



Revenue and Transportation Interim Committee

PO BOX 201706
Helena, MT 59620-1706
(406) 444-3064
FAX (406) 444-3036

58th Montana Legislature

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February 11, 2004

TO: Revenue and Transportation Committee

FROM: Jeff Martin, Legislative Research Analyst

SUBJECT: Taxation of Class Eight Business Equipment

At its December 11, 2003, meeting, the Revenue and Transportation Committee reviewed the results of the first calculation of the so-called "trigger" to determine whether the tax rate on class eight business equipment would be reduced incrementally from 3% to 1% and then be exempt from property taxation. The Committee also discussed looking at whether there may be a better method for determining the trigger and, perhaps, looking at other issues related to the taxation of personal property. The purpose of this paper is to: summarize some significant legislative changes to the taxation of personal property; highlight some issues related to the current policy of taxing class eight property; and propose the review and analysis of some aspects related to the taxation of class eight property.

In 1987 there were 20 classes of property subject to taxation, including five separate classes of personal property (several other classes included real and personal property). The five classes of personal property were as follows (not an inclusive list of property by class):

- Class six property (taxed at 4% of market value) included livestock, certain unprocessed agricultural products, personal property valued at less than \$5,000 (subsequently raised to less than \$15,000) intended for lease, and (in 1989) malting barley facilities and certain canola seed oil processing facilities.
- Class eight property (taxed at 11% of market value) included agricultural, mining, and manufacturing personal property; trailers and trucks with a rated capacity of more than 1 1/2 tons; and personal property intended for lease.
- Class nine property (taxed at 13% of market value) included buses and trucks having a rated capacity of more than 3/4 of a ton but less than 1 1/2 tons, commercial furniture and fixtures, medical and dental equipment, and mobile telephones.

- Class ten property (taxed at 16% of market value) included radio and television broadcasting equipment, cable television systems, coal and ore haulers, and theater projectors and sound equipment.
- Class sixteen property (taxed at 11% of market value) included harness, saddlery, other tack equipment, and noncommercial personal property.

Beginning with the June 1989 Special Session, the Montana Legislature has made significant changes to the taxation of personal property. Listed below is a summary of some of those changes.¹

June 1989 Special Session

- House Bill No. 20 (Ch. 10, Sp. L. June 1989) combined several classes of personal property into property class eight and reduced the tax rate to 9%; classified certain canola seed oil processing facilities in property class six; and provided reimbursements to local taxing jurisdictions for lost property tax revenue.

1995 Regular Session

- Senate Bill No. 417 (Ch. 570, L. 1995) provided a 3-year, phased-in reduction of class eight property from 9% to 6% (the 6% rate applied in tax year 1998); provided a phased-out schedule of reimbursements to local taxing jurisdictions for lost property tax revenue; revised the reimbursement schedule to local taxing jurisdictions for the rate reductions of personal property enacted during the June 1989 Special Session to coincide with the phased-out reimbursement schedule in this legislation; and revised local bonding and debt limitation provisions.

1999 Regular Session

- Senate Bill No. 200 (Ch. 285, L. 1999) reduced the tax rate on class eight property from 6% to 3%; provided a phased-in rate reduction and exemption of class eight property if a "trigger" related to the growth in real wages and salaries was met in tax year 2004 or subsequent years; exempted an aggregate of \$5,000 or less of class eight property (beginning in tax year 2000); incrementally reduced the tax rate on class six property from 4% to 1%; exempted class six

¹The summary does not include legislation to exempt certain types of property (e.g., the exemption of the first \$15,000 or less of hand-held tools--House Bill No. 415 (CH. 576, L. 1980).

property (livestock, canola seed oil processing facilities, malting barley facilities, and certain equipment intended for rent or lease) from taxation beginning in tax year 2003; provided reimbursements to local governments for lost property tax revenue.²

2003 Regular Session

- Senate Bill No. 155 (Ch. 505, L. 2003) revised the calculation of the "trigger" for determining whether the class eight tax rate is to be reduced; and provided that the calculation be made at least 1 year and 2 months before the affected tax year to allow for legislative action.

Related Changes to the Taxation of Heavy Vehicles

- In 1997, the Montana Legislature enacted Senate Bill No. 57 (Ch. 496, L. 1997) to revise the taxation of light vehicles and heavy trucks and buses. In particular, heavy trucks and buses were exempted from personal property taxation and subject to a fee in lieu of tax based on the age and weight of the vehicle. The fee in lieu of tax was revenue neutral with respect to the class eight tax rate of 6% in 1998. In 2001, the Legislature enacted House Bill No. 247 (Ch. 500, L. 2001) to reduce the fee in lieu of tax on heavy vehicles by 50% over a 3-year period, beginning January 1, 2003. The overall reduction corresponded to the tax rate reduction in class eight property from 6% to 3%. The legislation also provided a reimbursement to local governments for the reduction in the fee in lieu of tax.

There are several issues related to the exemption of class eight property that the Committee may want to consider:

- In tax year 2002, class eight personal property accounted for about 6.9% of statewide taxable value. In some counties, particularly smaller counties, personal property accounts for a much larger percentage of the tax base. If the class eight trigger is met, the fiscal impact would be larger in those counties in which personal property accounts for more of the tax base.
- The rate reduction and exemption of class eight property would also affect the tax rate applied

²Senate Bill No. 184 (Ch. 584, L. 1999), generally revising the laws related to reappraisal and other property tax matters, eliminated the reimbursement mechanisms contained in several other tax bills, including House Bill No. 128 (revise taxation of telecommunication providers), House Bill No. 174 (revise taxation of electrical generation facilities), House Bill No. 420 (revise metal mines gross proceeds tax), House Bill No. 658 (exempt certain stripper well production from taxation), Senate Bill No. 200, and Senate Bill No. 530 (revise taxation of oil and gas production), and provided a consolidated reimbursement mechanism. House Bill No. 124 (Ch. 574, L. 2001) revised the laws governing local government and state revenue collection and allocation. The legislation included the consolidated reimbursements in Senate Bill No. 184 for revenue received in fiscal year 2001.

to class twelve railroad and airline property. Federal law³ prohibits imposing discriminatory taxes on these types of properties. The tax rate on class twelve property is the lesser of 12% or the weighted average tax rate applied to other commercial and industrial property. An interesting anomaly would occur if the class eight trigger is met. In the tax years that the class eight property tax is reduced, the tax rate on class twelve property would fall. However, when class eight becomes exempt, the tax rate on class twelve would increase, because the higher tax rates applied to class nine property (taxed at 12%) and class thirteen property (taxed at 6%) would become relatively more important in determining the tax rate on class twelve property.⁴

- The exemption from taxation of class eight property may cause taxpayers to challenge the taxation of personal property in other classes of property. If personal property in other classes of property were exempt, the fiscal impact to local governments and other taxpayers could be substantial.
- Reductions in personal property tax rates are generally advocated to promote economic development by making Montana more competitive with other states. Based on data provided by the Legislative Fiscal Division, the effective tax rate⁵ on personal property was 2.9% in tax year 1995 (9% tax rate) compared with 1.3% in tax years 2000 and 2001 and 1.4% in tax year 2002 (3% tax rate in all 3 years). The Department of Revenue compared the initial effective property tax rate on \$100,000 of business equipment in Montana with the effective tax rates on business equipment in 10 western states and North Dakota and South Dakota. According to the Department's figures, of the 13 states, Montana ranked sixth based on effective tax rates⁶--North Dakota and South Dakota do not tax personal property.
- The rate reduction and eventual exemption of class eight property is based upon changes in real wages and salaries. A variant to the wage and salary indicator or some other indicator or indicators of economic activity may be a better way for determining the trigger.

To address the points described above, the Committee may want to do the following:

- review trends in class eight market value, taxable value, estimated tax collections, and effective tax rates since 1989 (update to Legislative Fiscal Division analysis);

³The Railroad Revitalization and Regulatory Reform Act of 1976 and the Tax Equity and Fiscal Responsibility Act of 1982.

⁴"Biennial Report of the Montana Department of Revenue, July 1, 2000 to June 20, 2002." p. 59

⁵Effective property tax rates are calculated by dividing taxes paid on the property by the market or assessed value of the property.

⁶In Montana, at least, effective tax rates on personal property will vary by location.

- compare the effective tax rates of class eight property with other classes of property in Montana since 1989;
- analyze the current distribution of class eight property by county;
- compare effective tax rates on business equipment in Montana with other states (update Montana Department of Revenue analysis, if necessary; review the findings of the report "50-State Property Tax Comparison," sponsored by the Minnesota Taxpayers Association);
- evaluate the impacts of the rate reduction on class twelve railroad and airline property;
- review whether there are legal issues related to the taxation of other classes of personal property if class eight is exempt and evaluate the fiscal impacts of exempting personal property in other classes of property (coordinate with the Property Tax Reappraisal Committee);
- consider alternatives to determining the existing trigger; and
- consider other information and analysis.

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