EXHIBIT #2
DATE 1.10.05
HB 115

Legislative Property Tax Exemption Study Committee
FINAL REPORT
August 12, 2004

Introduction

During the 58th legislative session the legislature enacted HB429, an act establishing a Property Tax Exemption Study Committee. The Legislature felt that:

> *Property has been and continues to be taken off the property tax rolls under the property tax exemption laws....*
> *Local governments and school districts experience financial constraints because of property tax exemptions....*
> *Other taxpayers bear a larger tax burden because of property tax exemptions....*
> *It is the goal of the legislature to ensure that Montana has an equitable property tax system...*
> *It is the desire of the legislature to determine whether existing property tax exemptions contribute to or impede the goal of an equitable property tax system.*

The committee was composed of ten members, including: two members from the House of Representatives, one from each party; two members from the Senate, one from each party; the remaining six members were appointed by the governor and represented local government, K-12 public schools, two representatives of property tax-exempt organizations, one representative of business, and one representative of the executive branch.

The purpose of the committee was to conduct a study to determine whether property tax exemptions contribute to or impede the goal of an equitable property tax system, and determine whether existing property tax exemption laws should be modified or repealed to achieve a more equitable property tax system.

The committee held three public meetings; on September 22, 2003; February 18, 2004; and April 28, 2004 to examine current exemption laws, how the Department of Revenue administered those laws, properties exempted under those laws, property tax exemption laws from other states, and to listen to public comment concerning exemptions, and formulate recommendations and, if deemed necessary, propose changes to current law.

Areas Studied and Issues Considered

The Committee's first course of action was to review and understand the existing property tax process and exemptions. A report given by the Department of Revenue explained the assessment and taxation process, and how exemptions of property would affect tax burdens within taxing jurisdictions. The report clarified that when a property is exempted, the tax burden for that property is shifted to the other taxpayers in that jurisdiction.

The Committee examined laws relating to property tax exemptions, and the origins of exempt classes of property. The exempt property categories are defined in 15-6-201, MCA. The constitutional basis for property tax exemptions is contained in the Montana Constitution, Article VIII, Section 5. The 1972 Constitution gave the Legislature the authority to exempt "any other classes of property", which provided wide latitude for exemptions. Most exemptions fall into the categories of governmental, educational, religious, charitable, economic incentive, or exempting property from taxes but imposing a fee in lieu of taxes. The Committee learned that most properties are not automatically exempt, that those properties have to qualify through an exemption process, and some may only receive partial exemptions. The 501(c) (3) designation for income tax was discussed. It was clarified that 501(c) (3) corporations do not receive automatic property tax exemption, but must demonstrate a charitable use for the property through an application process.

The Committee reviewed a report on property exempt from taxation that detailed what types of exemptions and abatements have been granted on real and personal property, the numbers of exemptions that have been granted, and the estimated reduction in property tax revenues due to the exemptions. The following tables illustrate the estimated amount of property tax revenue that was not received in 2003 due to exemptions and tax abatements for non-governmental property.

Table 9
Estimated Reduction in Taxes Due to Exemptions/Abatements
Tax Year 2003

Description	Taxable Value	Estimated Tax Liability	Taxable Value At Full Tax Rate	Estimated Full Tax Liability	$ Difference in Tax Liability
PTAP (Land & Improvements)	5,998,813	2,849,436	10,378,095	4,929,595	($2,080,159)
DAV (Land & Improvements)	-	-	2,006,846	953,252	($953,252)
Other (Land & Improvements)	310	147	27,837,212	13,222,676	($13,222,528)
New/Expanding Industry (Imps only)	2,076,037	776,438	3,309,046	1,237,583	($461,146)
Remodeling (Improvements only)	317,588	118,778	597,556	223,486	($104,708)
Total	$8,392,748	$3,744,799	$44,128,756	$20,566,592	($16,821,793)

Estimates based on statewide average mill levy of 475

Table 10
Abatement of Personal Property
Tax Year 2003

Description	Market Value	Taxable Value	Taxable Value At Full Tax Rate	Taxable Value Difference
Class 5, Air & Water Pollution Control	$5,992,972	$158,290	$179,789	($21,499)
Class 8, Machinery & Equipment	$166,913,955	$2,987,187	$5,007,419	($2,020,232)
Class 9, Electric & Gas Personal Prop	$611,424	$51,360	$73,371	($22,011)
Statewide Total	**173,518,351**	**3,196,837**	**5,260,579**	**($2,063,742)**
2001 Statewide Average Mill		0.374	0.374	0.374
Property Tax Liability		$1,195,617	$1,967,456	($771,840)

The total amount of tax revenue unavailable due to exemptions and abatements on real and personal property was approximately $17,000,000 in 2003. The total amount of property tax levied statewide for 2003 was $ 969,307,568. The statewide reduction in the amount of taxes levied, due to exemptions and abatements, is 1.7%.

The committee studied the application process for exemptions controlled by 15-6-201, MCA. While properties owned by governmental entities are automatically exempt, other properties must go through an application process. The properties must meet ownership and/or use tests, and supporting documentation must be supplied to receive a tax exemption. If an application is lacking required documentation, the application is denied. Partial exemptions are granted where only a portion of the property qualifies for the exemption. Fifty percent of the applications processed are for personal property, of which the majority are vehicles, with the remainder being other personal property and real property. If the ownership or use of the property changes after an exemption has been granted, the exemption will be removed by the Department of Revenue if the owner doesn't make a successful reapplication. The Department of Revenue administers the application process for abatements, such as new and expanding industry and remodeling of residential and commercial properties; however, the local taxing jurisdiction has final authority for those abatements.

The Committee was concerned that the number of applications for exemption and the dollar amount of exemptions being granted were on the rise and becoming excessive. They requested a report on the number and type of exemptions applied for and granted in 1993 compared to 2003, to determine if there has been a substantial increase in the amount of property being exempted. The following table is a comparison of the two years exemption data.

	Tax Year 1993		*Tax Year 2003*	
Total Number Of Applications	***347***		***390***	
Real Property Applications	***169***	***49%***	***167***	***43%***
Personal Property Applications	***178***	***51%***	***223***	***57%***
Applications Granted	***303***	***87%***	***329***	***84%***
Applications Denied	***44***	***13%***	***61***	***16%***

Between 1993 and 2003 the percentage increase in the number of exemption applications filed was 12%. The percentage of exemptions granted actually decreased slightly between 1993 and 2003.

The Committee looked at how the types of exemptions Montana grants compare to exemptions granted by other states. A table comparing Montana exemption types to nine other western states revealed that Montana exemptions are similar to neighboring western states. Each state had exemptions for governmental, educational, religious, and charitable properties, along with specific exemptions for economic development.

The Committee reviewed and discussed a report generated by the Department of Revenue titled *Property Tax Exemptions; Analysis and Points of Concern*. The report thoroughly examined the exemption statutes, the types of properties being exempted by each statute, and any areas of concern or issues the committee may want to consider and make recommendations on. The review and discussion of this report was the backbone of the committee's decision-making process, and led to recommendations in the form of bill drafts.

Property Tax Exemptions - Perceptions and Fact:

In the course of conducting the study the committee members became aware of a number of misconceptions concerning property tax exemptions. Some of those misconceptions are:

That all property owned by a church is tax exempt – **Fact**: only those properties used for worship services and supporting land area along with a parsonage are exempt.

Property owned by corporations that have attained 501(c)(3) status from the IRS are automatically exempt – **Fact**: charitable organizations would have to file exemption applications and pass ownership and use tests to qualify for exempt status on their property.

All property owned by religious colonies is exempt – **Fact**: some colony property may qualify for exemption under religious or educational use. All other colony property is taxed.

The number and amount of exemptions granted has increased tremendously over the last 10 years - **Fact**: a comparison of 1993 exemptions applied for and granted, versus the number applied for and granted in 2003, shows a 12% increase, with roughly the same percentage of applications being granted and denied.

Once a property receives exempt status, it is permanently exempt and off the tax rolls – **Fact**: exemptions are granted to taxpayers on property that qualifies. Through the application process, the property must pass ownership and/or use tests, dependent on the exemption type sought, to qualify for an exemption. If the ownership or use of the property changes after the exemption is granted, the Department of Revenue requires a new application be filed, and the property must meet the criteria to continue receiving an exemption.

Tax revenue from property that is exempted is lost by the taxing jurisdiction the property is located in – **Fact:** when a property is exempted, it's taxable value is not used in the calculations to set mills. The result may be that a higher mill rate might be calculated for the other non-exempt properties in the jurisdiction. This may create a shift of the tax burden of the exempt property to the non-exempt properties in the jurisdiction.

Conclusions

After studying the exemption statutes, how they are administered, and what type of properties are being exempted; the Committee found that:

It is good public policy to exempt certain properties. Some of the exemptions help education, some help keep health care costs down, and some are deemed to be for the good of the people through religious activities and veterans organizations. The citizens of Montana provided direction to the Legislature in this area in the Constitution and the Legislature has tried to implement exemptions that are deemed to be in the best interests of all Montana citizens while maintaining a fair and balanced property tax system.

There is an adequate application process for exemptions, along with on-going review of exempt properties to ensure only qualifying properties receive exempt status.

There was a consensus within the committee that negative perceptions exist within the Legislature about the proliferation of tax exemptions and the collateral loss in property tax revenues. After reviewing all the information on property tax exemptions, the committee determined that the negative perception, and concerns about the numbers of exemptions granted, and the financial impact on local and state government are overstated. In fact the revenue that has been forgone as a result of granting exemptions is less then 2% of total property tax revenue.

The primary concern of the committee was insuring fairness in how tax burdens are shared among various property owners. The committee believes that the benefits provided by property tax exemptions far outweigh the lost revenue.

The proposed law changes recommended by the committee will ensure a more fair distribution of the tax burden in counties, will help with the perception problem by resolving areas of abuse, and will provide more clear direction to taxpayers and the Department of Revenue. Any additional tax revenue that results from the changes to current law should be minimal.

The committee's goal was to recommend only those changes that were in the best interest of the public as a whole.

Recommendations

There has been concern about the number of tax exemption applications, their impact on property tax revenues, and a collateral shifting of tax burden to other taxpayers. After studying the exemption process and how it is administered, the Committee concluded it is not nearly the problem it is perceived to be. The Committee concluded that it would be beneficial to rewrite 15-6-201, MCA, the exemption statutes. The intent would be not to change existing law, but to organize the exemptions into categories that would make the statutes less confusing and more user friendly. The rewrite of the statutes is contained in the addendum, as bill draft **LC6001**.

Additionally, the Committee identified some areas where exemption statutes needed revision to prevent possible abuse and to provide a more fair and equitable property tax system.
The Committee's recommended revisions include:

- Limiting the amount of property acreage that is tax exempt for churches and parsonages;
- Providing a definition of "clergy" for property tax exemption purposes;
- Limiting the acreage exemption for educational property and requiring an attendance policy, curriculum and instruction;
- Providing that property purchased for charitable use is exempt at the time of purchase, providing that if exempt property is not used for a charitable purpose within 8 years, or is sold then lost tax revenue must be reimbursed, and providing that the reimbursement amount is a lien upon the property;
- Deleting the tax exemption for property in the state used exclusively for filming motion pictures;
- Limiting the agricultural acreage for the purely public charity exemption to 160 acres for exemptions applied for after December 31, 2004.

Those recommendations are contained in the addendum as bill drafts **LC6003** and **LC6004**.

<u>Addendum</u>

List of committee members
Bill drafts
Meeting agendas
Meeting minutes