omimex Canada, LTD v. State of Montana, Department of Revenue, Montana Supreme Court, 2008 MT 403, December 2, 2008.

⁸Verizon Wireless v. State of Montana, Department of Revenue, Montana First Judicial District, Cause No. CDV-2010-358 (Memorandum and Order on Petition for Judicial Review), May 4, 2011.

STUDY QUESTIONS

The disputes between taxpayers and the Department of Revenue recited above are not necessarily representative of all the disputes, and do not include anything about the assessment of industrial properties. However, they do give rise to questions that may be considered during the course of the study.

- What is the statutory authority (and related rules) of the Department of Revenue to centrally assess certain types of property and assess industrial property?
- What are the number and types of property subject to central assessment and how does Montana's property classification scheme affect the assessment of property?
- What legislative enactments since 1999 have affected the classification of property?
- What are the Department of Revenue's methods for valuing centrally assessed property and industrial property?
- What are the trends in valuation of and property taxes paid on centrally assessed property and industrial property? How do these trends compare with other types of property?
- What is the nature of the disputes between taxpayers regarding assessment, classification, and treatment of intangible property?
- What is the pattern of property tax protests by owners of centrally assessed property and industrial property, reviews by the Department, appeals made to the State Tax Appeal Board, and appeals made in courts?
- What are the advantages and disadvantages of assessing industrial property centrally or locally?
- Should other methods of valuation be considered in meeting the goal of predictability and stability of valuation consistent with the market value standard and equalization of property values?
- Should the appeals process be revised?

MAJOR STUDY AREAS

If the Revenue and Transportation Committee undertakes the study, its primary focus of work may include the following:

1. Review the theory and practice of the unit valuation method of assessing certain types of property.
2. Review statutory provisions and related rules for the valuation, including the treatment of intangible property, and classification of centrally assessed property and industrial property. Determine the types of property that have been reclassified particularly as it affects the method of valuation.
3. Review the valuation methods used by the Montana Department of Revenue to determine the fair market value of centrally assessed property and industrial property.
4. Analyze the trends in the valuation of and property taxes paid on centrally assessed property and industrial property, and compare these trends with other types of property.

5. Evaluate the types and magnitude of disputes between taxpayers and the Department and determine whether there is a particular pattern to the disputes.
6. Evaluate the final resolution of various property tax disputes.
7. Consider whether different methods of valuing centrally assessed property would be appropriate and consider whether industrial property should be assessed locally.
8. Consider ways to streamline the appeals process.
9. Develop options, if options are considered necessary, to revise the assessment of centrally assessed property or industrial property, or both, and the appeals process in Montana, with attention focused on predictability and stability of the valuation process and on the legal, policy, and fiscal effects that any option might entail.

PROPOSED SCHEDULE

The following schedule is proposed for conducting the study:

1. **September 2011 meeting**
 - a. review and approve revisions made to study plan June 15-16, 2011
 - b. background report on the unit value method of assessing certain property
 - c. review statutory provisions and related rules, for valuing centrally assessed property, including the treatment of intangible property, and industrial property to obtain fair market value
 - d. review rules adopted December 24, 2010, related to the central assessment of property
 - e. Department overview of valuation methods for centrally assessed property and industrial property
2. **December 2011 meeting**
 - a. review changes in classification of property and method of valuation of certain types of property based on changes in legislation or Department of Revenue actions
 - b. analyze the trends in the valuation of and property taxes paid on centrally assessed property and industrial property, and compare these trends with other types of property
 - c. panel discussion on valuation trends and Department of Revenue valuation methods
3. **February 2012 meeting**

- a. review the patterns of property classification and valuation disputes between taxpayers, including owners of industrial property, and the Department of Revenue and resolution of disputes
 - b. panel discussion on property tax disputes, to the extent feasible (may exclude unresolved disputes)
4. **April 2012 meeting**
- a. review other methods of assessing centrally assessed property and industrial property consistent with the fair market value standard. This element may include a discussion of changes in the valuation of railroad property enacted in 1999 (Ch. 531, L. 1999)
 - b. discuss alternative approaches to the current appeals process
 - c. develop initial options for consideration in July
5. **July 2011 meeting**
- a. analyze impact of options and recommendations related to the assessment of centrally assessed property and industrial property
 - b. review draft legislation, if any
 - c. formulate findings, conclusions, and recommendations
6. **September 2011 meeting**
- a. approve draft legislation, if any
 - b. finalize recommendations and approve outline for the final report

Each phase of the study should include participation by the Department of Revenue and affected property taxpayers. A series of panel discussions may help the Committee to assess the magnitude and complexity of the study and to make recommendations to the next Legislature.

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