



SJ 23: UPDATED OVERVIEW OF CLASSIFICATION, ASSESSMENT, AND TAXATION

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Revenue and Transportation Interim Committee

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MONTANA STATE LEGISLATURE

SJ 23: UPDATED OVERVIEW

[Original Overview](#) Prepared by Jeff Martin, September 2011

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INTRODUCTION

This report, prepared as part of the 2011-2012 [Senate Joint Resolution No. 17](#) study of the valuation of centrally assessed property and industrial property and the 2017-2018 [Senate Joint Resolution No. 23](#) study of centrally assessed and utility property, is divided into two parts.

The first part provides an overview of changes made by the Montana Legislature in the classification of property since 1989, including business equipment, railroads and airlines, telecommunications, and electric generation and energy-related property.

The second part provides an overview of the process of valuing centrally assessed property for tax purposes. It includes information on the unit value method of valuation, statutory provisions related to centrally assessed property, indicators of market value, reconciliation of the indicators of value, and allocation of values among taxing jurisdictions. It also includes a discussion of the Montana Department of Revenue rules for valuing centrally assessed property.

TRENDS IN PROPERTY CLASSIFICATION

In 1987, Montana had 20 classes of property subject to taxation, including 5 classes of personal property. The tax rate on most tangible personal property was between 11% and 16% of market value. Class six property, which included livestock, agricultural products, and personal property intended for rent or lease, was taxed at 4% of market value (see below for more discussion). Class four land and improvements were taxed at 3.86% of market value. Most centrally assessed property (except for railroad and airline property, rural electric cooperatives, rural telephone cooperatives, and mines) was taxed at 12% of market value.

During the 1989 special session, the Montana Legislature consolidated most personal property into class eight property and reduced the tax rate from 11% of market value to 9% (House Bill No. 20, Chapter 10, Special Laws of June 1989).

In 1991, the Legislature reduced the number of property classes from 17 to 12. The legislation combined the following classes of property:

- nonproductive mining claims with class three agricultural land;
- trailers and mobile homes, nonproductive real estate, and out-of-production agricultural land and timberland with class four property; and
- airline property with railroad property (Chapter 773, Laws of 1991).

In 1993, the Legislature eliminated class eleven property that included improvements on agricultural land (Chapter 267, Laws of 1993). This property was taxed at 80% of the taxable percentage of class four property residential and commercial land and improvements.

In 1995, the Legislature provided that personal property tax applied to any class of personal property, excluding livestock, owned by a sole proprietor, firm, association, partnership, business, corporation, or limited liability company is a

business equipment tax.¹ The legislation also provided for a statement to be used in reporting business equipment (Senate Bill No. 393, Chapter 348, Laws of 1995).

The number of classes remained constant until 1999. During the 1999 session, the Legislature passed several measures that affected the classification and taxation of property, including business equipment, electric generation facilities, telecommunications property, and intangible personal property. The Legislature also revised the valuation of centrally assessed railroad property.

In 2015, the Legislature exempted air and water pollution control equipment and carbon capture equipment, which are class five property, from taxation for 10 years. The property must be placed into service after January 1, 2014 (Chapter 407, Laws of 2015). The original legislation contained a termination date of December 31, 2025, but the 2017 Legislature removed the termination date (Chapter 444, Laws of 2017).

The 2017 Legislature created class seventeen property for qualified data centers. Qualified data center property is locally assessed but class seventeen also includes certain centrally assessed interstate and intrastate dedicated communications infrastructure that is owned or leased by the owner of a qualified data center. Class seventeen property is taxed at 0.9% (Chapter 428, Laws of 2017).

Business Equipment

Since 1989, the Legislature has gradually reduced the tax rate on business personal property. In 1999, the Legislature reduced the tax rate on business equipment to 3% and phased out over a 4-year period the taxation of class six property, which included livestock, certain rental personal property, canola facilities, and malting barley facilities (Senate Bill No. 200, Chapter 285, Laws of 1999). The legislation also provided an aggregate exemption of \$5,000 of class eight property and provided for the phaseout of the taxation of class eight property based on changes in real Montana wage and salary income. In 2005, Senate Bill No. 48 (Chapter 531, Laws of 2005) increased the aggregate exemption to \$20,000 and eliminated the phaseout of the taxation of class eight property.

In 2011, the Legislature reduced the business equipment tax rate on the first \$2 million of taxable market value to 2% (Senate Bill No. 372, Chapter 411, Laws of 2011). If, in any year beginning after fiscal year 2013, the revenue collected from individual income taxes and corporation license taxes exceeds the amount collected in the previous fiscal year by more than 4%, the tax rate on the first \$3 million of taxable market value is 1.5% in the next tax year beginning after December 31.

The 2013 Legislature again reduced the business equipment tax rate, created an exemption, and removed the revenue triggers enacted in 2011. The first \$100,000 in market value became exempt from taxation for all class eight taxpayers. The tax rate for market value greater than \$100,000 and less than \$6 million is 1.5% and the tax rate for market value in excess of \$6 million is 3% (Senate Bill No. 96, Chapter 396, Laws 2013).

Electric Generation and Telecommunications Property

In 1997, the Legislature restructured the electric utility industry with the enactment of Senate Bill No. 390 (Chapter 505, Laws of 1997). The legislation also directed the Revenue Oversight Committee to “analyze the amount of state and local tax revenue derived from previously regulated electricity suppliers that will enter the competitive market” and to “recommend legislative

¹ Codified in 15-6-122, MCA.

changes, if any, to address the establishment of comparable state and local taxation burdens on all market participants in the supply of electricity”.

The Legislature also enacted Senate Bill No. 396 (Chapter 506, Laws of 1997), the Natural Gas Utility Restructuring and



Customer Choice Act. Similarly, the legislation directed the Revenue Oversight Committee to “analyze the amount of state and local tax revenue derived from previously regulated natural gas suppliers that will enter the competitive market” and to “recommend legislative changes to address the establishment of comparable state and local taxation burdens on all market participants in the supply of natural gas”.

In the course of adopting the study plans for the tax analyses of the electrical utilities and natural gas suppliers, the Revenue Oversight Committee decided to 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 class twelve property (railroads and airlines). Although a review of valuation methods was part of the study plan, not much time was devoted to this area.

Based on the study of the Revenue Oversight Committee, the 1999 Montana Legislature reclassified electrical generation facilities (House Bill No. 174, Chapter 556, Laws of 1999) and telecommunications property (House Bill No. 128, Chapter 426, Laws of 1999) to help make these industries more competitive with other states.² The Legislature also imposed a wholesale energy transaction tax on kilowatt hours of electricity transmitted in the state and a retail telecommunications excise tax to help offset the revenue loss from the lower property tax rates on these properties.

The new class thirteen property included centrally assessed telecommunications services companies, electrical generation facilities of centrally assessed electric power companies, electrical generation facilities of exempt wholesale generators or entities certified as exempt wholesale generators pursuant to the Public Utility Holding Act of 1935, and non-centrally assessed generators.

Class thirteen property does not include qualifying generation facilities (or cogeneration facilities), as defined in 16 U.S.C. 796, that are taxed under property class four (land and improvements) and class eight (business equipment), rural electric cooperative property, or rural telephone cooperative property.

In 2001, Senate Bill No. 506 (Chapter 591, Laws of 2001) exempted small electrical generation equipment from a generation facility with a nameplate capacity of less than 1 megawatt from taxation for a period of 5 years after the generation of electricity begins (15-6-225, MCA).

In 2017, the Legislature created class seventeen property for qualified data centers (see section below). The new law also provides a lower tax rate (0.9%) for certain dedicated communications infrastructure based on when the property is

² The Revenue Oversight Committee did not recommend changes to the taxation of natural gas suppliers.

constructed. Dedicated communications infrastructure not eligible for classification as class seventeen property is included in class thirteen and taxed at 6%.

Railroad and Airline Property

In 1976, Congress created the Railroad Revitalization and Regulatory Reform Act 1976 (4-R Act). The purpose of the legislation was to reverse the economic decline of the rail industry by, among other means, barring the discriminatory state taxation of railroad property.³ The 4-R Act prohibits states 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;
- levying or collecting a tax on an assessment that may not be made under paragraph (1) of this subsection;
- levying or collecting an ad valorem property tax on rail transportation property at a tax rate that exceeds the tax rate applicable to commercial and industrial property in the same assessment jurisdiction; and
- imposing another tax that discriminates against a rail carrier providing transportation subject to the jurisdiction of the board under this part (see 49 U.S.C. 11501).

In the Tax Equity and Fiscal Reform Act of 1982, Congress imposed the same restrictions (except for the last item listed above) on states for the taxation of airline transportation property (see 49 U.S.C. 40116)

The Legislature first dealt with the federal limitations on the taxation of railroad property in 1981. Railroad property was classified in 15-6-141, MCA, and taxed at 15% of market value—all other property was taxed at 12% of market value. In order to comply with the 4-R Act, the Legislature amended 15-23-202, MCA, (renumbered 15-23-205, MCA) by providing that the Department of Revenue may modify the taxable percentage applied to railroads (Chapter 367, Laws of 1981).

In 1985, the Legislature created a separate class of property for railroad and airline property to comply with federal limitations on the taxation of these properties (Chapter 743, Laws of 1985).⁴

Railroad and airline property is taxed at the percentage rate “R” or 12%, whichever is less. R is equal to A/B where: A is the total statewide taxable value of all commercial property, except class twelve property; and B is the total statewide market value of all commercial property, except class twelve property.

Commercial property is defined in 15-1-101, MCA. It includes property used or owned by a business, a trade, or a corporation or used for the production of income. Commercial property does not include agricultural lands; forest lands; single-family residences, including mobile homes and manufactured homes; and ancillary improvements and improvements necessary to the function of a bona fide farm, ranch, or stock operation, and property described in 15-6-135, MCA.

³ CSX Transportation, Inc. v. Georgia State Board of Equalization, 552 U.S. 9 (2007).

⁴ During the March 1986 special session, the Legislature created a separate class for airline property (Ch. 7, Sp. L. March 1986). Airline property was recombined with railroad property in 1991 (Ch. 773, L. 1991).

Each year the Department of Revenue calculates the tax rate for railroad, rail car, and airline property after adjusting the value A by a value-weighted mean sales assessment ratio for all commercial and industrial real property and improvements.

In 1999, the Legislature adopted a statutory method for valuing railroad property (House Bill No. 669, Chapter 531, Laws of 1999). The legislation was enacted to resolve long-standing valuation disputes between Burlington Northern and the Department of Revenue. For about 20 years Burlington Northern and the Department had disagreed over the valuation of railroad property resulting in lengthy valuation disputes and litigation. For tax years 1997 and 1998, the Department and the railroad agreed to an experimental valuation formula based on income and cost. House Bill No. 669 put into law that procedure for valuing railroad property.⁵

The Department determines the current year valuation of a railroad system by multiplying the base value of the railroad by the value change factor. The base value is the system value of railroad transportation property of a railroad in the preceding tax year, and the value change factor is the sum of the income change factor, weighted by 50%, the gross profit margin change factor, weighted by 25%, and the property change factor, weighted by 25% (15-23-205, MCA).

Wind Generation Facilities and Renewable Energy Property

In 2005, the Legislature passed Senate Bill No. 115 (Chapter 563, Laws of 2005) creating class fourteen property. Initially class fourteen property included wind generation facilities of a centrally assessed electric power company, wind generation facilities owned or operated by an exempt wholesale generator or an entity certified as an exempt wholesale generator pursuant to 42 U.S.C. 16451, noncentrally assessed wind generation facilities, facilities owned or operated by any electrical energy producer, and wind generation facilities owned or operated by cooperative rural electric associations described under 15-6-137. Class fourteen property is taxed at 3% of market value.

During the May 2007 special session, the Legislature passed House Bill No. 3 (Chapter 2, Special Laws of May 2007), which provided property tax incentives for new investment in the conversion, transport, manufacturing related to, and research and development of renewable energy, new technology energy, and clean coal energy and carbon dioxide equipment and facilities.

The 2007 legislation classified biodiesel and biogas production facilities, all biomass and coal gasification production facilities, natural gas combined cycle production facilities, geothermal facilities, certain transmission lines, and other property as class fourteen property (see p. 9 for a more detailed description of class fourteen property). The legislation also provided a property tax abatement under Title 15, chapter 24, part 31, for certain class fourteen renewable energy, new technology energy, and clean coal energy-related property and allowed a property tax exemption, under certain conditions, for land adjacent to transmission lines.

The 2007 legislation also created class fifteen property for certain pipelines and carbon dioxide equipment and facilities and class sixteen property for certain direct-current converter station property. Class fifteen property is taxed at 3% of its market value, and class sixteen property is taxed at 2.25% of its market value.

The Legislature added biomass generation facilities up to 25 megawatts in nameplate capacity to class fourteen property in 2009 (Senate Bill No. 198, Chapter 357, Laws of 2009) and added certain energy storage facilities in 2011 (Senate Bill No. 172, Chapter 309, Laws of 2011).

⁵ Senate Taxation Committee, *Minutes*, April 8, 1999, pp. 13-20.

Qualified Data Centers

In 2017, the Legislature created class seventeen property for qualified data centers and certain dedicated communications infrastructure. Class seventeen property is taxed at 0.9%.

A qualified data center is “the land, improvements, and personal property of a facility designed or modified to house networked computers or equipment supporting computing, networking, or data storage that is:

- (i) composed of one or more buildings under single ownership on contiguous parcels of land that consist of at least 300,000 square feet, where the total cost of land, improvements, personal property, and software is at least \$150 million; and
 - (ii) commences construction after June 30, 2017.
- (b) The term includes but is not limited to:
- (i) cooling systems, cooling towers, and other temperature infrastructure;
 - (ii) power infrastructure for transformation, distribution, or management of electricity used for the maintenance and operation of the facility, such as exterior dedicated business-owned substations, backup power generation systems, battery systems, and related infrastructure; and
 - (iii) any other equipment necessary for the maintenance and operation of the facility.”⁶

Qualified data center property is locally assessed. Class seventeen also includes centrally assessed interstate or intrastate dedicated communications infrastructure owned or leased by the owner of a qualified data center and composed of telecommunication or data lines, equipment, and services, including copper or fiber optic lines or microwave, satellite, or other wireless communication systems.

To qualify as class seventeen property, construction of the dedicated communications infrastructure must begin after June 30, 2017, and before July 1, 2027. In addition, the dedicated communications infrastructure is included in class seventeen only for 15 years from the start of construction. After the 15-year period, the property is included in class thirteen property and taxed at 6%. The qualified data center property remains class seventeen property taxed at 0.9%.

Response to a Supreme Court Decision on Classification of Oil and Gas Gathering Lines

On December 2, 2008, the Montana Supreme Court decided an appeal filed by Omimex Canada, Ltd., from the judgment of the First Judicial District Court, Lewis and Clark County, “declaring that the Montana Department of Revenue may centrally assess Omimex’s property and classify it under 15-6-141, MCA, as class nine property” rather than as class eight personal property under 15-6-138, MCA.⁷ The Supreme Court reversed the District Court decision regarding the classification of Omimex’s low-pressure gas gathering lines. Omimex also had appealed the central assessment of its property, but the Court did not deal with this issue.

The effect of the Supreme Court decision was not confined to Omimex, but would apply to other natural gas pipelines that did not have a major natural gas distribution system in the state.⁸ In a memo to the Revenue and Transportation Interim Committee analyzing the decision, Lee Heiman, Committee staff attorney, noted that the “decision may have serious financial

⁶ Codified in 15-6-162, MCA.

⁷ Omimex Canada, Ltd., v. State, 347 Mont. 176, 201 P.3d 3 (2008).

⁸ The pipeline companies that would have been affected by the Supreme Court decision included Energy West Development, Colorado Interstate Pipeline, Havre Pipeline, Northern Border Pipeline, Omimex Pipeline, Liscom Creek Pipeline, Devon Energy Production Company, and Fidelity Exploration.

consequences . . . if it is applied to similar properties".⁹ Mr. Heiman also said that because the decision was based on statutory construction and not on constitutional principles, the Legislature could revise how this property is taxed.

Senate Bill No. 489 (Chapter 487, Laws of 2009) dealt with the Supreme Court Omimex decision by revising the laws related to the taxation of oil and natural gas pipelines. The legislation:

- clarified that regulated natural gas and oil pipelines and common carrier pipelines are taxed as class nine property under 15-6-141, MCA; and
- clarified that oil and gas production property, including flow lines and gathering lines, is taxed as class eight property under 15-6-138, MCA.

The legislation specifically included flow lines and gathering lines in the description of oil and gas production equipment in 15-6-138(1)(c)(iii).

However, natural gas gathering lines do not include gas gathering facilities of a stand-alone gas gathering company that provide gas gathering services to third parties on a contractual basis, that own more than 500 miles of gas gathering lines in Montana, and that were centrally assessed in tax years prior to 2009. This property is considered natural gas transmission pipeline property subject to central assessment under 15-23-101, MCA (see 15-6-138(6), MCA).

The legislation also revised the description of centrally assessed property under 15-6-141(1)(d), MCA, by removing the phrase "companies having a major distribution system in this state" and inserting the following italicized language:

... allocations for centrally assessed natural gas *distribution utilities, rate-regulated natural gas transmission or oil transmission pipelines regulated by either the public service commission or the federal energy regulatory commission, a common carrier pipeline as defined in 69-13-101, a pipeline carrier as defined in 49 U.S.C. 15102(2), or the gas gathering facilities specified in 15-6-138(5)*.

The property of two companies--Liscom Creek Station and Fidelity Exploration and Production Company--has been reclassified from class nine property to class eight property as a result of the legislation. The property of Omimex, on the other hand, is classified as class nine property.¹⁰

VALUATION OF PROPERTY

Article VIII, section 3, of the Montana Constitution requires that the state (Department of Revenue) "appraise, assess, and equalize the valuation of all property which is to be taxed in the manner provided by law".

Property in Montana is taxed on the basis of fair market value. Section 15-8-111, MCA, provides in part that:

- (1) All taxable property must be assessed at 100% of its market value except as otherwise provided.

⁹ Memo from Lee Heiman, Legislative Services Division Attorney, to members of the Revenue and Transportation Interim Committee, "Omimex Supreme Court Decision", December 15, 2008, p. 3. The memo is available on the Revenue and Transportation Interim Committee webpage at http://leg.mt.gov/css/Committees/interim/2007_2008/rev_trans/default.asp under "Publications".

¹⁰ For more information on the classification and taxation of certain oil and gas property, see Jeff Martin, "Don't Mess with Taxes: HJR 44 Study of the Taxation of Certain Oil and Natural Gas Property and Other Topics Considered by the Revenue and Transportation Interim Committee," Montana Legislative Services Division, (Helena, December 2006), Part One.

- (2) (a) Market value is 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

In Montana, the valuation of property is typically described as being locally assessed or centrally assessed (give or take a few differences in interpretation). In Montana, the Department of Revenue centrally assesses property described in 15-23-101, MCA, using the unit value method. Industrial property is assessed by Department appraisers in Helena in the county in which it is located.

Locally Assessed Property

Local assessment means that a taxpayer's property is valued separately in each county or taxing jurisdiction in which the taxpayer's property is located. Examples of locally assessed property that is taxed on the basis of market value include:

- Class four property (15-6-134, MCA): residential and commercial land and improvements. The tax rate for residential property is 1.35% and the tax rate for commercial property is 1.89%.
- Class five property (15-6-135, MCA): qualifying new industrial property, real and personal property used for the production of gasohol, all property that is devoted to research and development, and machinery and equipment used in electrolytic reduction facilities (Columbia Falls aluminum plant). Class five property is taxed at 3% of market value.¹¹
- Class seven property (15-6-137, MCA): rural electrical associations that serve less than 95% of the electricity consumers within the incorporated limits of a city or town. Class seven property is taxed at 8% of market value.
- Class eight property (15-6-138, MCA): business equipment, including (non-centrally assessed) oil and gas production equipment. The first \$100,000 of market value is exempt from taxation. The first \$6 million of market value in excess of \$100,000 is taxed at 1.5%. Taxable value in excess of \$6 million is taxed at 3%.
- Class seventeen property (15-6-162, MCA): qualified data centers. Class seventeen property is taxed at 0.9% of its market value.

Locally assessed property also includes class three agricultural land (15-6-133, MCA) and class ten forest land (15-6-143, MCA) valued on the basis of productivity. The productivity value of class three agricultural land is taxed at the same rate as class four residential property, 1.35%, and the productivity value of class ten property is taxed at 0.37%.

Centrally Assessed Property

The Department of Revenue is required to centrally assess the property of a taxpayer that is operated in more than one county or state as an integrated enterprise. Centrally assessed property is contained in several classes of property:

- Class one property (15-6-131, MCA): the annual net proceeds of mines except coal (taxed under Title 15, chapter 23, part 7), bentonite (taxed under Title 15, chapter 39). Class one is taxed at 100% of net proceeds.

¹¹ Class five property also includes centrally assessed rural electric cooperatives, rural telephone cooperatives, and pollution control equipment. These properties are discussed under centrally assessed properties.

- Class two property (15-6-132, MCA): the gross proceeds of metal mines. Class two property is taxed at 3% of its annual gross proceeds.
- Class five property (15-6-135, MCA): rural electric cooperatives, rural telephone cooperatives, and pollution control equipment.¹² The combined actions of the 2015 and 2017 Legislature exempted pollution control equipment placed into service after January 1, 2014, from taxation for 10 years. Class five property is taxed at 3% of market value.
- Class nine property (15-6-141, MCA): electric transmission and distribution lines, natural gas distribution utilities, electric cooperatives operating in certain municipalities, rate regulated natural gas or oil transmission pipelines, common carrier pipelines, certain gas gathering facilities, and other centrally assessed property except property classified in another class. Class nine property is taxed at 12% of its market value.
- Class twelve property (15-6-145, MCA): rail car, railroad transportation property, and airline property. Class twelve property is taxed at 3.04% (2016) of its market value.¹³
- Class thirteen (15-6-156, MCA): electric generation facilities and telecommunications property. Class thirteen property is taxed at 6% of its market value.
- Class fourteen property (15-6-157, MCA): wind generation facilities, biodiesel production facilities, biomass generation facilities up to 25 megawatts in nameplate capacity, biomass gasification facilities, coal gasification facilities, ethanol production facilities, integrated gasification combined cycle facilities, energy storage facilities, geothermal facilities, renewable energy manufacturing facilities, equipment used to capture carbon dioxide for sequestration or injected for recovery of oil or gas, certain high-voltage direct current transmission lines, electric transmission lines originating at class fourteen facilities, and certain alternating current transmission lines. Class fourteen property is taxed at 3% of its market value.
- Class fifteen property (15-6-158, MCA): carbon dioxide and liquid pipeline property, including pipelines used to transport carbon dioxide for sequestration or having 90% of capacity dedicated to transporting fuels produced by coal gasification, biodiesel, biogas, or ethanol facilities; carbon sequestration equipment; closed-loop enhanced oil recovery equipment; and pipelines connecting a class 14 fuel production facility to an existing pipeline. Class fifteen property is taxed at 3% of its market value.
- Class sixteen property (15-6-159, MCA): high-voltage direct-current converter stations that can direct power to two different regional power grids. Class sixteen property is taxed at 2.25% of its market value.
- Class seventeen property (15-6-162, MCA): certain centrally assessed interstate or intrastate dedicated communications infrastructure that is owned or leased by the owner of a qualified data center and is composed of telecommunications or data lines, equipment, and services, including but not limited to copper or fiber optic lines or microwave, satellite, or other wireless communication systems. Class seventeen property is taxed at 0.9% of its market value.

¹² The value of pollution control equipment is certified to the county in which it is located.

¹³ Montana Department of Revenue, Biennial Report, July 1, 2014 – June 30, 2016, p. 160.

Depending on the ownership and use, some property in property classes thirteen, fourteen, fifteen, and sixteen is locally assessed.

Valuation of Centrally Assessed Property

Section 15-23-101, MCA, directs the Department of Revenue to centrally assess the following each year:

- (1) the railroad transportation property of railroads and railroad car companies operating in more than one county in the state or more than one state;
- (2) property owned by a corporation or other person operating a single and continuous property operated in more than one county or more than one state including but not limited to:
 - (a) telegraph, telephone, microwave, and electric power or transmission lines;
 - (b) rate-regulated natural gas transmission or oil transmission pipelines regulated by the public service commission or the federal energy regulatory commission;
 - (c) common carrier pipelines as defined in 69-13-101 or a pipeline carrier as defined in 49 U.S.C. 15102(2);
 - (d) natural gas distribution utilities;
 - (e) the gas gathering facilities specified in 15-6-138(5);
 - (f) the dedicated communications infrastructure specified in 15-6-162(5);
 - (g) canals, ditches, flumes, or like properties; and
 - (h) if congress passes legislation that allows the state to tax property owned by an agency created by congress to transmit or distribute electrical energy, property constructed, owned, or operated by a public agency created by congress to transmit or distribute electrical energy produced at privately owned generating facilities, not including rural electric cooperatives;
 - (3) all property of scheduled airlines;
 - (4) the net proceeds of mines, except bentonite mines;
 - (5) the gross proceeds of coal mines; and
 - (6) property described in subsections (1) and (2) that is subject to the provisions of Title 15, chapter 24, part 12.

The Department uses the unit value method to value centrally assessed property except for mines. This method calculates the market value of a utility or other business entity's entire operating system, regardless of location of assets or customer base. The entity's market value is not a summation of the values of its various components but its value as a whole as a going concern.¹⁴

The Department of Revenue is guided by ARM 42.22.102 in valuing centrally assessed property:

42.22.102 CENTRALLY ASSESSED PROPERTY

(1) The department shall centrally assess the interstate and inter-county continuous properties of the following types of companies:

- (a) railroad;
- (b) railroad car;
- (c) microwave;
- (d) telecommunications;
- (e) telephone cooperatives;

¹⁴ Advisory Commission on Intergovernmental Relations, "The Role of the States in Strengthening the Property Tax," Vol. 1, Washington D.C., June 1963, p. 148.

- (f) gas;
- (g) electric;
- (h) electric cooperatives;
- (i) ditch;
- (j) canal;
- (k) flume;
- (l) natural gas pipeline;
- (m) oil pipeline; and
- (n) airline.

(2) The property of a centrally assessed company is separated into two categories: operating and non-operating. All operating property will be apportioned to the taxing units as provided in ARM 42.22.121 and 42.22.122.

(3) The department will determine centrally assessed property based on the property's operating characteristics such as but not limited to property use, integration of operations, management, and corporate structure.

In 1999, the Department, through the administrative rule process, added ARM 42.22.102(3) to clarify its current practice of valuing centrally assessed property under existing law.¹⁵ According to the Department, the rule "effectuates the legislature's intent to centrally assess those unique properties whose true value can only be determined by examining their operating characteristics".¹⁶ This applies to companies that have operating characteristics that exhibit unity where the property is functionally operated as a single entity but may not have a physical connection.

In December 2010, the Department adopted a series of rules dealing with centrally assessed property.¹⁷ The Department adopted the Western States Association of Tax Administrators--Committee on Centrally Assessed Property *Appraisal Handbook: Unit Valuation of Centrally Assessed Properties* (August 2009) as the reference and overall appraisal guide for conducting unit valuations of centrally assessed properties in Montana. In the same rule, the Department adopted the National Conference of Unit Valuation States standards (published October 2005) as standards when conducting unit valuations of centrally assessed properties (ARM 42.22.109).

The Department also adopted rules related to intangible property of centrally assessed entities (see the discussion below) and a rule clarifying the reporting requirements for centrally assessed companies (ARM 42.22.105).

The valuation of centrally assessed property includes all tangible and intangible operating assets of the business.

According to the National Conference of Unit Valuation States:

The value of the going-concern value includes an intangible enhancement of the value of the operating business enterprise, which is produced by the assemblage of the land, buildings, labor, equipment, and the marketing operation. This assemblage creates an economically viable business that is expected to continue. The value of the going concern refers to the total value of the property, including both the real property and the intangible personal property

¹⁵ See Department of Revenue's Response No. 8, Montana Administrative Register, 1999 Issue No. 24, p. 2918, December 16, 1999.

¹⁶ DOR's Brief in Support of Cross-Motion for Partial Summary Judgment, in Pancanadian Energy Resources, Inc. v. Montana Department of Revenue, Cause No. DV-02-3223, February 28, 2003.

¹⁷ A description of the rules contained in an economic impact statement presented to the Revenue and Transportation Interim Committee at a November 19, 2010, meeting, written and oral comments on the proposed rules and economic impact statement, and Department of Revenue responses to the comments can be found in Montana Administrative Register, 2010, Issue No. 24, pp. 2993-3021, December 22, 2010. The December issue is available at <http://sos.mt.gov/ARM/Register/archives/MAR2010/index.asp>.

attributed to business enterprise value. (The Appraisal of Real Estate, 12th ed., Chicago: Appraisal Institute, 2001, p. 27.)¹⁸

The unit value method typically includes a cost indicator of value, a capitalized income indicator of value, and a market indicator of value when sufficient information is available (ARM 42.22.111(1)).

Cost Indicator

There are several different cost indicators that may be used when valuing centrally assessed property. These include historical cost less depreciation, original cost less depreciation, reproduction cost less depreciation, and replacement cost less depreciation, among others.

Historical cost less depreciation, or net book value, is generally used for regulated public utilities. It “is the historical cost of the utility’s taxable assets less the accumulated accounting depreciation applicable to the assets calculated according to the method used” by the regulatory agency.¹⁹ According to the Western States Association of Tax Administrators, the historical cost less depreciation indicator is not adjusted for obsolescence because the regulatory depreciation should take obsolescence into account.²⁰

Reproduction cost is an estimate of the cost to replace the existing property with a new property that is a duplicate of the existing property, while replacement cost is the current cost to replace a property with a new property of equal utility. The difference from reproduction cost may be functional obsolescence.²¹

Replacement cost less depreciation and reproduction cost less depreciation differ in the estimate of undepreciated cost and the estimate for functional obsolescence, but the market value should be the same if depreciation is properly determined.²²

Income Indicator

The income indicator of value may include direct capitalization of income, yield capitalization, or discounted cash flow.

The Department of Revenue conducts an annual rate capitalization study for each indicator by type of industry. The studies are available at <https://revenue.mt.gov/home/publications>.

Market Indicator

The market indicator includes sales of comparable assets or the business entity’s stock and debt value.

Because the sale of similar properties occurs infrequently, the stock and debt indicator is typically used. Under the stock and debt indicator of value (the value of shareholder’s equity and liabilities of the company, including current liabilities, long-term debt, reserves, and deferred credits), the market value of the items on the liability side of the balance sheet is determined. The

¹⁸ National Conference of Unit Value States, *Unit Valuation Standards*, p. 2. Retrieved from <http://www.ncuvs.org/>.

¹⁹ Western States Association of Tax Administrators--Committee on Centrally Assessed Property, *Appraisal Handbook: Unit Valuation of Centrally Assessed Properties*, August 2009, p. II-8.

²⁰ *Ibid.*, p. II-12.

²¹ *Ibid.*, p. II-2.

²² *Ibid.*, p. II-13.

principle is that since total assets equal total liabilities, the market value of the liabilities is the market value of properties represented on the asset side of the balance sheet.²³

Weighting of Indicators

Ideally, each of these approaches should yield about the same value of the entity being assessed. In practice, however, they often result in a range of possible values. To resolve the differences, the appraiser will weight each approach in order to produce what the appraiser considers an accurate estimate of the market value of the unitary property. Weighting of the indicators is called “correlation” or “reconciliation” and may involve significant judgment on the part of the appraiser based on the appraiser's experience, judgment, and available data. The particular weighting method may cause disputes between the appraiser and the taxpayer on which indicator should receive the most weight.

Finally, a proportionate share of the entity's total correlated unit value is allocated to Montana and to political subdivisions within the state (15-23-105, MCA).

DEPARTMENT OF REVENUE REQUIRED INFORMATION TO TAXPAYERS

Senate Bill No. 382 (Chapter 276, Laws of 2011), enacted last session, requires the Department of Revenue to provide certain information to taxpayers owning centrally assessed property. Section 15-1-210, MCA, directs the Department to post on its website the capitalization rates used to derive the income indicator of value 30 days before sending assessment notices to taxpayers.

The Department must also show supporting documentation on how the rates were calculated, including the rationale for adding or deleting a company included in the prior year's study, must accept public comment on the rates and documentation, and must post a written response to each comment.

The Department is required to show underlying calculations when providing a taxpayer with a determination of value. The Department must also provide a written explanation to the taxpayer if the Department changes its reliance on any indicator of value by more than 15%.

Finally, the requirements of 15-1-210, MCA, do not affect appraisal judgment and do not invalidate an appraisal or provide an independent grounds for appeal because of inaccuracies or inadequate compliance.

INTANGIBLE PERSONAL PROPERTY

In a financial compliance audit of the Department of Revenue for the two fiscal years ending June 30, 1996, the Legislative Audit Division concluded that the Department of Revenue was not specifically identifying and taxing intangible personal property²² (but was presumably taxing intangible property of centrally assessed companies). The audit recommended that the Department tax intangible property in accordance with state law. The Department concurred with the recommendation and indicated it would work in consultation with the Revenue Oversight Committee in dealing with the matter.

In the fall of 1998, the Revenue Oversight Committee requested legislation to exempt intangible personal property from taxation. As enacted by Senate Bill No. 111 (Chapter 583, Laws of 1999), the legislation provided that:

²³ Advisory Commission on Intergovernmental Relations, *op. cit.*, p. 161.

15-6-218. Intangible personal property exemption. (1) Except as provided in subsection (3), intangible personal property is exempt from taxation.

(2) For the purposes of this section, “intangible personal property” means personal property that is not tangible personal property and that:

(a) has no intrinsic value but is the representative or evidence of value, including but not limited to certificates of stock, bonds, promissory notes, licenses, copyrights, patents, trademarks, contracts, software, and franchises; or

(b) lacks physical existence, including but not limited to goodwill;

(3) The exemption for intangible personal property that is centrally assessed, other than property under 15-23-101(4) and (5), must be phased in over 3 years beginning in tax year 2000. Ten percent of the intangible personal property is exempt for tax year 2000, and two-thirds of the intangible personal property is exempt for tax year 2001. Centrally assessed intangible personal property is fully exempt from taxation in tax year 2002 and thereafter.

(4) The department shall adopt administrative rules prior to valuation determinations for tax year 2000 that specify the valuation methodology for centrally assessed intangible personal property. To the extent that the unit value includes intangible personal property, that value must be removed from the unit value according to the provisions in subsection (3).

(5) The department must report intangible personal property annually to the revenue and taxation interim committee of the Montana legislature and to the Montana legislature meeting in the year 2001.

In 2005, House Bill No. 85 (Chapter 318, Laws of 2005) put 15-6-218, MCA, in its current form:

15-6-218. Intangible personal property exemption. (1) Intangible personal property is exempt from taxation.

(2) For the purposes of this section, “intangible personal property” means personal property that is not tangible personal property and that:

(a) has no intrinsic value but is the representative or evidence of value, including but not limited to certificates of stock, bonds, promissory notes, licenses, copyrights, patents, trademarks, contracts, software, and franchises; or

(b) lacks physical existence, including but not limited to goodwill.

(3) To the extent that the unit value of centrally assessed property includes intangible personal property, that value must be removed from the unit value.

In December 2010, the Department adopted new rules, along with the rules described above, dealing with intangible property. The rules (ARM 42.22.101) provided that intangible personal property has the following attributes:

- Intangible personal property must be separable from the other assets in the unit and capable of being held under separate title or ownership.
- Intangible personal property must be able to be bought and sold, separate from the unit of operating assets, without causing harm, destroying, or otherwise impairing the value of the unit of assets being valued through the appraisal process.
- Intangible personal property must have value as a result of its ability to create earnings that exceeds its contributory value to the unit; or, it must be capable of earning an income as a stand-alone entity or apart from the other assets of the unit.
- Intangible personal property is not the same as intangible value. Intangible value is the value of an entity as a going concern — its ability to make excess revenues over the normal rate of return. Intangible value is part of the overall value of assets. Intangible value is not exempt from property taxation in Montana.

The rules also provide a definition of goodwill:

- “Goodwill” means booked or accounting goodwill. The booked goodwill must be present on the subject properties’ financial statements, and must have been created through the purchase price accounting process as defined by GAAP or other accounting authority (ARM 42.22.101).

The Department of Revenue amended ARM 42.22.101 effective September 19, 2014, to remove the definitions of “goodwill” and “intangible personal property”. The reason for the removal was to comply with the decision in *Gold Creek Cellular of Mont. L.P. v. Dept. of Revenue* (2013 MT 273), which held that the definitions of “goodwill” and “intangible personal property” were in conflict with 15-6-218, MCA.²⁴

Department rules (42.22.110) also establish percentages for determining the value of exempt tangible property for centrally assessed property:

Exemption Percentage for Intangible Personal Property			
Type of Property	Cost Indicator	Income Indicator	Market Indicator
Airlines	10%	10%	10%
Pipelines	5%	5%	5%
Electric Cooperatives	5%	5%	5%
Telephone Cooperatives	5%	5%	5%
Electric Utilities	10%	10%	10%
Telecommunications	15%	15%	15%

If a railroad is assessed according to the provisions of 15-23-205, MCA, the amount of intangible property deducted from the system value of the railroad is equal to 5% of the system value. If the railroad is assessed using cost, income, and market indicators of value (e.g., a new railroad), 5% of the value of each indicator reflects the value of intangible property for each indicator.

Finally, the rules allow a taxpayer to recommend to the Department at any time a higher deduction for intangible personal property. Previously, the Department and centrally assessed taxpayers were supposed to review the percentage deductions every 2 years.

²⁴ For detailed discussion see Jaret Coles, Legislative staff attorney, “Court Decisions on the Treatment of Intangible Personal Property,” March 2016. Available on the Revenue and Transportation Interim Committee webpage at <http://leg.mt.gov/content/Committees/Interim/2015-2016/Revenue-and-Transportation/Meetings/March-2016/court-dec-treatment-intang-property.pdf>.