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HJ 35 Tax Study

66th Montana Legislature

TO: HJ 35 Study Committee Members

FROM: Jaret Coles, Staff Attorney, and the Legal Services Office[1]

RE: Constitutional Property Tax Parameters

DATE: January 10, 2020

The Montana Constitution establishes the limits on legislative authority for legislative action. The general rule is that the Constitution is a limit and not a grant of legislative authority. *State ex rel. Evans v. Stewart*, 53 Mont. 18, 161 P. 309 (1916).

Sections 1 through 5 and 7 of Article VIII of the Montana Constitution establish the framework within which the Montana property tax system must function. In the following portion of this memorandum, each pertinent section of Article VIII of the Montana Constitution will be followed by a general discussion with references to appropriate decisions.

Section 1. Tax purposes. Taxes shall be levied by general laws for public purposes.

The requirement that taxes be levied by general laws is essentially a restatement of the requirement for all laws contained in Article V, section 12, of the Montana Constitution. That section provides that the Legislature may not pass a special or local law when a general law can be made applicable.

In *Grossman v. State*, 209 Mont. 427, 682 P.2d 1319 (1984), the Montana Supreme Court reviewed the plan of using coal severance tax income to service bonds for loans to local governments for water systems and determined that the plan affected the inhabitants of the

[1] The majority of this memorandum is an update of a Jan. 12, 2004, memorandum from Greg Petesch, former director of legal services for the Montana Legislative Services Division and Lee Heiman, former staff attorney for the Montana Legislative Services Division. See Greg Petesch and Lee Heiman, "Memo to Joint Meeting of Tax Reform Study Committee and Property Tax Reappraisal Study Committee," Jan. 12, 2004.

particular areas as communities and not merely as individuals. The Court noted that the Legislature could not draft a general act of statewide application providing for the issuance and sale of revenue bonds and at the same time keep a handle on the way the proceeds were spent or loaned except through the direct authorization of projects. The Court determined that because no class of governmental entity was excluded, the law was "general" legislation within the meaning of the Montana Constitution.

The *Grossman* Court also held that the question of whether a particular purpose for which taxes may be levied and collected is a public purpose is for the Legislature to decide in the first instance, and the courts will indulge every reasonable presumption in favor of the legislative decision. The use of the loan proceeds was clearly for public purposes.

However, the use of in-state investment fund money derived from taxation to guarantee loans or bonds of private individuals or private entities, either directly or through the capital reserve account or through the economic development guaranty fund, was found not to be a public purpose in *Hollow v. State*, 222 Mont. 478, 723 P.2d 227 (1986).

The words "public purposes" were found to be synonymous with "governmental purposes" in *State ex rel. Mills v. Dixon*, 66 Mont. 76, 213 P. 227 (1923). While courts are generally deferential to legislatures in the area of determining public purpose, the Hollow case indicates that the Montana Supreme Court will carefully scrutinize the legislative determination of what constitutes a public purpose.

Section 2. Tax power inalienable. The power to tax shall never be surrendered, suspended, or contracted away.

This section essentially states that the power to tax is a fundamental governmental power.

After the Legislature enacted Chapter 823, Laws of 1991, to tax retirement pension benefits that had previously been untaxed, the retirees sued, claiming that they had a contractual right to a continued exemption from taxation. The Supreme Court held that the former tax exemption was only a policy statement that could be changed by the Legislature and that the Legislature did not clearly manifest an intention in the law in question to create a private contractual right. Additionally, the Supreme Court held that the state was prohibited by this section from promising any group of taxpayers that it would never tax them. *Sheehy v. Public Employees Retirement Division*, 262 Mont. 129, 864 P.2d 762 (1993).

This section was also interpreted in light of the referendum to suspend the income tax increase that would have resulted from the defeat of the sales tax. After enough petition signatures had been gathered on an income tax increase passed by the Legislature to suspend the increase and refer it to the people for a vote, a suit was filed, claiming that the suspension of the law constituted a surrender of the legislative power of taxation. The Supreme Court held that it would not apply case law from other states cited by the plaintiffs and that the referendum simply resulted in the suspension of one law by which the taxing power was exercised. The Court also noted that in any event, as pointed out by the District Court, the state was still collecting taxes

and would continue to do so no matter which law was ultimately effective after the vote of the people. *Nicholson v. Cooney*, 265 Mont. 406, 877 P.2d 486 (1994).

Section 3. Property tax administration. The state shall appraise, assess, and equalize the valuation of all property which is to be taxed in the manner provided by law.

This section is the crux of the property tax system in Montana and has been the subject of most of the litigation concerning property taxes. The 1972 Montana Constitution revised Article XII, section 15, of the 1889 Montana Constitution by removing references to county boards of equalization and the state board of equalization. These changes left the Legislature free to determine the method of securing property tax administration. Chapter 405, Laws of 1973, transferred the powers and duties of the State Board of Equalization to the Department of Revenue and the State Tax Appeal Board. In *Department of Revenue v. Burlington Northern, Inc.*, 169 Mont. 202, 545 P.2d 1083 (1976), the Montana Supreme Court held that the State Board of Equalization's administrative functions were transferred to the Department of Revenue, while the appellate functions were transferred to the State Tax Appeal Board.

Article VIII, section 3, of the Montana Constitution has several component parts, all of which are critical to any system of property taxation. The first requirement imposes a duty on the state to administer the property tax system. This change of duty was referred to in the statement of intent attached to Chapter 27, Special Laws of 1993. It stated that with the adoption of the 1972 Montana Constitution, the state assumed responsibility for the appraisal, assessment, and valuation of property for property tax administration. Although the state was granted this new responsibility and authority by the Constitution, county assessors were retained by local governments to assist the state in the assessment function, acting as agents of the Department of Revenue. After the enactment of Chapter 27, Special Laws of 1993, all appraisal and assessment duties relating to property taxation were assigned to the Department of Revenue. The responsibility and authority to perform any assessment functions were transferred from the county assessors to the Department of Revenue.

The second requirement of this section is that the state appraise property subject to taxation. Appraisal is the setting of a value for property tax purposes. The appraisal of property is governed by Title 15, chapter 7, MCA. The third requirement of this section is that the state assess property subject to taxation. Assessment is the setting of the estimated value of property for purposes of taxation and the setting of the amount of a tax. The assessment of property is governed by Title 15, chapter 8, MCA. The fourth requirement of this section is that the state equalize the valuation of property subject to taxation. These requirements have been the major areas of contention in the property tax arena.

There has been a great deal of litigation over the requirements of this section. It is important to note that appraised value and assessed value are synonymous under Montana law. See section 15-8-111, MCA.

Prior to the adoption of the 1972 Montana Constitution, the appraisal, assessment, and taxation of property in Montana was largely in the hands of county officials subject to supervision,

appeal, and equalization by the State Board of Equalization. Although property values were by law subject to a continuous process of revision, there was a considerable variation in performance among counties in keeping valuations current. After the adoption of the 1972 Montana Constitution, the Department of Revenue assumed jurisdiction over the property tax system.

In early 1975 the reappraisal of property in Lewis and Clark County was declared unconstitutional as violating equal protection, due process, and uniformity requirements in *Larson v. State*, 166 Mont. 449, 534 P.2d 854 (1975). The *Larson* decision was premised on the basis that because there was no statewide plan in place, the county reappraisal would result in a disproportionate tax burden in Lewis and Clark County as compared to the rest of the state.

In 1975, the Legislature enacted Chapter 294, Laws of 1975, requiring the Department to administer and supervise a program for the revaluation of all taxable property in Montana at least every 5 years, including the adoption of a comprehensive written plan of rotation fixing the order of revaluation in each county on the basis of the last revaluation of property in each county. The plan was intended to adjust disparities among counties. The plan was to provide that all property in each county be revalued every 5 years or that 20% of the property in each county be revalued each year. Chapter 294 also required that the same method of appraisal and assessment be used in each county so that at the end of each 5-year cycle, comparable property with similar market values would have substantially equal taxable values. The appraisal plan and its implementing legislation were found constitutional in *Patterson v. Department of Revenue*, 171 Mont. 168, 557 P.2d 798 (1976). The *Patterson* Court stated that violation of statutory uniformity requirements generally results in violation of equal protection and due process requirements. The Court noted that all like property was appraised by a uniform standard under the plan according to uniform procedures set forth in the same designated manual. The appraisal rotation was fixed by a uniform rule requiring that property that had gone the longest since appraisal was to be appraised first and that all property was required to be appraised by the end of the 5-year cycle. The uniform rule for determining the reappraisal rotation and the type and amount of property to be appraised in each year in each county was all that was required to meet uniformity requirements.

The next cycle of revaluation began in 1978 and was scheduled for completion in 1983. The cycle was extended until 1985 by the 1981 Legislature. During the cycle commencing in 1978, the appraisal of class four property was done pursuant to the valuation guidelines from two appraisal manuals. Residential property was appraised from the 1972 Montana Appraisal Manual, and commercial property was appraised from the 1976 Marshall-Swift Appraisal Manual. The use of the different manuals resulted in valuations that were not always comparable for similar class four property across the state. The Marshall-Swift values tended to be much higher. This use of different manuals generated what became known as the 34% controversy.

A group of taxpayers applied to the Cascade County Tax Appeal Board for a reduction in the valuation of their commercial property. The County Tax Appeal Board denied relief, and the taxpayers appealed to the State Tax Appeal Board. The State Tax Appeal Board ordered the Department of Revenue to reduce all contested valuations by 34%. The Department appealed to the District Court, which affirmed the State Tax Appeal Board. The Department then appealed to the Montana Supreme Court. The Supreme Court determined that the State Tax Appeal Board

had the authority to order the reductions. The Court stated that where it is impossible to secure both the standard of the true value of a taxpayer's property and the uniformity and equality in taxation required by law, the latter requirement is to be preferred as the just and ultimate purpose of the law. Therefore, unequal appraisals may be reduced even though they result in an assessment as true market value or 100% of market value as required by section 15-8-111, MCA. Reduction in valuation is required where it is satisfactorily shown that under the system as applied, it is impossible to meet both the true value and equality standards. *Department of Revenue v. State Tax Appeal Board*, 188 Mont. 244, 613 P.2d 691 (1980). However, the Supreme Court also held that in order to obtain relief on the ground that property is assessed inequitably, it is essential that the taxpayer prove: (1) that there are several other properties within a reasonable area comparable to the taxpayer's; (2) the amount of assessments on these properties; (3) the actual value of the comparable properties; (4) the actual value of the taxpayer's property; (5) the assessment complained of; and (6) that by comparison the taxpayer's property is assessed at a higher proportion of its actual value than are the comparable properties, thereby creating discriminations. These criteria are among those to be used in a comparison of true value to assessed value ratios. Where the criteria were not followed and no ratio comparisons made, the State Tax Appeal Board's blanket reduction of 34% on commercial improvement appraisals was set aside. *Department of Revenue v. State Tax Appeal Board*, 188 Mont. 244, 613 P.2d 691 (1980), followed in *Devoe v. Department of Revenue*, 233 Mont. 190, 759 P.2d 991 (1988). The Supreme Court remanded the case to the District Court. The taxpayers renewed their protest, and in 1980, the Cascade County Tax Appeal Board granted several taxpayers a 34% reduction from their 1978 assessed values for the remainder of the appraisal cycle. The Department of Revenue did not appeal the decision. The Department of Revenue then determined that statewide, the commercial valuations averaged 12% higher than the residential valuations and ordered each county assessor to reduce all commercial valuations by 12%. This resulted in a 22% increase for the Cascade County taxpayers who had been granted the 34% reductions by the State Tax Appeal Board. The taxpayers challenged the Department's action. The Supreme Court held that the Department of Revenue properly assumed the responsibility of solving the problem and in equalizing the valuations. In acting in the manner that it did, the Department was acting under its constitutional mandate and authority to equalize values of taxable property. The 12% reduction did not constitute a reappraisal. The power and duty to equalize included the power to alter appraised values that were set at the beginning of an appraisal cycle. *Hanley v. Department of Revenue*, 207 Mont. 302, 673 P.2d 1257 (1983).

This solution apparently temporarily ended the appraisal dispute. The next 5-year reappraisal cycle began in 1986. The cycle was to end December 31, 1992, and a new cycle was to commence January 1, 1993. In 1987, the Legislature enacted Chapter 613, Laws of 1987, requiring the Department of Revenue to conduct a sales assessment ratio study for the purpose of annually determining the correct assessment level for similar property located in specific areas of the state. The 1989 Legislature enacted Chapter 636, Laws of 1989, revising the sales assessment ratio study procedures, required the Department of Revenue to publish the results of the studies, and revised the reappraisal plan requirements. The Legislature also extended the reappraisal cycle for 2 years. The Department was directed to partition the state into as many as 100 areas of residential property and as many as 20 areas of commercial property. The areas were to be studied separately. The actual sales prices of real property sold for 3 tax years prior to the study were compared with their appraised values at the time, and a ratio was determined. If

the average appraised values of the properties in the study when compared to the average of the actual sales amounts were less than 95% or more than 105%, the assessments within each area were to be adjusted to bring all ratios to the common value of 1. Detailed methods for conducting the studies were contained in the 1989 amendments. The studies were to commence on January 1, 1990, and were to continue for succeeding tax years. Patricia Barron, a resident of Great Falls, had her valuation increased from $28,019 to $40,325 based on the sales assessment ratio study for the area. Ms. Barron appealed to the Cascade County Tax Appeal Board contesting the constitutionality of the adjustment. The Board denied the appeal, noting that an error had been found and that the Department of Revenue would correct the valuation. An appeal was taken to the State Tax Appeal Board. The Board determined that equalization of values had not been achieved. Before the sales assessment ratio study adjustment to values, 40 of the 243 properties were overappraised and 203 were underappraised. After the adjustment, 102 properties were overappraised and 141 were underappraised. The Board noted that even after a 30% adjustment to the valuation of the Barron property, it was still appraised at only 51% of its purchase price of $75,000. The Board determined that the Barron property should be assessed at $75,000. The Board then went on to state that in its opinion, Chapter 636, Laws of 1989, was unconstitutional for failure to achieve equalization of values. The Department of Revenue then commenced an original proceeding in the Supreme Court challenging the State Tax Appeal Board ruling. The Montana Supreme Court held that the sales assessment ratio study formerly contained in section 15-7-111, MCA, offended state constitutional principles. The Court explained that the use of 1990 tax values derived from the stratified sales assessment ratio study and the subsequent application of a percentage factor to certain residential properties, which in 1989 were assessed or appraised at or above their true market values, resulted in unfair discrimination by requiring those property owners to bear a disproportionate share of the state tax burden in violation of the equal protection and due process requirements of both the United States and Montana Constitutions. The Court further found that application of the ratio violated statutory appraisal provisions requiring general and uniform appraisal, assessment, and equalization of all taxable property in the state. The application of the Court's order was prospectively continued to December 31, 1990, to allow collection of 1990 taxes. *Department of Revenue v. Barron*, 245 Mont. 100, 799 P.2d 533 (1990). *Barron* was followed in *DeVoe v. Department of Revenue*, 263 Mont. 100, 866 P.2d 228 (1993).

After the Supreme Court's decision in *Barron*, the 1991 Legislature enacted Chapter 680, Laws of 1991, amending section 15-7-111, MCA, to require the Department of Revenue to use a stratified sales assessment ratio study to adjust property values in a given district during an appraisal cycle. The legislation also provided for a right to appeal adjusted values and for shorter appraisal cycles. The Department of Revenue divided the state into 48 districts. The sales assessment ratio for the urban Helena area resulted in a 4% adjustment of appraised values. Prior to the adjustment, 39 of the 249 properties sold in the assessment study were overappraised, 162 properties were underappraised, and 48 fell within the 95% to 105% of sales price range. After the adjustment, 58 properties were overappraised, 123 properties were underappraised, and 68 fell within the 95% to 105% of sales price range. When expanded to the entire 20,535 parcels in the district, 49.4% would remain underappraised. Sheehys appealed the tax assessment on their property to the County Tax Appeal Board. The County Tax Appeal Board denied the appeal. Sheehys then appealed to the State Tax Appeal Board. The State Tax Appeal Board ruled in favor of the Sheehys. The Department of Revenue then filed a petition for

judicial review. In the meantime, *Barron* was decided. The District Court affirmed the decision of the State Tax Appeal Board. The Department appealed to the Supreme Court. The Department contended that the appeal provided for in Chapter 680, Laws of 1991, adequately addressed the *Barron* decision. The Montana Supreme Court held that even with the changes made by Chapter 680, Laws of 1991, the stratified sales assessment ratio study adjustment failed to meet constitutional muster. Instead of the 30% factor considered in *Barron*, the Department was using a 4% factor. The method may have achieved equalization between areas, but did not achieve equalization between individual properties where inequities already existed. The statutes were found to deny equal protection. *Department of Revenue v. Sheehy*, 262 Mont. 104, 862 P.2d 1181 (1993).

The Department of Revenue had begun the next cycle of revaluation or reappraisal of property in 1987 and completed the cycle on December 31, 1992. As part of the reappraisal plan, the Department for the first time used a computer-assisted mass appraisal system. The system uses its files of property assessment data to produce computer-assisted valuations for residential, agricultural, commercial, and industrial property. The system uses three approaches to valuation, the cost approach, the market data approach, and the income approach. The cost approach involves estimating the depreciated cost of reproducing or replacing the building and site improvements. The estimated value of land is added to the depreciated cost. This approach is used where there is lack of market and income data. The market data approach involves the compilation of sales and offerings of property that are comparable to the property being appraised. The sales and offerings are adjusted for dissimilarities and a value range is obtained by the comparison of the properties. The income approach measures the present worth of the future benefits of the property by the capitalization of the net income stream over the remaining economic life of the property. The approach involves making an estimate of the "effective gross income" of a property, derived by deducting the appropriate vacancy and collection losses from its estimated economic rent, as evidenced by the yield of comparable properties. Applicable operating expenses are then deducted, resulting in an estimate of net income that may be capitalized into an indication of value.

In December 1993, a group of taxpayers commenced a class action suit to challenge the constitutionality of the statewide appraisal of residential and commercial property conducted by the Department of Revenue using the computer-assisted mass appraisal system. The District Court found for the taxpayers and held that using more than one method of appraisal had resulted in the failure to equalize values as required by Article VIII, section 3, of the Montana Constitution. On appeal, the Montana Supreme Court reversed the decision, finding that perfection in the field of valuation is unattainable. The Supreme Court determined that the use of the market data approach, income approach, cost approach, or some combination of approaches was a reasonable attempt to equalize appraisal of real property throughout the state. *Albright v. State*, 281 Mont. 196, 933 P.2d 815 (1997). See also *Ostergren v. Department of Revenue*, 2004 MT 30, 319 Mont. 405, 85 P.3d 738 (2004). The Court noted that three themes were prevalent in the Constitutional Convention debate concerning Article VIII, section 3, of the Montana Constitution: (1) equalization between counties; (2) flexibility so that the Legislature would be able to define means of taxation; and (3) more than one approach was permissible as a legitimate means of determining value (market data approach and income approach).

The Court distinguished the current valuation system from the nonuniform application of stratified sales assessment ratios (no new appraisal) found invalid in *Sheehy* and *Barron*. The Court upheld the valuation system.

The 1997 Legislature then enacted Senate Bill No. 195, as Chapter 463, Laws of 1997. Chapter 463 phased in changes in reappraisal values by 2% a year for residential and commercial land and improvements (class four property), agricultural land (class three property), and forest land (class ten property). Chapter 463, Laws of 1997, also provided for the valuation and phasing in of the value of new construction and reduced the tax rate applied to class three and class four property by 0.022 percentage points each year. The legislation suspended the 1997 tax year statutory deadlines related to property taxation (i.e., appraisals, assessments, reimbursements, taxing unit budgets, and the collection of property taxes). It also delayed the next reappraisal cycle for class three, four, and ten property until 2007 (subsequently changed to 2003 by Chapter 584, Laws of 1999) and clarified that all other classes of property must be revalued annually. The legislation revised the property tax limitations under Initiative Measure No. 105 by changing the exceptions to the limitations and by changing the base year from 1986 to 1996 and provided methods for the voters of a taxing unit to approve an increase in property taxes. The legislation also created a committee to study all aspects of the state property tax system.

The Legislature made a variety of changes in the 1999 through 2013 sessions.[2] Importantly, the 1999 Legislature enacted Senate Bill No. 184, as Chapter 584, Laws of 1999. Chapter 584 revised the appraisal cycle for residential and commercial land and improvements (class four property), agricultural land (class three property), and forest land (class ten property) from three years to six years starting in 2003, with a phase-in of 16.66% per year. The 2009 Legislature enacted House Bill No. 658, as Chapter 483, Laws of 2009, which created another 6-year cycle for tax years 2009 through 2014.

The constitutional validity of the 6-year cycle was eventually challenged when the value of a company's investment property significantly declined in the year following its tax appraisal. After the Department of Revenue refused to conduct a midcycle reevaluation of the property, the company argued that the Department of Revenue should conduct a midcycle reevaluation to relieve it from paying taxes based on an inflated value of the property and that the failure to do so subjected the company to disparate treatment in violation of its equal protection rights. The District Court agreed and ordered the Department to conduct a midcycle reevaluation. The Department appealed and the Supreme Court reversed, concluding that a 6-year cyclical plan of reappraisal does not violate a taxpayer's rights when the property depreciates in value during the cycle because the Montana Constitution requires only a periodic attainment of equality of tax treatment. The Court also determined that the District Court had improperly exercised legislative authority in ordering the Department to conduct a reevaluation. *Covenant Investments, Inc. v. Department of Revenue*, 2013 MT 215, 371 Mont. 186, 308 P.3d 54.

A claim that the Department of Revenue failed to equalize valuations was considered in 2013. The plaintiff refinery claimed that tax valuations for its refinery were higher than for other refineries in Yellowstone County. The plaintiff alleged that the Department of Revenue had

[2] For a detailed description of statutory changes after the 1997 Legislative Session, see Megan Moore, Montana Legislative Services Division, Property Tax History, January 2020.

failed to equalize its valuation of the plaintiff's property in violation of Article VIII, section 3, of the Montana Constitution. However, the Department of Revenue established that it used the same method of valuation for all three properties, and the plaintiff failed to establish any issues of material fact showing that the Department of Revenue had acted illegally or improperly. Thus, the Supreme Court affirmed summary judgment for the Department of Revenue on the claim, finding that the action was not within the scope of declaratory actions under section 15-1-406, MCA, without first appealing to administrative tax appeal boards. *CHS, Inc. v. Department of Revenue*, 2013 MT 100, 369 Mont. 505, 299 P.3d 813.

In 2015, the Legislature enacted Senate Bill No. 157, as Chapter 361, Laws of 2015. Chapter 361 made significant changes to residential and commercial land and improvements (class four property) and agricultural land (class three property) by revising the reappraisal cycle for these classes from a 6-year cycle to a 2-year cycle starting in tax year 2015. Additionally, the various homestead and comstead exemptions were removed.

It is our opinion, based upon the analysis of the cited decisions, that Article VIII, section 3, of the Montana Constitution simply requires the state to uniformly administer a method of valuing similar property so that equal valuation is achieved. In *Department of Revenue v. State Tax Appeal Board*,188 Mont. 244, 613 P.2d 691 (1980), the Court held that where it is impossible to secure both the standard of the true value of a taxpayer's property and the uniformity and equality in taxation required by law, the latter requirement is to be preferred as the just and ultimate purpose of the law. Therefore, unequal appraisals may be reduced even though they were an assessment at true market value or 100% of market value as required by section 15-8-111, MCA. Reduction in valuation is required where it is satisfactorily shown that, under the system as applied, it is impossible to meet both the true value and equality standards.

Section 4. Equal valuation. All taxing jurisdictions shall use the assessed valuation of property established by the state.

This section is similar to Article XII, section 5, of the 1889 Montana Constitution. It is intended to guarantee that the same assessed values will be used by all taxing authorities.

Section 5. Property tax exemptions. (1) The legislature may exempt from taxation:

(a) Property of the United States, the state, counties, cities, towns, school districts, municipal corporations, and public libraries, but any private interest in such property may be taxed separately.

(b) Institutions of purely public charity, hospitals and places of burial not used or held for private or corporate profit, places for actual religious worship, and property used exclusively for educational purposes.

(c) Any other classes of property.

(2) The legislature may authorize creation of special improvement districts for capital improvements and the maintenance thereof. It may authorize the assessment of charges for such improvements and maintenance against tax exempt property directly benefited thereby.

This section was a substantial revision of the 1889 Montana Constitution. The 1889 Montana Constitution required that property be listed in Article XII, section 2, of the 1889 Montana Constitution in order to be exempt. Under the 1972 Montana Constitution, all exemptions are at the discretion of the Legislature. The section also specifically permits taxation of private interests in government-owned property and the assessment of special improvement district charges on tax-exempt property.

The Court has developed a policy of strict construction of exemptions. Where a church owned land, adjacent to the church, that was used for a church road and recreational activities of church members, the District Court erred, in a quiet title action brought by the church, in denying a tax exemption for the land actually used for the road providing access to the church. However, as there was no direct evidence of the use for church purposes of the other undeveloped property adjacent to the road and church, the Supreme Court strictly construed the tax exemption laws to deny an exemption for the other undeveloped property. *Old Fashion Baptist Church v. Department of Revenue*, 206 Mont. 451, 671 P.2d 625 (1983).

Exemptions have also played a role in taxing the beneficial use of tax-exempt property. Investor-owned utility companies used portions of federally owned power lines located in Montana to transmit electrical power to out-of-state users. The companies argued that their interest in the power lines did not give them the right to possession and control and therefore was not an interest that was subject to a beneficial use tax. The Supreme Court disagreed, stating that what was involved was a private contractual right to use a portion of the transmission capacity of the exempt federal power line. The contract right clearly fit into the state constitutional language establishing that any private interest in property may be taxed separately. *Pacific Power & Light Co. v. Department of Revenue,* 237 Mont. 77, 773 P.2d 1176 (1989).

Section 7. Tax appeals. The legislature shall provide independent appeal procedures for taxpayer grievances about appraisals, assessments, equalization, and taxes. The legislature shall include a review procedure at the local government unit level.

This section was a new provision in the 1972 Montana Constitution. The Legislature has implemented this section through the County Tax Appeal Board and the State Tax Appeal Board process. County Tax Appeal Board procedures are contained in Title 15, chapter 15, MCA, and State Tax Appeal Board procedures are contained in Title 15, chapter 2, part 3, MCA.

The Legislature determined that the County Tax Appeal Board provides the review procedure at the local government unit level mandated by Article VIII, section 7, of the Montana Constitution. An appeal and review before the local board is a condition precedent to a State Tax Appeal Board review. Except in cases where fraud or the adoption of a fundamentally wrong principle of assessment is shown, an appeal to the local board is the exclusive remedy granted the taxpayer. If a taxpayer is denied a hearing before the local board because of a late assessment, the assessment is invalid because it denies the taxpayer a constitutional right to a hearing before the local board. *Butte Country Club v. Department of Revenue*, 186 Mont. 424, 608 P.2d 111 (1980).

Section 15-7-102, MCA, gives the State Tax Appeal Board specific power to hear tax appraisal appeals, including the power to pass judgment on appraisal methods. *Department of Revenue v. State Tax Appeal Board*, 188 Mont. 244, 613 P.2d 691 (1980).

The role of the various entities was discussed in a 1983 case. A company appealed a property appraisal to the County Tax Appeal Board, the State Tax Appeal Board, the District Court, and the Supreme Court, who all reached the same result. The Supreme Court said that it is not a judicial function to act as an authority on taxation matters. The Court will not evaluate the advantages and disadvantages of a particular assessment method as applied to a taxpayer. Tax appeal boards are particularly suited for settling disputes over the appropriate valuation of a given piece of property or a particular improvement, and the judiciary cannot properly interfere with that function. *NW. Land & Development of Montana, Inc. v. State Tax Appeal Board*, 203 Mont. 313, 661 P.2d 44 (1983), followed in *United Grain Corp. v. Department of Revenue*, 248 Mont. 297, 811 P.2d 555 (1991), and partially overruled in *DeVoe v. Department of Revenue*, 263 Mont. 100, 866 P.2d 228 (1993). In *DeVoe*, a taxpayer presented evidence of market value, but the State Tax Appeal Board refused to consider the evidence in a commercial property tax appeal. Citing *Department of Revenue v. Paxson*, 205 Mont. 194, 666 P.2d 768 (1983), the Supreme Court held that the Board was required to consider the theory and figures offered by a taxpayer, although not bound to adopt them, and that to refuse to accept a taxpayer's appraisal was an abuse of discretion. In *Paxson*, the Department of Revenue assessed Paxson's land for tax purposes. Paxson contended that the valuation was too high because part of the land was in a flood plain. The County Tax Appeal Board entered an order granting a 20% reduction in the assessment. This was upheld by the State Tax Appeal Board. The District Court concluded that the 20% reduction was arbitrary and capricious since no evidence was contained in the record to support this figure. The Court then adopted Paxson's theory of reduction and figures. On appeal, the Supreme Court upheld the overturning of the 20% reduction as not supported by the evidence but vacated the District Court's order and remanded the case to the State Tax Appeal Board. The Supreme Court held that the responsibility of fact finding and arriving at the proper taxable valuation is the function of the administrative bodies and not the courts.

The authority of the State Tax Appeal Board to independently assess a taxpayer's market value was discussed in a 2011 case. Puget Sound Energy appealed the Department of Revenue's final assessment of Puget to the State Tax Appeal Board. The Board, in turn, concluded that the Department erred and assessed Puget's value in excess of the Department of Revenue's assessment. Puget petitioned the District Court for review, arguing that the State Tax Appeal Board lacked authority to adopt an assessment that exceeded the Department's original assessment and violated Puget's due process rights. The District Court agreed. On appeal, the Supreme Court reversed the District Court. Appeals to the State Tax Appeal Board, in accordance with Section 7 of Article VIII of the Montana Constitution differ depending on whether the appeal is from the County Tax Appeal Board, pursuant to section 15-2-301, MCA, or is brought directly from a Department of Revenue decision, pursuant to section 15-2-302, MCA. Because Puget appealed directly, the State Tax Appeal Board was the factfinding tribunal and had authority to adopt assessments in excess of the Department of Revenue's original assessments. Section 15-8-111(1), MCA, mandates that all property must be assessed at 100% of its market value and applies equally to the Department and to the State Tax Appeal Board. The Department of Revenue error did not create an exception for the State Tax Appeal Board to

assess a taxpayer's property at less than 100% of its market value. Puget's due process claim lacked merit, as it placed the determination of ultimate market value before the State Tax Appeal Board. *Puget Sound Energy, Inc. v. Department of Revenue*, 2011 MT 141, 361 Mont. 39, 255 P.3d 171.

OTHER CONSTITUTIONAL CONCERNS

Equal Protection

In addition to the provisions of Article VIII of the Montana Constitution, the equal protection clause contained in Article II, section 4, of the Montana Constitution, and the due process clause contained in Article II, section 17, of the Montana Constitution also apply to property taxation. The equal protection clause essentially requires that similarly situated individuals and entities be treated in the same manner. In the area of taxation, the Legislature is required to have a rational basis for its action. *Montana Stockgrowers Association v. State*, 238 Mont. 113, 777 P.2d 285 (1989), followed in *GBN, Inc. v. Department of Revenue*, 249 Mont. 261, 815 P.2d 595 (1991).

A taxpayer whose property value decreased as a result of the 1997 reappraisal filed suit over the 2% phasein of changes of property values set forth in section 15-1-111(1), MCA. Taxpayers who had an increase in property values because of reappraisal had the effects of the increase mitigated because of the 2% annual phasein, but taxpayers suffering a decrease in property value just realized a phased-in portion of the decrease. In *Roosevelt v. Dept. of Revenue*, 1999 MT 30, 293 Mont. 240, 975 P.2d 295 (1999), the Supreme Court held 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 property taxes based on the actual or less than actual value of the property causes the property owners in the first class to "bear a disproportionate share of Montana's tax burden" in violation of equal protection under the Montana Constitution (quoting from *Barron*). The Court said that there was no rational basis for the state to impose property taxes in that manner. The Court declared that section 15-1-111(1), MCA, as applied to this taxpayer, was unconstitutional and that the taxpayer was entitled to be assessed at the actual 1997 market value of the property. The Court specifically declined to rule on the constitutionality relating to the class of property owners who are paying taxes based on the market value of their property (those whose value did not change because of reappraisal) and the class of taxpayers who were paying property taxes based upon less than the actual value of their property (those whose value was being phased in to the 1997 value at 2% a year). Both the decision and dissent addressed the problems of equality of valuation in tax treatment, but noted that if the equality is corrected within a reasonable time, no constitutional harm occurred.

In 2002, an equal protection analysis was applied to vocational-technical school levies. Plaintiffs challenged the constitutionality of section 20-25-439, MCA, asserting that the tax levy for vocational-technical schools resulted in an unequal tax burden on five counties where the schools are located, even though the schools are part of the statewide University System. The state contended that the levy is not unconstitutional because it is rationally related to a legitimate government purpose. The District Court found that the levy is constitutional because it is rationally related to the legitimate government interest of supporting the schools, in that the

schools provide specific benefits to their individual counties. The Supreme Court agreed that the rational basis analysis applied. The constitutional tax provisions in Article VIII, sections 1 and 3, of the Montana Constitution are broad directives whose specifics are left to the Legislature, so no constitutionally significant interests are implicated that require greater than a rational basis analysis. A tax classification under the rational basis test will be upheld if it is reasonable and not arbitrary and if it applies equally to all who fall within the same classification. A classification is not reasonable if it confers particular privileges or imposes particular disabilities on a class of persons arbitrarily selected from a larger number of persons, all of whom stand in the same relation to privileges conferred or disabilities imposed. Neither the uniformity doctrine nor equal protection prevents the state from making classifications that result in different state taxes among the various counties as long as the classifications are rationally related to a legitimate government purpose. Simply because other state taxes for education funding are assessed in every county does not mean that the Legislature is prohibited from creating subclasses for tax purposes. Attendance at vocational-technical schools by local residents and course offerings related to local interests serve as a rational basis for putting the five counties in a separate class for purposes of the levy. Counties with vocational-technical schools are not arbitrarily selected from the rest of the state because those counties do not stand in the same relation to the greater privileges conferred on those counties by the schools than the rest of the state, so the disability of the levy is rationally imposed. The constitutionality of 20-25-439 was affirmed. *Kottel v. State*, 2002 MT 278, 312 Mont. 387, 60 P.3d 403 (2002).

Classes of Property

The Legislature has classified property for purposes of taxation. Statutes that provided for the classification of property for purposes of taxation did not infringe upon the guarantee of the equal protection of the laws. *Hilger v. Moor*e, 56 Mont. 146, 182 P. 477 (1919). The Legislature may properly go even to the extent of placing identical articles in the hands of different owners in different classes, because different uses result in different productivity. A classification will be upheld if it has a reasonable relation to some permitted end of governmental action. *Wheir v. Dye*, 105 Mont. 347, 73 P.2d 209 (1937). However, where a classification results in discrimination, it is an unconstitutional exercise of the legislative function to classify property for taxation. *Victor Chemical Works v. Silver Bow County*, 130 Mont. 308, 301 P.2d 730 (1956).

Despite the Legislature's broad authority over classification, it is most likely a violation of equal protection provisions of the Montana Constitution to levy different mill levy rates on different classes of property within a jurisdiction.[3] The 1889 Montana Constitution, in Article XII, section 1, required that property taxes be levied under "a uniform rate of assessment and taxation", and Article XII, section 11, required that taxes be levied and collected by general laws and in a manner that was "uniform upon the same class of subjects within the territorial limits of the authority levying the tax". These two provisions became know as the "uniformity" provisions. In *Hilger v. Moore*, 56 Mont. 146, 182 P. 477 (1919), the Montana Supreme Court held that the uniformity of assessment was by class of property based upon the proportion of the property's

[3] For further analysis regarding this issue, see a staff attorney memorandum by Lee Heiman, Montana Legislative Services Division, Levying Different Property Tax Mills Against Different Classes of Property, Dec. 6, 2007.

"use, its productivity, its utility, its general setting in the economic organization of society" (56 Mont. at 173) . Property may be valued differently in different classes to recognize the different characteristics of the property. Other states with uniformity provisions have interpreted their provisions to disallow classes and require that all property be uniformly taxed based upon its market value and then taxed uniformly by each taxing jurisdiction with the same mill levy.

The revenue provisions in the Montana Constitution adopted in 1972 did not contain any uniformity language. The delegates excluded uniformity clauses and specifically recognized that the uniformity of taxation was required by the equal protection clause of the U.S. Constitution. See Verbatim Transcript Vol. II, pp. 579, 580, 582.

In *Powder River County v. State*, 2002 MT 259, 312 Mont. 198, 60 P.3d 357, the Montana Supreme Court specifically discussed the uniformity clauses of the 1889 Montana Constitution and how uniformity was to be applied under the 1972 Montana Constitution. At issue was a challenge to the legality of the Legislature's changes to the way oil, gas, and coal were taxed as enacted in the 1989 and 1995 sessions. The new form of taxation was no longer property tax based. Oil, gas, and coal were separately taxed, and the revenue was distributed to the state, local governments, and schools based upon formulas. The Court specifically stated that the uniformity principle established in *Hilger* was still the law in Montana:

> In other words, in order to secure a just valuation of all property, the method of assessing value must be uniform, and subsequently, after the property has been justly valued via a uniform method, property within the same class must be uniformly taxed, that is, taxed at the same percentage. *Id.* ¶ 52 (citing *Hilger,* 56 Mont. at 170, 182 P. at 481-82).

Uniformity allows classification to reflect the character of the property and thus allows different taxes per dollar of value of the taxed property. Uniformity does not allow different levies against different classes of property. The number of mills levied is based upon a political decision of the taxing entity with regard to all taxable property within the entity's jurisdiction.

State Residence of Taxpayer

Another area of constitutional concern is the treatment of nonresidents. Use of residency to classify persons is a matter of federal law under the U.S. Constitution. Classification based upon residency is prohibited by the privileges and immunities clause of the U.S. Constitution, Article IV, section 2. The U.S. Supreme Court in *Austin v. New Hampshire*, 420 U.S. 656, 43 L. Ed. 2d 530, 95 S. Ct. 1191 (1975), said that although the privileges and immunities clause does not guarantee precise equality of taxation between residents and nonresidents, the practical operation and effect of the tax must be examined, and a substantial equality of treatment of residents and nonresidents is required. Often discussed in privileges and immunities tax cases is the history of the clause: it was adopted because under the Articles of Confederation, each state was a taxing island imposing taxes on nonresidents in preference to residents. The other underlying theme behind prohibiting the use of state residency as a tax classification is that of representative democracy. Nonresidents are not represented in state legislatures, and thus there is no political check on taxation of them. Of course, a nonresident is subject to the same taxes as a resident,

and unless the taxation is transparently aimed at nonresidents, the tax revenue from nonresidents can be more than that collected against residents.

A twist on the privileges and immunities clause is the "fundamental rights" test set out in *Baldwin v. Fish and Game Commission of Montana*, 436 U.S. 371, 56 L. Ed. 2d 354, 98 S. Ct. 1852 (1978). The U.S. Supreme Court upheld Montana's imposition of a nonresident hunting license fee that was 7.5 times as much as a resident license. The Court held that hunting was a recreational activity that simply did not come within the purview of the protection of fundamental rights protected by the privileges and immunities clause. The Court did not provide any test for determining what those fundamental rights might be, but did include the right not to be deprived of a livelihood. How this doctrine extends to taxation has not been determined.

Often the matter of residence is a question of equal protection guarantees under the 14th amendment to the U.S. Constitution. For tax questions under the U.S. Constitution, in most cases, the courts use the "rational basis" test similar to that test under the Montana Constitution. For tax classifications based upon fundamental constitutional rights, a "compelling state interest" test is employed. Under the federal equal protection clause, fundamental rights are those rights explicitly or implicitly guaranteed by the U.S. Constitution and include the right to vote, the right to engage in interstate travel, and the right to speak. (See *Dunn v. Blumstein*, 405 U.S. 330, 31 L. Ed. 2d 274, 92 S. Ct. 995 (1972).) The right to travel and possibly the rights guaranteed by the privileges and immunities clause could be fundamental rights that the state could not use as tax classifications without a "compelling state interest".

SUMMARY

This is the property tax system that the Legislature has currently created. The methods involved in the appraisal system and the resulting valuations of property are constitutional. The Legislature has chosen to phase in the valuations. The property tax system remains burdened by the need to provide funding for the state's share of the basic system of education. The Legislature is free to act within the parameters discussed in this paper.

- Similarly situated individuals and entities must be treated in the same manner.
- A rational basis is required for classification of property.
- Taxes must be levied by general laws for public purposes.
- The valuation of property for tax purposes must be equalized.
- Valuation by uniform standards under a uniform plan results in equal values.
- Equality of values overrides true value of a particular property.
- Market value is a statutory and not a constitutional requirement.

- All jurisdictions must use values established by the state.
- An appeal procedure for valuation and taxes is required.
- Taxation cannot be based primarily the state residence of a taxpayer.

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