FISCAL NOTE

Bill #:	SB0346	**Title:**	Separate classes for commercial and residential property
Primary Sponsor:	Toole, K	**Status:**	As Introduced

Sponsor signature Date

David Ewer, Budget Director Date

Fiscal Summary

	FY 2006 Difference	FY 2007 Difference
Expenditures:		
General Fund – DoR operating	$54,478	$38,708
General Fund – OPI school funding one-time	$0	($4,600,000)
Revenue:		
General Fund	$1,446,683	($2,377,509)
State Special Revenue- University	$90,729	$854,573
Net Impact on General Fund Balance:	$1,392,205	$2,183,783

☒	Significant Local Gov. Impact	☒	Technical Concerns
☐	Included in the Executive Budget	☒	Significant Long-Term Impacts
☐	Dedicated Revenue Form Attached	☒	Needs to be included in HB 2

Fiscal Analysis

ASSUMPTIONS:

Department of Revenue

1. Under current law, commercial land and improvements are included in class 4, along with residential land and improvements. Class 4 property is taxed at a taxable valuation rate that declines from 3.22% to 3.01% over the period tax year 2005 to tax year 2008. Business equipment is included in class 8 and is taxed at a taxable valuation rate of 3%.
2. Beginning with tax year 2006, the proposal provides for the following:
   a) Moves commercial land and improvements into class 8.
   b) Increases the taxable valuation rate for all class 8 property to 4%.
   c) Provides for an income tax credit for owner-occupied property tax payers.
   d) Removes the “trigger” that would result in the reduction in the tax rate for class 8, business equipment property from 3 percent to 0 percent over a three-year period.
   e) Increases the threshold amount of class 8 property that an entity may own and be exempt from property taxation from $5,000 of market value to $20,000.
   f) Provides for a class 8 tax rate reduction formula for expanding industries.

3. Although there would be some amount of impact associated with the tax rate reduction for expanding industry provided for in section 13 of the bill, it is not known how many industries would qualify for the rate reduction, or the fiscal impacts associated with the reductions. The fiscal note does not include fiscal impacts for this section of the bill, but the following example illustrates how the rate reduction formula works. The class 8 tax rate reduction formula for expanding industries is based upon the number of new full time employees the expansion creates. Assume an expanding industry purchases $1 million in machinery or equipment that creates two new full time positions. Also assume the industry currently employees 20 full time employees. The tax rate is calculated as (one minus) 2 new employees divided by 20 current employees, or 90% multiplied by the tax rate for class 8, which is 4% under the bill. The tax rate would be 3.6% (90% x 4%) on the $1 million new machinery or equipment.
4. The income tax credit provided for in SB 346 would be calculated by September 1 of each year by the Department of Revenue (DOR). The income tax credit is based upon the increase in property tax liability in class 8, but only the increase generated by mills levied for state purposes, including the 6 mill levy in support of the university system. The calculation is as follows: a base amount of class 8 property tax revenue generated on state mills in tax year 2005 is calculated by DOR, then this amount is subtracted from the amount of property tax liability associated with state mill levies in future years. The difference between these two amounts is the net amount of revenue that will be available to provide owners of owner-occupied, single-family residences with a refundable tax credit against individual income taxes.
5. The total amount of state property taxes levied on this property will change each year due to not only the changes provided for in the bill (increase in the class 8 tax rate and a increase the current law class 8 exemption from $5,000 to $20,000 which will remove some property from taxable status), but also because of lost revenues from future natural growth.
6. Commercial class 4 property is anticipated to grow by 4.0% per year, and class 8 business equipment is projected to grow by 3.5% in tax year 2005 and 2.9% in succeeding years.
7. The credit would be claimed as a credit against individual income taxes when taxpayers filed their individual income tax returns. Based on the bill's effective date, the credit can be applied to calendar year 2006 tax liabilities. It is assumed that the first credits claimed under this bill would be in FY 2007 when taxpayers file their tax year 2006 returns.

<u>Increase in Taxes Paid under the Proposal</u>

8. Most property taxes are paid in November and May of the fiscal year following assessment. However, under the provisions of 15-16-119, MCA, owners of personal property that is not-liened to real property pay property taxes 30-days after assessments are mailed. This means that instead of paying taxes in November and May of the following fiscal year, they will pay sometime before April in the current fiscal year. Therefore there are some FY 2006 property tax impacts associated with the bill.
9. The table on the following page shows both taxable values for the tax year, and the taxable value in respect to when the taxes are paid on the property. Tax year information is shown in the table to illustrate how tax year taxable values are carried forward into fiscal years. Additionally, the credit amount is based upon taxes levied in the tax year, and the income tax portion of the fiscal note will focus on that side (left-hand) of the table.

SB 346 ***Tax Year*** Taxable Value Impacts

Tax Year - Current Law Estimated Taxable Value

	TY 2004	TY 2005	TY 2006	TY 2007
Class 4	$281,061,001	$292,303,441	$303,995,579	$316,155,402
Class 8	117,240,984	121,344,418	124,863,407	128,484,445
Total	398,301,985	413,647,859	428,858,985	444,639,847

Tax Year - Proposed Law Estimated Taxable Value

	TY 2004	TY 2005	TY 2006	TY 2007
Class 4 to 8	$281,061,001	$292,303,441	$406,158,036	$439,580,390
Class 8	117,240,984	121,344,418	164,627,966	169,403,442
Total	398,301,985	413,647,859	570,786,002	608,983,831

Tax Year - Estimated Change in Taxable Value

	TY 2004	TY 2005	TY 2006	TY 2007
Class 4 to 8	$0	$0	$102,162,458	$123,424,988
Class 8	0	0	39,764,559	40,918,996
Total	0	0	141,927,017	164,343,984

SB 346 ***Fiscal Year*** Taxable Value Impacts

Fiscal Year - Current Law Estimated Taxable Value

	FY 2005	FY 2006	FY 2007
Class 4	$281,061,001	$292,303,441	$303,995,579
Class 8	118,800,289	122,681,634	126,239,401
Total	399,861,290	414,985,075	430,234,980

Fiscal Year - Proposed Law Estimated Taxable Value

	FY 2005	FY 2006	FY 2007
Class 4 to 8	$281,061,001	$292,303,441	$406,158,036
Class 8	118,800,289	137,792,167	166,442,647
Total	399,861,290	430,095,608	572,600,683

Fiscal Year - Estimated Change in Taxable Value

	FY 2005	FY 2006	FY 2007
Class 4 to 8	$0	$0	$102,162,458
Class 8	0	15,110,533	40,203,245
Total	0	15,110,533	142,365,703

10. Shown on the right-hand side of the table, under current law, the taxable value of the properties affected by the bill is projected at $414,985,075 in FY 2006, and $430,234,980 in FY 2007.
11. Proposed taxable value of the properties affected by the bill is estimated at $430,095,608 in FY 2006, and $572,600,683 in FY 2007. This is a change of $15,110,533 in FY 2006, and $142,365,703 in FY 2007.
12. The weighted average state mill levy on the property affected by the proposal is 101.74 (95 mills for state purposes, weighted average of 0.74 mills for vo-tech milled in five counties, and 6 mills levied in support of the university system).
13. Estimated state property taxes paid on commercial real property and business equipment are estimated to increase by $1,537,346 ($15,110,533 x 101.74 mills) in FY 2006, and $14,484,287 ($142,365,703 x 101.74) in FY 2007. This represents a gain of $1,446,683 (95.74 ÷ 101.74 = 94.1%) for the general fund and $90,663 (6 ÷ 101.74 = 5.9%) for the university system in FY 2006. For FY 2007, the gain in revenue is estimated to be $13,629,714 (94.1%) to the state general fund, and $854,573 (5.9%) to the university system.

<u>Calculation of Amount Available for the Credit</u>

14. Section 2(b) requires the Department of Revenue to calculate by September 1 of each year, the amount of property taxes levied in the current year on certain commercial land, improvements, and personal property. Subtracting the base *tax year* 2005 taxes levied from the current *tax years* taxes levied provides the amount of available credit for property tax relief. (The taxable values for the following revenue calculations are shown on the left-hand side of the table)
15. It is estimated that, the amount of state taxes levied in the base tax year on commercial real and personal property is $42,084,533 ($413,647,859 x 101.74 mills).
16. Under the proposal, the estimated amount of state taxes levied on commercial real and personal property is $58,071,768 ($570,786,002 x 101.74 mills) in tax year 2006.
17. Subtracting the tax year 2005 (base year) estimate from the proposed tax year 2006 estimated tax amounts yields $15,987,235 ($58,071,768 - $42,084,533) available for property tax relief credits under the proposal.
18. This credit would be applied against calendar year 2006 individual income tax liability paid in calendar year 2007, affecting FY 2007 income tax revenue. These credits would reduce general fund revenue due to the loss in individual income tax revenues, but will be offset by the increase in property tax revenues assumption #12) for a net loss of $2,357,521 ($15,987,235 - $13,629,714) in general fund revenues in FY 2007.

Owner-Occupied Housing

19. The department must determine the amount of credit per qualified owner by dividing the total amount of credit available by the total number of owner-occupied, single-family, residences. An accurate count of owners of owner-occupied single-family residences is not available through the Department of Revenue's Property Tax Data System. As a proxy, the US Census Annual Estimates of Housing Units provides numbers on housing units, by tenure, by state. For 2003, the Census data show 210,734 owner-occupied, single-family housing units in Montana, which represents 50% of 419,726 estimated total housing units.
20. Between April 1, 2000 to July 1, 2003, the number of housing units in Montana grew by an average annual rate of 0.57% a year.

	2000	**2001**	**2002**	**2003**	**Average Annual Growth**
Estimated Total Housing Units in Montana	412,633	415,362	417,106	419,726	
Annual Growth Rate		0.66%	0.42%	0.63%	0.57%

21. Using the 0.57% annual growth rate, projected owner-occupied single family residences are estimated as follows for calendar year 2004 to calendar year 2007:

	Projected			
	2004	**2005**	**2006**	**2007**
Housing Units-Total	422,118	424,523	426,942	429,374
Estimated Owner Occupied Housing Units (Single unit detached or attached)	211,935	213,142	214,357	215,579

22. The estimated tax year 2006 average credit against individual income tax liability for owners of owner-occupied, single-family residences is $74.58 ($15,987,235 ÷ 214,357 housing units).

Administrative Costs

Department of Revenue (DOR)

23. DOR estimates an additional 0.61 FTE would be needed in FY 2006 to alter existing information systems to administer the credit. An additional 0.75 FTE would be needed in FY 2007 to assist in auditing as the credits claimed on 2006 taxes are received on returns. Total associated additional administrative expenditures to administer the income tax credit are $35,758 in FY 2006, and $19,988 in FY 2007.
24. In order to effectively administer and ensure compliance with the provisions related to increasing the class 8 exemption from $5,000 to $20,0000, DOR would incur annual administrative expenses totaling $18,720 per year for printing and mailing approximately 40,000 reporting forms.

Office of Public Instruction – school funding GTB impacts

25. The increase in property tax values would impact the state's obligation to fund the guaranteed tax base aid for school districts and counties.
26. Property tax values would increase by 7.68% in year FY 2007 and remain at the higher level. This increase in taxable value will cause a **one-time reduction** in guaranteed tax base (GTB) costs. The

guarantee level is determined by the prior year taxable values applied against current year taxable values. For example, the lower guarantee level in FY 2006 will apply to the higher taxable values in FY 2007 and cause decreased state contribution as districts levy fewer mills to adjust for the higher in taxable values.

27. The change in taxable value is assumed to be proportionally distributed across all districts in the state.
28. The one year decreased state cost will be approximately $3.2 million in FY 2007 for district general fund levies as calculated by the school fund model. Countywide retirement GTB will decrease $1.4 million based on a historical average of 27% of the costs paid for by the state and a FY 2004 county levies equal to $68.6 million (7.68% times $68.6 million local levies times 27%).
29. In FY 2008 and beyond, the lower overall level of taxable values will not have a significant impact in statewide guaranteed tax base aid costs.

Summary

25. The net affect on the general fund from this proposal in FY 2006 would be $1,392,205 ($1,446,683 additional property tax revenue generated from state millage less $54,478 administrative expenses). In FY 2007, the net effect is a loss of $2,396,229 in general fund revenues ($13,629,714 increased property tax revenues less $15,987,235 decreased income tax revenues less $38,708 in administrative expenses) which is offset by the $4.6 million one-time decrease in school funding for a net impact to the general fund of $2,183,783. Note that the ongoing impact to the general fund will be negative.

FISCAL IMPACT:

	FY 2006 Difference	FY 2007 Difference
Department of Revenue		
FTE	0.61	0.75
Expenditures:		
Personal Services	$23,964	$12,231
Operating Expenses	$24,714	$20,677
Equipment	$5,800	$5,800
TOTAL	$54,478	$38,708
Funding of Expenditures:		
General Fund (01)	$54,478	$38,708
Revenues:		
General Fund (01)	$1,446,683	($2,377,509)
State Special Revenue (02)	$90,663	$854,573
Office of Public Instruction		
Expenditures:		
Local Assistance	$0	($4,600,000)
Funding of Expenditures:		
General Fund (01)	$0	($4,600,000)
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):		
General Fund (01)	$1,392,205	$2,183,783
State Special Revenue (02)	$90,663	$854,573

EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:
Although the proposal increases taxable value, under 15-10-420, MCA, county and city governments can only generate additional property tax revenue at one-half the rate of inflation from the prior year, unless the property is considered "newly taxable property". Under 15-10-420, MCA, moving property from one tax class to another does not constitute "newly taxable property".

School districts are not included under 15-10-420, MCA. However, they do have restrictions on the size of their budgets, and will not be able to increase property tax revenues by the full amount of the increased taxable value under the proposal.

LONG-RANGE IMPACTS:
The one-time $4.6 million reduction in GTB cost reduction will end and the general fund will continue to see revenue decreases into the future. However, these general fund decreases will continue to grow as the commercial real and personal property is anticipated to grow at more than 3.5% annually; all of this growth will be translated into tax credits against the general fund.

TECHNICAL NOTES:
1. The Department of Revenue does not provide taxing authorities with the total amount of taxable value for the jurisdiction until August 1 of each year (15-10-202, MCA). Mills are then set and the counties notified of the amount of taxes, fees, and assessment to be levied by the second Monday in October (15-10-305, MCA). Therefore, information on the taxes levied would not be available by September 1 as this bill requires in Section 1(2)(b).
2. Section 1(2)(d) requires the Department of Revenue to divide the credit available by the number of owner-occupied, single-family residences. An exact count of the number of owner-occupied, single-family residences is not available. Additionally, there is no length of occupancy provision to determine if the residence is owner-occupied or not.
3. New section 1 requires the department to calculate the amount of the property tax relief income tax credit. Once that is done, there is no direction as to what happens next. How do taxpayers find out that the credit exists? How do they know how much it is?
4. The bill selectively moves class 4 commercial property to class 8, but leaves multi-family rental units and golf courses in class 8 commercial .
5. The proposal would allow the new class 8 property, commercial real property to qualify for the new reduced tax rate of 1%. The additional fiscal impacts are unknown, and are not included in the fiscal note.
6. If this bill is amended to clarify how the credit will be reported, the administrative costs may have to be adjusted.

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ELIMINATE THE CLASS 8 TRIGGER

30. Revenue estimates in HJR2 do not include any impacts for a class 8 reduction due to the trigger; the fiscal note does not show any fiscal impacts associated with elimination of the trigger.
31. For illustrative purposes, the following analysis shows the impacts if the trigger were met in the fall of 2005. Under current law, the class 8 current 3 percent tax rate would be reduced to 2 percent for tax year 2007; 1 percent for tax year 2008; and 0 percent for tax year 2009 and thereafter.

32. Table 2 illustrates the fiscal impacts over the period FY 2007 through FY 2010 on the state general fund and other taxing jurisdictions if the trigger is hit in the fall of 2005. Most property taxes are paid in the fiscal year following assessment, however some business equipment tax is due in the current fiscal year.
33. Under this proposal, the revenue reductions shown below in Table 2 would not occur, saving the state general fund and other jurisdictions the amount of revenue listed.

Table 2
Fiscal Year - Class 8 Estimated Reduction in Revenue With and Without the Trigger

Fiscal	Estimated Reduction in Property Tax Revenue by Taxing Jurisdiction					
Year	State Government[1]	University 6-Mill[2]	Local Government	Local Schools	TIF	Total
2004	$ -	$ -	$ -	$ -	$ -	$ -
2005	-	-	-	-	-	-
2006	-	-	-	-	-	-
2007	(1,462,047)	(98,026)	(3,659,756)	(2,936,772)	(553,483)	(8,710,083)
2008	(5,402,978)	(361,673)	(14,606,557)	(11,721,035)	(2,125,099)	(34,217,342)
2009	(9,583,721)	(640,530)	(27,981,601)	(22,453,843)	(3,919,802)	(64,579,496)
2010	(12,414,334)	(828,452)	(39,145,839)	(31,412,589)	(5,284,445)	(89,085,659)

[1]State Government amount includes the (average) 1.5 vo-tech mill levy located in five counties
[2]The University 6-Mill is collected on all property, including incremental taxable value.

Additionally, the impacts referred to in the analysis are property tax reductions with respect to the trigger. However, 15-10-420, MCA, allows local governments, to float their mill levies to remain at the prior years revenue level (plus one-half of inflation) and local schools are allowed by provisions of Title 20 to increase mill levies to offset loss in values. Much of the revenue loss could be shifted to other property taxpayers. It is highly likely that local governments would float their mill levies to eliminate some or all of the reduction in property taxes shown above, and effectively shift the property tax burden to other taxpayers. The impacts to the state general fund, the university system, and to tax increment financing districts *would* occur, as these jurisdictions cannot "float" mill levies to counter these impacts.

CLASS 12 RAILROAD AND AIRLINE PROPERTY

34. If the trigger is met, the class 8 business equipment rate reduction would impact the taxable valuation rate applied to class 12 railroad and airline property. As the class 8 tax rate is reduced to 2 percent in tax year 2007; to 1 percent in tax year 2008, and 0 percent in tax year 2009, there would be a commensurate reduction in the class 12 taxable valuation rate, as that rate reflects the composite tax rate of all commercial and industrial property in the state. Table 3 shows the estimated impacts to the class 12 tax rate, holding all else constant, if the trigger is met in the fall of 2005. (The tax rate on class 12 property would actually

Table 3
Property Taxes Paid by Class 12 Property

	FY 2005	FY 2007	FY 2008	FY 2009
Class 8 Tax Rate	3.00%	2.00%	1.00%	0.00%
Class 12 Tax Rate	3.81%	3.56%	3.32%	4.08%
Revenues Assuming Trigger is Met				
State General Fund	4,299,418	4,017,304	3,746,474	4,604,101
University System	270,445	252,699	235,663	289,610
Difference in Revenues - Trigger Not Met				
State General Fund	n.a.	282,114	552,944	(304,683)
University System	n.a.	17,746	34,782	(19,165)

rise again in tax year 2009, as class 8 property would be removed from the calculation of the class 12 tax rate.) Eliminating the trigger will act to prevent any reductions to class 12 taxable value and revenue. Along with the estimated tax rate reduction, Table 3 also shows the estimated impacts to the state general fund and university system accounts from a reduced class 12 tax rate.

Office of Public Instruction – school funding GTB impacts

35. The reduction in property tax values from loss in class 8 property taxable values would impact the state's obligation to fund the guaranteed tax base aid for school districts and counties.
36. Property tax values would decrease by 2.5% in each year FY 2007 through FY 2009. In each other these years there will be a guaranteed tax base (GTB) cost increase from the decline in taxable value. The guarantee level is determined by the prior year taxable values applied against current year taxable values. For example, the higher guarantee level in FY 2006 will apply to the lower taxable values in FY 2007 and cause increased state contribution as districts levy more mills to compensate for the drop in taxable values.
37. The three-year increased cost will be approximately $1.1 million per year for FY 2007 through FY 2009 for district levies as calculated by the school fund model. Countywide retirement GTB will increase $460,000 based on a historical average of 27% of the costs paid for by the state and a FY 2004 county levies equal to $68.6 million (2.5% times $68.6 million local levies times 27%).
38. In FY 2010 and beyond the lower overall level of taxable values will not have a significant impact in statewide guaranteed tax base aid costs.

SUMMARY– CHANGE IN EXEMPTION THRESHOLD AND TRIGGER ILLUSTRATION

39. As Tables 2 and 3 illustrate, eliminating the trigger would *increase* state general fund revenue by $1,744,161 ($1,462,047 + $282,114) in FY2007: while revenues to the university system's 6-mill account would *increase* by $115,772 ($98,026 + 17,746) in FY 2007.
40. General fund costs for schools of approximately $1.56 million per year for three years, FY 2007-FY 2009, would result from reducing property tax rates.
41. Including the impacts if the trigger is met in the fall of 2005, the 6-mill university account would *decrease* by $11,610 in FY 2006, then *increase* by $84,883 ($115,772 - $30,889) in FY 2007.