



Dan Bucks
Director

Montana Department of Revenue

EXHIBIT 4
DATE 2.2.05
HB 72



Brian Schweitzer
Governor

MEMORANDUM

TO: Dan Bucks

FROM: Michele R. Crepeau, Tax Counsel
Office of Legal Affairs *MRC*

DATE: January 31, 2005

SUBJECT: Phase-In of Revised Property Values

QUESTION PRESENTED

You have asked whether the Department may phase-in the difference between a property value established by the Department at the beginning of a reappraisal cycle and a revised value that was established mid-cycle after the discovery of a change in use of the property.

SHORT ANSWER

If the revised value is greater than the original value, then the Department is required to phase-in the difference. If the revised value is less than the original value, then the Department is prohibited from phasing-in the difference.

RELEVANT FACTS

House Bill 72, currently before the Legislature, seeks to revise the method by which the Department values agricultural land. Research conducted by the Department during the pendency of the legislative process, revealed that a number of parcels of land that had been classified and valued as grazing land had, in fact, been used as summer fallow farmland for some time. Upon discovery of the change in use of these properties, the Department is required to revise the value of the parcels to reflect the current use. In virtually all cases, these revisions will increase the value of the parcels.

DISCUSSION

The History of Phase-In

Montana's Constitution requires the state to "appraise, assess, and equalize the valuation of all property which is to be taxed in the manner provided by law." Art, VIII, Section 3, Mont. Const. In order to effect the requirements of Article VIII, Section 3, the Legislature enacted § 15-7-112, MCA, requiring that:

"[t]he same method of appraisal and assessment shall be used in each county of the state to the end that comparable property with similar true market values and subject to taxation in Montana shall have substantially equal taxable values at the end of each cyclical revaluation program hereinbefore provided."

The Legislature also enacted § 15-8-111, requiring that property be assessed at 100% of its market value unless otherwise provided, and § 15-7-111, establishing a six-year reappraisal cycle. However, in 1997, concerns arose in the Legislature that increases in taxes as a result of increased real property values were creating a hardship for property owners whose property had appreciated in value. Roosevelt v. Montana Department of Revenue, 293 Mont. 240, 246, 975 P.2d 295, 299 (1999). Therefore, § 15-7-111, was amended to require any changes in value that resulted between one cycle and the next be phased-in over the course of the new cycle. Id.

Reclassification and Phase-In

When the Department became aware that certain parcels of land that had been classified as grazing land were, in fact, being used as summer fallow farmland, the Department was required to reclassify the land according to its actual use. Section 15-7-201, MCA. The value of summer fallow farmland in most instances will be greater than that of grazing land. Section 15-7-111, requires the Department to phase-in "the value of newly constructed, remodeled, or reclassified property in a manner consistent with the valuation" of other property within the same class. (Emphasis added). Therefore, in the instant case, the Department is required to phase-in the positive changes in value that result from the Department's reclassification of the subject properties.

Reductions to Value and Phase-In

Not all changes in value may be phased-in. In 1996, the Department valued a taxpayer's property at \$890,850. Roosevelt at 243. In 1997, the Department appraised the same property at the lower value of \$701,890. Id. Despite the reduction in value, the taxpayer appealed the valuation to his county tax appeal board (CTAB). Id. Following a hearing, the CTAB further reduced the property's value to \$658,840. The Department phased-in the reduction in value pursuant to § 15-7-111 as it existed at that

time. The taxpayer appealed the legality of the phase-in to the State Tax Appeal Board (STAB). Prior to a hearing before STAB, the taxpayer and the Department filed a joint petition for interlocutory adjudication before the District Court. The District Court ultimately determined that the phase-in provisions § 15-7-111, were unconstitutional on their face and as applied to the taxpayer.

The District Court's decision was appealed to the Montana Supreme Court, which reversed in part and affirmed in part, the District Court's Decision. In its detailed decision, the Court determined that the phase-in provisions of § 15-7-111 "created three classifications of Class Four property taxpayers." The Court described these classes as those:

- 1) "whose market value declined from 1996 to 1997 and who were, therefore, assessed in 1997 based upon a value greater than the market value of their property";
- 2) "whose market value did not change from 1996 to 1997, and whose property is being assessed based on its actual market value"; and
- 3) "whose property increased in value from 1996 to 1997 and who were, therefore, assessed in 1997 based on a value less than the fair market of their property."

Roosevelt at 248. The Court reasoned that the classifications created by § 15-7-111, implicated the taxpayer's constitutional right to equalized valuation pursuant to Article VIII, Section 3, of the Montana Constitution. Because the right established by Article VIII, Section 3, is not a fundamental right, the Court applied a mid-tier review. Under that standard, the Court reviewed the classifications created by the phase-in provisions of § 15-7-111 to determine if they bore a rational relationship to a legitimate state interest.

The Court concluded that:

"creating a class of property owners whose taxes are assessed on a basis greater than [the] market values of their property while other property owners are assessed based on the actual or less than the actual market values of their property, causes the property owner in the first class to pay a disproportionate share of this state's property taxes, in violation of the right to equal protection of the laws guaranteed by Article II, Section 4, of the Montana Constitution."

While the Court affirmed that portion of the District Court's decision regarding the constitutionality of § 15-7-111's phase-in provisions as they applied to taxpayer's whose property values declined from cycle to cycle, it reversed the District Court's determination that the provisions were unconstitutional on their face.

CONCLUSION

Montana's Constitution, statutes, and case law, together provide clear mandates regarding the phase-in of property tax values. From these sources I have determined that the Department must phase-in the difference between a property value established by the Department at the beginning of a reappraisal cycle and a revised value that was established mid-cycle after the discovery of a change in use of the property if that value increases. The Department may not phase-in any decrease in value.