



Montana Legislative Services Division

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SENATE TAXATION

EXHIBIT NO. 4

DATE 4-12-05

BILL NO. HB 703

April 7, 2005

Representative Bob Bergren
1132 29th Avenue West
Havre, Montana 59501

Dear Representative Bergren:

I am writing in response to your request for an analysis of the legality of House Bill No. 703. House Bill No. 703 revises the method of determining the value of railroad systems for property taxation purposes. The bill requires railroads to report the average agricultural commodity freight rate charged by the railroad for shippers in Montana for the most recently completed calendar year and the average agricultural commodity freight rate charged by the company for shippers outside of Montana for the most recently completed calendar year. The bill provides for a valuation adjustment based on average agricultural commodity freight rates.

Section 15-8-111, MCA, provides that all taxable property must be assessed at 100% of its market value except as otherwise provided in that section. Market value is described as 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. Section 15-8-111(1)(b), MCA, provides that if the Department of Revenue uses construction cost as one approximation of market value, the Department is required to fully consider reduction in value caused by depreciation, whether through physical depreciation, functional obsolescence, or economic obsolescence. Section 15-8-111(1)(c), MCA, provides that if the Department uses the capitalization of net income method as one approximation of market value and sufficient, relevant information on comparable sales and construction cost exists, the Department is required to rely upon the two methods that provide a similar market value as the better indicators of market value. The purpose of House Bill No. 703 is to provide an alternative method of calculating the capitalization of net income as an approximation of market value of railroad property. Section 15-8-111(6)(f), MCA, provides that railroad transportation properties in section 15-6-145, MCA, are assessed based on the valuation formula described in section 15-23-205, MCA. Section 15-23-205, MCA, is amended in House Bill No. 703.

Section 15-23-205(7), MCA, provides that in determining the taxable value of railroad property, the Department shall determine the percentage rate "R" provided for in section 15-6-145, MCA, in order to achieve compliance with the requirements of the federal Railroad Revitalization and Regulatory Reform Act of 1976 (4-R Act). The substance of the 4-R Act is contained in 49 U.S.C. 11501. The purpose of the 4-R Act is to provide the means to rehabilitate and maintain the physical facilities, improve the operations and structure, and restore the financial stability of the railway system in the United States". See Burlington Northern Railroad Co. v. Oklahoma Tax Commission, 481 U.S. 454 (1987). Under 49 U.S.C. 11501, Congress has determined that certain acts unreasonably burden and discriminate against interstate commerce and a state or subdivision of a state is prohibited from performing those acts. A state is prohibited from

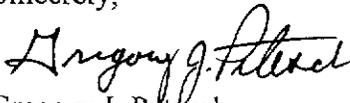
assessing rail transportation property at a value that has a higher ratio to the true market value of the rail transportation property than the ratio that the assessed value of other commercial and industrial property in the same assessment jurisdiction has to the true market value of the other commercial and industrial property. A state is prohibited from levying or collecting a tax on an assessment that may not be made under section 49 U.S.C. 11501. That section also denies the railroad any remedy unless it proves that its own ratio exceeds the other properties' ratio by at least 5%.

In Chicago & Northwestern Railway v. Gillis, 82 SD 470, 148 NW2d 581 (1967), the South Dakota Supreme Court observed that the valuation of railroad property is not a straightforward exercise. There are no settled or infallible rules for the ascertainment of the actual value of railroad property for the purpose of taxation.

House Bill No. 703 is not intended to discriminate against railroads. House Bill No. 703 is an attempt to use a revised calculation of the capitalization of net income for the difficult task of valuing railroad property. House Bill No. 703 leaves intact section 15-6-145, MCA, which is the Montana statute that is designed to achieve compliance with the 4-R Act. Because the 4-R Act is a Congressional implementation of the Commerce Clause, contained in Article I, section 8, of the United States Constitution, if House Bill No. 703 passes 4-R Act muster, it will pass Commerce Clause muster.

I hope that I have adequately addressed your question. If you have additional questions, please feel free to contact me.

Sincerely,



Gregory J. Petesch
Director of Legal Services

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