RECIPES FOR CHANGE:
A MENU OF PROPERTY TAX ALTERNATIVES

November 1998

Prepared on Behalf of the Interim Property Tax Committee

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PROLOGUE

Between the final meeting of the Interim Property Tax Committee on September 14, 1998, and publication of this report, a general election was held on Tuesday, November 3, 1998. One result of the election was the adoption by the electorate of Constitutional Initiative No. 75 (CI-75). Although the implications of CI-75 are not fully known or understood, they promise to be significant.

Very briefly, CI-75 requires a public vote on many, perhaps most, increases in taxes and fees. It also requires and precludes a variety of other things by making other substantive changes to the state Constitution. Some of these nuances include:

< A supermajority of the Legislature is required to increase taxes or fees under emergency situations.

< Elected officials are subject to personal liability if the provisions of CI-75 are violated.

< With respect to a tax or fee increase "referred" to the electorate by the Legislature, the Governor must approve each measure before the public may vote. Without gubernatorial approval, a tax or fee referendum cannot be forwarded to the electorate.

Consequently, when the 56th Montana Legislature convenes on January 4, 1999, its members will not only face the myriad complexities of tax policy and the practical application of tax policy, they will also have to confront the varied, complicated, and even conflicting requirements and proscriptions of the Montana Constitution in its "post CI-75" form.

INTRODUCTION AND ACKNOWLEDGMENTS

As the 21st century nears, Montanans persevere with a property tax system that has its roots in the 19th century. In itself, that reality is neither good nor bad; it is simply a fact.

It is also a fact that the property tax is the tax that most Americans, including most Montanans, love to hate. Year after year, the property tax is identified as the most despised excise imposed by government. At the same time, the property tax is the most stable revenue source upon which governments, especially local governments and schools, rely to support the programs and services ostensibly demanded by taxpayers.

The foundation of the property tax system--market valuation--is a tried and true practice, historically recommended by economists, guarded by statisticians, and until recently, generally supported by elected policymakers and the people they represent. However, with rapid changes, particularly increases, in market value, the traditional system has come under increasing criticism, even attack, and support has begun to deteriorate.

Montanans, like the citizens of many states, have encountered the good fortune of significant appreciation in property values, especially noticeable in the past two decades for home owners. Because of that good economic fortune, property taxpayers have understandably feared property taxes increasing at rates that many perceived as simply too high. Between 1993 and 1997, for example, the market value of residential property increased by an average of 43%; for commercial property the rate was "only" 25%. Given those rates of growth, many Montanans feared a direct translation of increasing values into increasing property taxes. And although history proves that property taxes have changed much more slowly, at least on average, than have market values, the fears persist.

Thus, the 55th Legislature confronted the difficult and multifaceted dilemma of what to do with property taxes. Through compromise and somewhat in an act of desperation, Senate Bill No. 195 was passed and approved as a temporary measure intended to virtually freeze property taxes for most home owners and businesses at 1996 levels.

The Interim Property Tax Committee was also born of the legislation, commissioned quixotically to ". . . revise, reform, or replace the property tax system". And so the journey began.

Before proceeding further, the Interim Property Tax Committee wishes to acknowledge a number of people, without whose input and assistance the Committee's efforts would have been less beneficial and rewarding. First among those deserving recognition and commendation are the several hundred citizens who braved the dark of night, inclement weather and roads, summer heat and winter cold, and any variety of other obstacles to attend at least one public hearing and make their respective voices heard. They were courageous in many ways and deserve the Committee’s thanks and the public’s appreciation.

Also worthy of acknowledgment are staff of the Montana Department of Revenue. From among the Department's ranks, scores of mostly anonymous county appraisal staff assisted the Committee in understanding topics ranging from appraisal techniques for different types of property to historical changes in the taxable valuation of specific jurisdictions. Staff within the Department's Office of Information and Research were also particularly helpful, especially Judy Paynter and Brad Simshaw. Randy Wilke, Gene Walborn, and Mary Whittinghill within the Property Assessment Division also provided valuable information, insights, and perspective.

To all the other people deserving of recognition here but not named individually or specifically, the Committee also extends its thanks.

Finally, the Committee conducted its work under the premise that the Legislature and local legislative bodies were formally authorized to set tax policy within their respective jurisdictions. With the adoption of CI-75 at the November 3, 1998, election, legislative authority over tax policy is no longer the case, if it ever was. So, although the full consequences of CI-75 are as yet unknown, an initial result is that the options outlined in the menu of alternatives must not only be considered by the Legislature and the Governor, but ultimately by the electorate as well. Recognizing the sizable expansion of the voting public's responsibility, the Committee's goal of increasing public education and understanding of Montana's tax system should probably no longer be viewed as merely a goal, but as an urgent necessity.

Senator Barry "Spook" Stang, Chairman

For every complex problem, there is a simple solution.
And it's wrong!

H.L. Mencken

ENABLING LEGISLATION

Sec. 10, Ch. 463, Laws of 1997

(Senate Bill No. 195)

Section 10. Property tax committee. (1) There is an interim property tax committee. The committee consists of 12 members. The speaker of the house shall appoint six house members, three from each party, and the senate committee on committees shall appoint six senate members, three from each party.

(2) The committee may study all aspects of the state property tax system and shall prepare a menu of alternatives to revise, reform, or replace the property tax system. The alternatives should include methods that remove volatility from the valuation of property. The alternative methods should include options designed to supplement or replace the current valuation system in order to prevent the exclusive reliance on market value.

(3) In order to provide a wide-ranging series of options for consideration, each individual member of the committee may pursue proposals independently and receive staff assistance on the proposals. The committee may discuss and make suggestions on all proposals. A vote of one-fourth of the members may include a proposal on the menu of alternatives. The menu of alternatives must be presented to the 56th legislature.

(4) The committee may solicit the advice of appropriate persons and entities as the committee considers necessary.

(5) The legislative branch shall provide staff support to the committee. The committee may contract for services as the committee considers necessary.

EXECUTIVE SUMMARY
AND
MENU OF ALTERNATIVES

The Interim Property Tax Committee was commissioned to study all aspects of Montana's property tax system and was charged to ". . . prepare a menu of alternatives to revise, reform, or replace the property tax system". This summary constitutes the Committee's response to its charge by describing the several alternatives forwarded by the Committee for additional consideration by the 56th Montana Legislature.

The Committee specifically and actively agreed to avoid attaching or even indicating any degree of preference or priority to the alternatives. The members also resisted attaching arguments for and against the alternatives. Consequently, the alternatives are merely described and grouped into those that are casually called "minor options" and those called "major options".

While the descriptions provided here provide only an outline of each alternative, draft legislation prepared at the Committee's request to more definitively delineate the alternative is included in Appendix A. It should be noted, however, that although the draft legislation was prepared for and considered by the Committee, only the concept or philosophy underpinning the drafts was endorsed by at least three members of the Committee as required in Senate Bill No. 195 (SB 195). Stated another way, none of the draft bills was specifically sanctioned by the Committee and, if introduced, any of the alternatives may be revised according to the wishes of the principal sponsor of the alternative.

Respectfully, the Interim Property Tax Committee submits for further consideration, the following menu of alternatives.

MINOR OPTIONS

Local Option Sales Tax Alternative

An option for reducing property taxes would be available in local jurisdictions through the enactment of a local option sales tax.

In several jurisdictions there is currently imposed a "resort tax" that is a sales tax on goods and services consumed primarily by tourists. Reportedly, these jurisdictions have seen or at least embarked upon marked improvement in local infrastructure, paid for by-and-large by resort tax revenue. (The communities of West Yellowstone, Red Lodge, Whitefish, and Virginia City have enacted resort taxes. The recreational area at Big Sky Ski and Summer Resort has also adopted a resort area tax for the fairly large, unincorporated area comprising the Big Sky ski area and its environs. St. Regis has also adopted a resort area tax encompassing an unincorporated area.)

This option would allow any municipality or county to enact a local option sales tax much in the same form and for the same purposes as the resort tax is currently an option for a few, smaller communities and a few unincorporated areas. The local option sales tax alternative includes a requirement for a favorable vote by the local electorate.

Highlights of the local option sales tax alternative include:

- The maximum rate of local option tax is capped at 3%.
- At least 5% of local option tax revenue must be used for reduction of local property taxes.
- The tax may be applied to goods and services sold by the following establishments:
  - hotels, motels, and other lodging or camping facilities;
  - restaurants, fast food stores, and other food service establishments;
  - taverns, bars, night clubs, lounges, and other public establishments that serve beer, wine, liquor, or other alcoholic beverages by the drink;
  - destination ski resorts and other destination recreational facilities; and
  - establishments that sell luxuries, loosely defined as any gift item, luxury item, or other item normally sold to the public or to transient visitors or tourists. "Luxuries" do not include food purchased unprepared or unserved, medicine, medical supplies and services, appliances, hardware supplies and tools, or any necessities of life.

Circuit Breaker Enhancement Alternative

Montana has at least three different methods by which lower-income home owners and elderly home owners may reduce their property tax burdens.

A direct reduction in property taxes is available for all lower-income home owners under 15-6-134, MCA.

- For tax year 1998, the maximum income thresholds will be just under $17,000 for singles and just over $22,640 for marrieds or heads of households. The proposal would increase the thresholds to at least $20,000 for singles and to at least $25,000 for marrieds or heads of households.
- The minimum reduction would remain at 30% of property taxes assessed, and the maximum reduction would remain at 80% of taxes assessed.

An indirect reduction in property taxes through an income tax credit mechanism is available to lower-income elderly home owners and renters under 15-30-171, et seq., MCA.

- For tax year 1998, the maximum income threshold is $12,000 of "household income" (which means income from all sources received by everyone in the "household" less $6,300).

< The maximum credit available is limited to $1,000.

Under the alternative considered by the Committee, "social security" and "railroad retirement" income would be excludable from "household income" and the maximum available credit would be increased to $1,500.

Finally, there is a type of reverse annuity mortgage available for certain lower-income, elderly home owners through the Montana Department of Commerce. Employing the reverse annuity mortgage allows low-income seniors to use the equity in their home to pay for normal living expenses, including property taxes on the home. Without specifically recommending any revisions to the reverse annuity mortgage program, the Committee recommended that the Department of Revenue and the Department of Commerce do more to make eligible taxpayers aware of this program.

Business Equipment Exemption

The "business equipment" tax applies generally to the personal property owned by commercial enterprises in Montana. Currently, property taxes on business equipment are determined by multiplying the market value of property (typically determined through national appraisal guides or through depreciated value techniques) by a 6% statutory tax rate. The resulting "taxable value" is multiplied again by the jurisdictional mill levy.

For example, business equipment having a *market value* of $100,000 would have a *taxable value* of $6,000 that would be subjected to the jurisdictional mill levy, e.g., 420 mills, resulting in a tax bill of $2,520. Measured another way, the effective tax rate (i.e., taxes paid divided by the market value of the property) on the equipment in this example would be 2.52%

Under the proposed alternative, the first $25,000 or less of market value of Class Eight business equipment would be exempt from property taxation, thereby relieving a substantial number of small, main street businesses from the business equipment tax. Depending on the amount of business equipment owned by a business or industrial enterprise, effects of the exemption to individual property owners would range from absolute exemption to minimal impact.

Under this option and using the figures from the above example, the $100,000 of business equipment would be reduced by $25,000, leaving $75,000 in market value. That amount would be multiplied by the 6% rate, resulting in a taxable value of $4,500. Applying the jurisdictional mill levy of 420 mills concludes in a tax bill of $1,890. The resulting effective tax rate of 1.89% compared to the prior 2.52% rate is a full 25% lower.

Comparatively, an enterprise with $1 million in business equipment would also receive the $25,000 exemption. Currently, by applying the same assumptions used previously, this entity would have business equipment with a *taxable value* of $60,000 (the $1 million times the 6%

rate). The $60,000 in taxable value would be multiplied by the local mill levy, 420 mills in this example, resulting in a tax bill of $25,200. Thus the current effective tax rate would again be 2.52%.

Under the proposed $25,000 exemption, the $1 million in business equipment would receive the $25,000 exemption, thus leaving $975,000 in market value. That market value multiplied by the 6% statutory rate results in a taxable value of $58,500. Following through by applying the mill levy of 420 mills, the tax bill would be $24,570 for an effective tax rate of 2.457%, a reduction of 2.5%

Any enterprise having business equipment with a total market value of $25,000 or less would have a 0% effective tax rate and a 100% reduction from current practice.

MAJOR OPTIONS

Acquisition Value Alternative

California, in 1978, was the first state to adopt “acquisition value” as the basis for the taxation of property. Since then, Florida and Michigan, at least, have adopted some form of “acquisition value” for property tax purposes.

Under the “acquisition value” approach, real property, such as a home, a business, or an industrial plant, is valued for tax purposes at its market value as of some base year or, if the property has sold since the “base year”, the value at which it was acquired by a new owner; thus, the term “acquisition value”.

In states that have adopted some form of acquisition value for property tax purposes, there is commonly some annual, nominal change allowed in the base value. For example, in California, the annual rate of change in base value for tax purposes is inflation (measured by the consumer price index or CPI) or 2%, whichever is less. In Florida, the maximum change is the lesser of 3% or CPI. In either state, the “assessed” value of property, i.e., the “base value” calibrated by the annual adjustment factor, cannot exceed the “market” value of the property.

While an acquisition valuation system can result in similar property within the same jurisdiction being taxed at highly different levels, the literature indicates that the method has ample support among taxpayers within jurisdictions that have adopted the policy.

Highlights of this proposal include:

< The alternative forwarded by the Committee would apply the acquisition value method to residential, commercial, and industrial real estate and improvements, but not to agricultural land.

< The “assessed value” would be adjusted annually at the lesser of CPI inflation or 1%.

< At implementation, the “base value” would be “assessed value” for tax (calendar) year 1993 unless:

  C the property was bought or sold after January 1, 1993. If bought or sold after January 1, 1993, the base value would be the price at which the new owner acquired the property.

  C improvements were made to the property. All improvements would be valued at their market value as of the date of the improvement. The value of the improvements would be assessed, in each year, separately from the base value of the property and from other improvements.

  C the use of the property changed. For example, if residential property was converted to commercial property after January 1, 1993, the property would be appraised at its value as commercial property as of the date of the change in use.

By the time this alternative could be implemented, January 1, 2001, at the earliest, the 1993 “base values” would all have been adjusted by 1% for each year 1994 through 2000, inclusive. Thus, a property with a “base value” of $100,000 in 1993 would have an assessed value of $108,285 for tax year 2001.

Another significant highlight of this alternative is that commercial and residential property are initially treated the same *vis-a-vis* base value and annual adjustments. However, if a commercial property has not been bought or sold by January 1, 2013, the Department of Revenue is required to appraise the value of the property at the then-current market value and record the newly determined value as the “assessed value” for property tax purposes. This process for revaluing commercial property would apply to any commercial property that had not been bought or sold within the most recent 20-year period, i.e., 1993-2013; 1994-2014; 1998-2018.

In contrast, a residential property with a 1993 “base year” value would retain the 1993 value (adjusted) until the property was bought or sold or otherwise improved.

Combination Alternative

An alternative combining several previously considered options was considered and forwarded by the Committee. Referred to as the “combination alternative”, this option, as considered by the Committee, would:

< implement for 1999 the most recent (1996) market valuations for Class Four property, basically, homes and businesses;

< exempt from property taxation 25% of the first $100,000 or less of market value of a single-family residence occupied by the home owner for at least 8 months per year;

< reduce the statewide equalization levy for K-12 school equalization from 40 mills to 37 mills;

< reduce the statutory nominal tax rate on homes and businesses from 3.816% (1998) to 3.25% (1999 and thereafter).

This alternative focuses on providing substantial and immediate property tax relief to home owners but could also provide significant relief to most commercial property as well. There would be no reduction in the amount of property taxes collected in the aggregate. Instead, taxes currently paid by home owners would be reduced and shifted to commercial, industrial, utility, and other taxpayers. It is implementable immediately; i.e., for tax year 1999.

The shifting that would occur under this option would accrue to different types (classes) of property in different ways. Home owners would gain the most relief, and commercial property could also gain significantly. Utility property, business equipment, and centrally assessed transportation property (railroads, airlines, etc.) would most likely bear a somewhat higher proportion of the burden than they now do.

Different geographical areas of the state would also fare differently, some areas getting more (or less) relief than other areas, and some types of property in some areas benefiting more (or less) than the same types of property in other areas.

As proposed, this alternative would significantly mitigate the effects of the 1996 statewide reappraisal for most home owners in the state. However, like any solution to be applied statewide, individual home owners would likely experience some change in their actual property tax liabilities.

Comprehensive Reform Alternative

An option for extensively revising property taxes has been forwarded by the Committee for consideration by the 56th Legislature.

As proposed, a 4% general, retail sales tax[1] would be imposed statewide and the revenue from the sales tax would be used to:

< reduce property taxes by about $500 million annually, which taxes are currently committed primarily to K-12 schools and the university system by:

    C exempting business equipment and livestock from property taxation (about $80 million); and

    C replacing approximately $400 million of property-tax-funded K-12 school costs with a like amount of state funding for K-12;

< provide sales tax rebates to certain (lower-income) individual income taxpayers;

1 Article VIII, section 16, of the Montana Constitution limits the rate of a statewide, general retail sales tax to a maximum of 4%.

< reduce the flat tax rate on automobiles and light trucks from 2% to 1.5% of value (about $20 million annually); and

< replace certain other revenue from eliminated property taxes.

The proposal would also:

< provide home owners an exemption from property taxation of 65% of the first $50,000 or less of market value of an owner-occupied residence;

< simplify the property tax system by eliminating the various statutory, nominal rates applied to the various classes of property for tax purposes and assessing all property subject to property taxation at 100% of value for tax purposes;

< limit future increases in property taxes;

< revise county classifications and debt limits for budgeting purposes; and

< repeal the remaining provisions of Initiative No. 105.

While the Legislature and the Governor could pass and approve this alternative, conceivably at least, there is general agreement among policymakers that such a far-reaching proposal must be referred to the public.[2] Consequently, if the electorate approved the measure, it would be unlikely that this alternative could be implemented before January 1, 2000; more likely, implementation would be in mid-2000 or later.

[2] Under CI-75, now Article VIII, section 17, of the Montana Constitution, the alternative would have to be segregated and referred to the electorate.

COMMITTEE ACTIVITIES

INTRODUCTION

The Interim Property Tax Committee (Committee) was established by the passage and approval of Senate Bill No. 195 of the 55th Legislature (Ch. 463, L. 1997). A 12-member committee, it was comprised of 6 members of the Senate and 6 members of the House of Representatives, each evenly divided between Republicans and Democrats. The members represented most areas of the state and a range of economic, demographic, political, and other interests.

Among the Committee's goals were to improve the members' individual knowledge and understanding of Montana's system of taxation and, to the extent possible, disseminate information regarding the state's tax system to Montanans. A related objective was to raise the issue of property tax reform to the highest possible level of consideration among the state's citizens.

Thus, it was with those goals and others that the members of the Committee undertook their charge. Over the course of the 1997-98 legislative interim, the Committee held some 20 meetings, each of which was, in part, a public hearing. The Committee met in communities large and small and in all regions of the state. The members reviewed and considered information gathered, analyzed, distilled, and presented by Montana legislative staff and staff of the Department of Revenue. Experts in property taxation and taxation systems in other states were also consulted. Perhaps foremost, the Committee solicited opinions, ideas, and recommendations from all Montanans. Fortunately for the process, home owners, business entrepreneurs, farmers and ranchers, housewives, teachers, public officials, laborers, professionals, full-time and part-time residents, retailers, manufacturers, industrialists, managers, retirees, and others responded by sharing their ideas with the Committee.

PUBLIC HEARINGS AND TESTIMONY

Beginning with the first meeting of the Committee, it quickly became clear that many, perhaps the majority of citizens testifying, felt that property taxes were too high, had been increasing rapidly, and were likely to continue to increase. Over the course of the interim, comments from the public followed a few broad themes:[3]

< property taxes in Montana, particularly on homes, are higher than elsewhere;

[3] Citizens' comments were not necessarily supported by any actual evidence, but the passion with which the sentiments were expressed ran high in virtually every community.

< residential property taxes have risen faster than inflation and incomes;
< high property taxes are an impediment to economic development;
< all taxes, but particularly property taxes (and especially those on homes), are too high;
< local governments and schools cannot, in many cases, provide adequate services with the resources available;
< the simple solution is for government to heed the pleas of the citizens and just reduce taxes; and
< the solution is not simple, but policymakers should move ahead knowing that they have the support and best wishes of the citizens.

There were other comments made frequently enough to command attention, but that did not rise to the level of themes. In general terms, these problem-identification types of comments from taxpayers included:

< “we” are spending too much on schools;
< some people are not paying their fair share of taxes;
< a minority of people are paying the majority of taxes;
< tourists should bear more of the tax burden (directly);
< residential taxpayers are at the breaking point;
< businesses can’t be expected to pay any more in taxes;
< agriculture is overburdened by taxes;
< people on fixed incomes already pay too much and can’t pay more;
< young families have other expenses and can’t bear the tax burden of owning a home;
< utilities, particularly electric and telephone service providers, bear too high a tax burden to compete in a deregulated environment;
< the natural resource industry pays a disproportionate amount of taxes;
< taxes on business equipment are too high and are the principal reason that economic development in Montana lags behind other states;
< “averages” are fine, but every community visited by the Committee is different (from the average) and, thus, the averages don’t reflect the real situation experienced in any community;
< the assessed valuations determined by the Department of Revenue are too high (including: way too high; unrealistic; ridiculous; absurd; and nonsense); and
< property values are being driven up by nonresidents and out-of-staters.

Some different attitudes and perspectives were expressed by public officials, particularly elected county and municipal officers. Sentiments from this group did not necessarily contradict comments made by the taxpayers, but did provide different points of view and included, in general:

< elected local officials believe they are better able to assess local needs than state legislators are;

< citizens hold elected local officials accountable for changes, particularly increases, in property taxes. Consequently, local officials are very cautious and circumspect when contemplating budget matters, particularly increasing taxes.

< local governments cannot provide the services expected by their citizens;

< unlike schools, local governments have had to operate since 1987 under the restrictions of Initiative No. 105 (I-105); and

< the current budgets of many local governments are virtually the same now as they were in 1987, but inflation has not been eliminated and demands for services, including mandates, continue to rise.

Whenever the discussion and comments focused on solutions, some generalities consistently emerged from taxpayers and citizens, including:

< reduce taxes;

< everyone should pay their fair share;

< tourists should pay their fair share;

< senior citizens on fixed incomes should be protected;

< alternative sources of funding, other than property taxes, need to be available for schools and for county and municipal governments;

< a statewide, general retail sales tax is the best solution;

< a sales tax has been repeatedly rejected by Montanans, they simply don't want one, don't waste your time;

< citizens would accept a sales tax, provided they have assurances that property taxes will be permanently reduced and other taxes won't increase in the future;

< citizens will not accept a sales tax until either the income tax or the property tax is eliminated;

< property taxes should be eliminated and replaced with a sales tax;

< homes should be exempt from property taxes or at least a person should not be subject to losing their home for delinquent property taxes; and

< economic activity will be spurred if taxes on businesses, particularly on business equipment, are reduced.

Regarding solutions, elected local officials again provided different if not additional insights and recommendations, including:

< one-size-fits-all solutions concocted in Helena usually do little to solve the specific problems of cities or counties;

< one-size-fits-all solutions devised in Helena sometimes exacerbate the specific problems of cities and counties;

< local governments need to be able to tap into sources of revenue other than property taxes;

< most County Commissioners strongly supported the property tax/sales tax reform proposal offered in Senate Bill No. 258 during the 1997 Session;

< most County Commissioners support enacting a statewide, general retail sales tax and using the revenue to replace property taxes, particularly for financing schools;

< local jurisdictions should have the authority to create solutions that will work locally;

< the state should shoulder a greater portion of the costs of funding education, without relying on property taxes;

< the state should stop passing mandates on to local governments; and

< whatever is done, the property tax base should not be reduced any further.

COMMITTEE WORK SESSIONS

One of the goals established by the Committee was to ". . . develop a more complete understanding of taxation, including the effects of how utility restructuring may affect property taxation". In pursuit of that goal, the Committee also identified several objectives:

Objective: Develop a history of the property tax system, including legal foundations, changes in the system since 1972, revisions for centrally assessed property, changes in tax rates, changes in property classes, exemptions, etc.

Objective: Determine, by class of property, who pays property taxes.

Objective: Determine what programs, services, functions, etc., are funded by property taxes.

Objective: Investigate what citizens know about the property tax system, what citizens' attitudes are about the services they receive for the property taxes they pay, what their ideas are with respect to a level of property tax that is "fair", what property taxpayers feel is an appropriate (equitable/fair) way of determining value for property tax purposes, etc.

Objective: Explore what influences and mechanisms, aside from valuation, exist that can control or affect property taxes.

Objective: Compare Montana's property tax system with the property tax systems in North and South Dakota, Wyoming, Idaho, Oregon, and Washington.

Objective: Coordinate the SB 195 study with the study of taxation and utility restructuring being conducted by the Revenue Oversight Committee.

Objective: Identify and catalog historical changes (trends) between property tax jurisdictions with respect to: market values; taxable values; types of property; mill levies; etc.

In retrospect, these objectives comprised the heart of the Committee's study. In somewhat greater detail, the following narrative describes activities relevant to one or more of the objectives.

GENERAL OVERVIEW AND HISTORY

At each of the Committee's meetings[4], staff presented information showing concise yet general trends in state and local finances since 1972.[5] Beginning with Chart 1, the range of historical information presented was intended and may have actually helped to dispel many of the preconceptions entertained by Committee members, taxpayers, news persons, citizens, and others.

In general terms and stated in overly simplistic terms:

- Montana's state and local governments rely less heavily on property taxes nowadays than they did 25 years ago;
- total state and local property tax collections have increased more slowly than inflation or personal incomes;
- total state and local taxes in Montana as a share of total personal income have remained fairly constant and are actually *less* now in percentage terms than they were 25 years ago; and
- public education's 60%-plus share of property taxes for elementary, secondary, and higher education has remained relatively constant over the past 25 years.

Composition of State and Local Tax Revenue

Chart 1 shows the proportionate shares of state and local taxes in 1972 and 1996. Counterintuitively, perhaps, and surprisingly to many who viewed the data, the share composed of property taxes *declined* from 51% to 41% of the total between 1972 and 1996.

The chart also shows that individual income and sales (and excise) taxes were and continue to be the other major component of state and local taxes in Montana. In 1996, these "three legs of the stool" comprised 77% of all state and local taxes. Comparatively, the big three accounted for 87% of the total in 1972.

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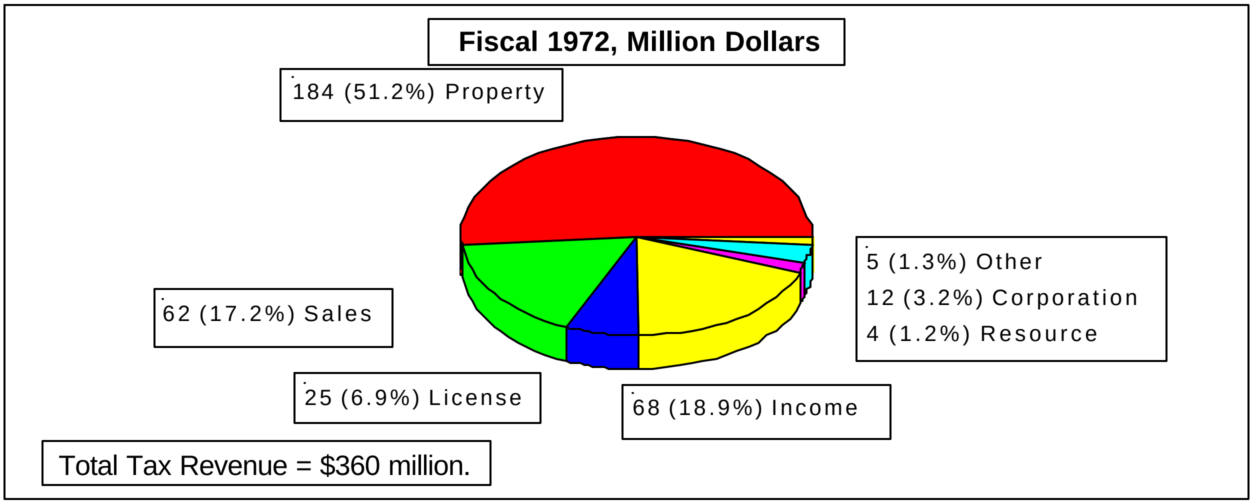
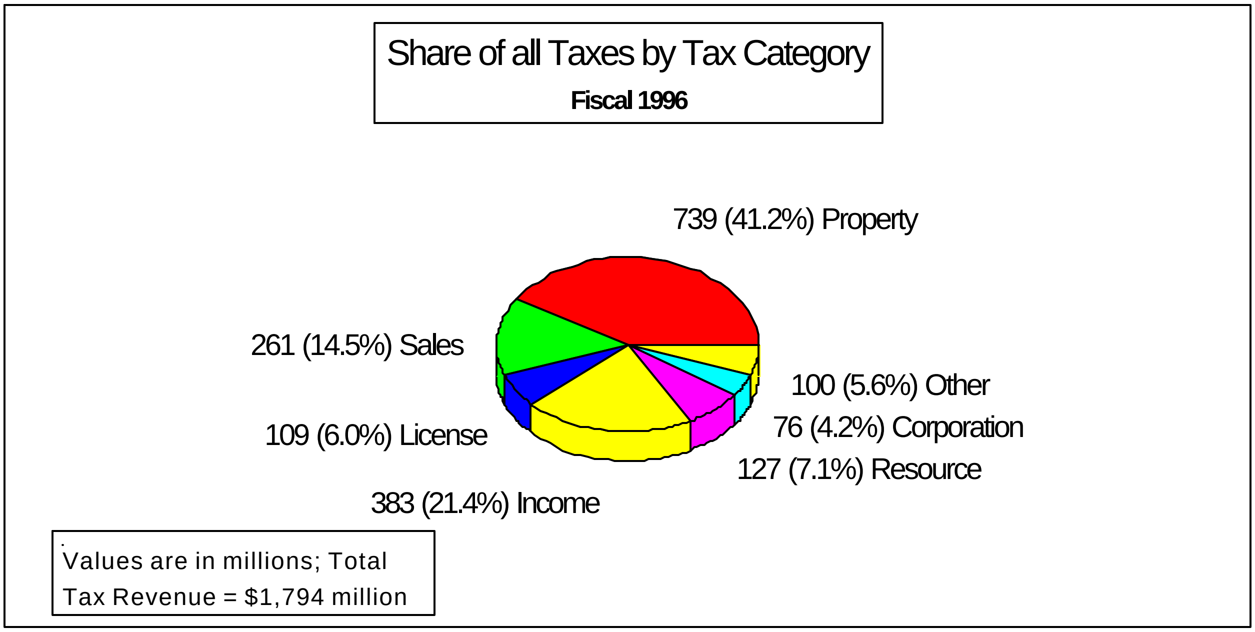
[4] This minimally overstates the case; however, staff did present the historical overview at 18 of the Committee's 21 meetings. Additionally, the material was presented by staff in several other venues and is also available for future presentations.

[5] See Appendix B for a complete set of the charts. Unless indicated otherwise, the year indicated is a state fiscal year, running from July 1 through June 30 of the following year. Thus, 1972 is the period of time from July 1, 1971, through June 30, 1972.

The indication is that sources of state and local tax revenue have been somewhat diversified over the past 25 years.

Chart 1





What is not immediately obvious from the information in Chart 1 is that the "size" of the pie expanded greatly between 1972 and 1996. Total state and local taxes in 1972 were $360 million, but had increased to $1,794 million by 1996, an average annual growth rate of about 5.9%.

That trend can also be seen for various, individual slices of the pie. For example, the proportionate share of property taxes shrunk from 51% of the total pie to about 41% over the 25-year period. But while the proportionate share was shrinking, the nominal (not adjusted for inflation) amount of property tax collections actually expanded from $184 million in 1972 to about $739 million in 1996, an average annual growth rate of about 4.7%. This phenomenon happens because the rate of growth in property tax collections was less than the overall rate of growth in total tax collections.[6]

Changes in the Economy

Chart 2 provides a quick look at changes in inflation and total personal income in Montana. Between 1972 and 1996, inflation, as measured by the Consumer Price Index (CPI), increased about 280% and total personal income increased more substantially, by about 450%. On an annualized basis, inflation averaged 4.4% each year and total personal income grew by not quite 6.6% annually.[7] This data was both illuminating and relevant because there were relatively frequent comments made by legislators and citizens that “incomes had not kept pace with inflation”.

On the bottom axis of Chart 2 is a line that bounces minimally up and down, but stays relatively flat over the 25-year period. This line represents total state and local taxes in Montana as a percentage of total personal income in Montana, a common way to measure tax burden. Over this period of time, taxes as a percentage of income ranged from a high of about 12.5% to a low of about 11.5%. Perhaps contrary to common perceptions and conventional wisdom, total state and local taxes in Montana as a percentage of total personal income were actually *less*, by about 8%, in 1997 than in 1972.

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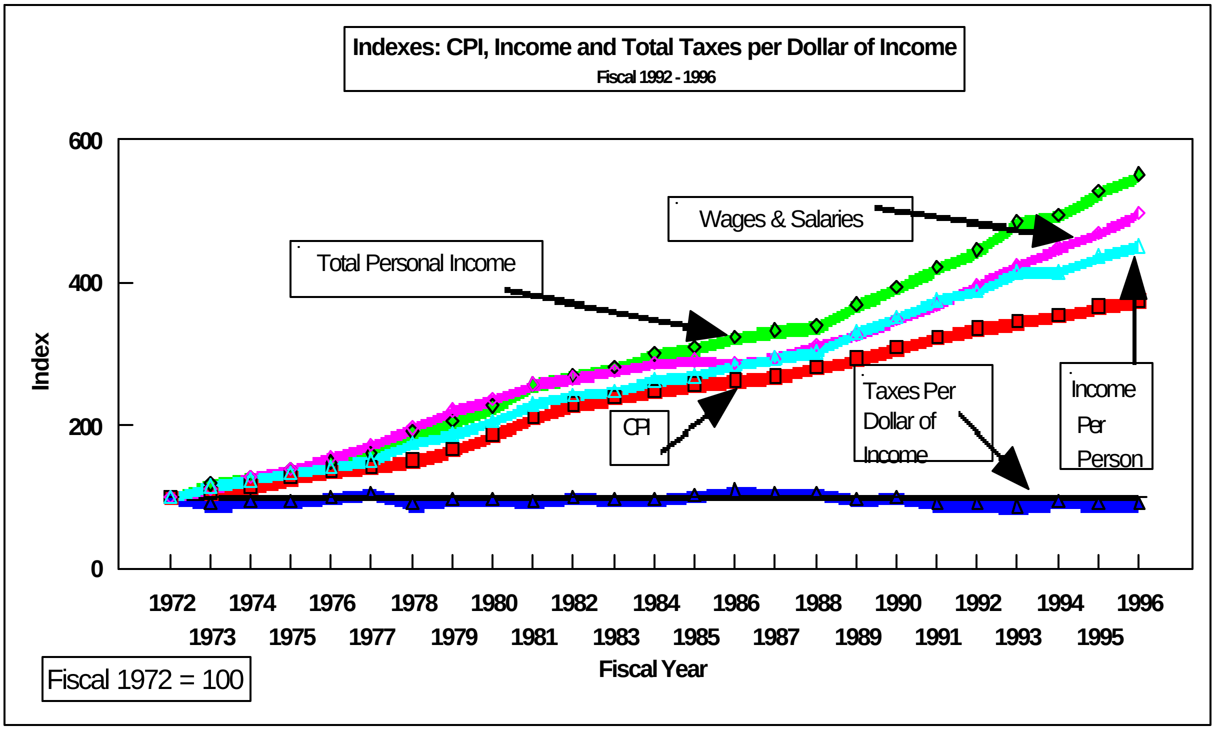
[6] It is worth noting that the phenomenon occurs in some manner in each of the "pie charts" that follow, including those in Appendix B.

[7] Changes in total personal income reflect changes in individuals' earnings from year to year and also capture changes in population.

Chart 2



Changes in Statewide Valuation

In discussing property taxation, two terms are frequently used that must be understood by themselves to also understand the greater complexities of the property tax system. The two terms are “market value” and “taxable value”.

As defined in 15-8-111, MCA, “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”. Fairly simply, the market value of something is the price someone who knows what they’re buying pays for something being sold by someone who knows what they’re selling.

As defined in 15-1-101, MCA, "taxable value means the percentage of market or assessed value as provided for in Title 15, chapter 6, part 1”. Taxable value is derived by multiplying the “market value” of a property by the statutory taxable rate applicable to the class of property into which the property is classified. For example, the taxable value of a home with a market value of $100,000 would be the market value multiplied by the 3.816% statutory taxable rate applicable to homes, i.e., Class Four property under 15-6-134, MCA, or $3,816.

Chart 3 tracks the total statewide market value and taxable value of all property subjected to property tax mill levies from 1971 to 1997. The lower half of the chart shows that the state's total market value increased from about $5.7 billion in 1971 to about $38 billion in 1997; an increase of about 560% over 25-plus years.[8] In contrast, the state's total taxable value increased only a bit under 100%, from about $0.965 billion in 1971 to about $1.867 billion in 1997.

On an annualized basis, the state's market value increased at an average of about 6.8% annually, but the total taxable value increased on average at less than one-half that rate, by only 2.7% annually. In fact, the state's taxable value was so static that the upper half of the chart is presented so that a clearer picture of changes in taxable value can be shown.[9]

Importantly, both market value and taxable value are shown in nominal, not inflation-adjusted, terms. Graphically, it is apparent that increases in the statewide market value kept pace fairly well with increases in personal income and CPI inflation. (See Chart 2.) At the same time, increases in the statewide taxable value fell far behind changes in either inflation or total personal income.

There are two significant jumps in the statewide market value: one in 1979 and another in 1987. In those two years, the Department of Revenue (DOR or Department) completed statewide reappraisals of Class Four property--basically homes and commercial realty. Because of the multiyear, cyclical nature of the reappraisals, appreciation in market values of Class Four properties occurring over a several-year period show up all at once. Noteworthy, however, is the observation that there were no corresponding jumps in taxable value. The underlying reason for that factor were legislative changes to the statutory taxable rates that offset the aggregate, statewide increase in market value appreciation.

Changes in the statewide taxable value visible on the upper portion of the chart appear for a variety of reasons, including the appreciation and depreciation of property values (including inflation and deflation), additional property being added to the tax roles (e.g., as more homes are built or existing homes are improved), the exemption of certain property (such as household goods, business inventories, or automobiles), restrictions imposed by federal laws (with respect to railroads and airlines), and legislative changes to the statutory tax rates for or the composition of the various classes of property.

[8] The market value includes only property that is subject to property taxation through mill levies. Thus, it does not include "exempt" property nor does it include property on which taxes are levied at a flat rate, such as automobiles or natural gas production.

[9] What is not discernable from the graphics are changes to the tax base. For example, in the early 1970s, such property as household goods, automobiles, and coal production were in the tax base subject to mill levies, but by 1997 each of those categories was exempted from mill levies and thus disappears from the statewide values shown.

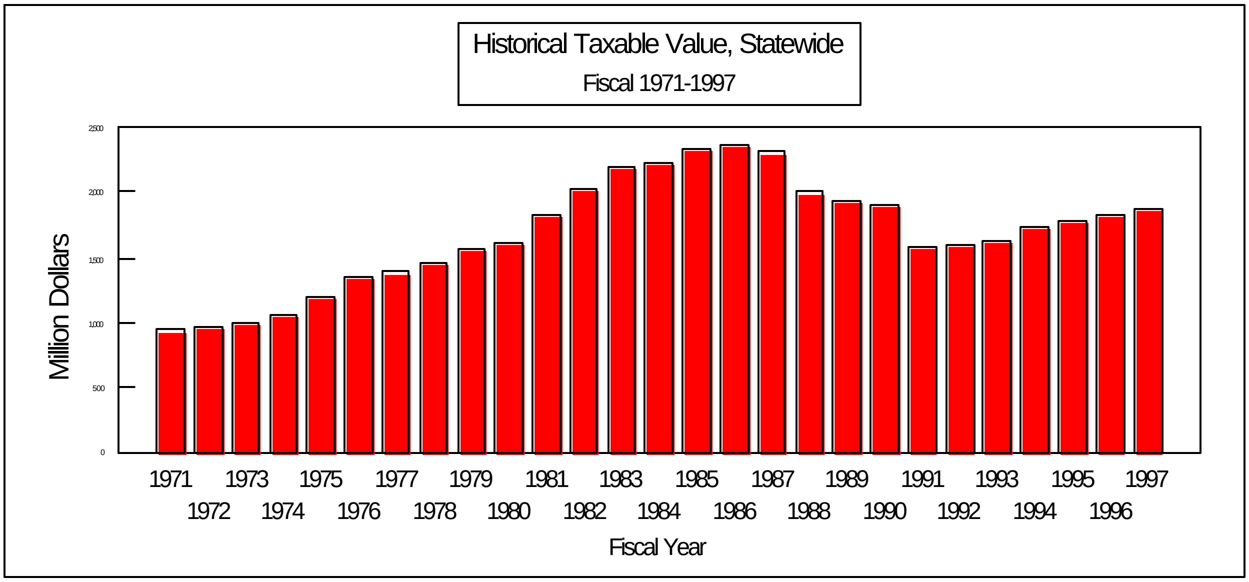
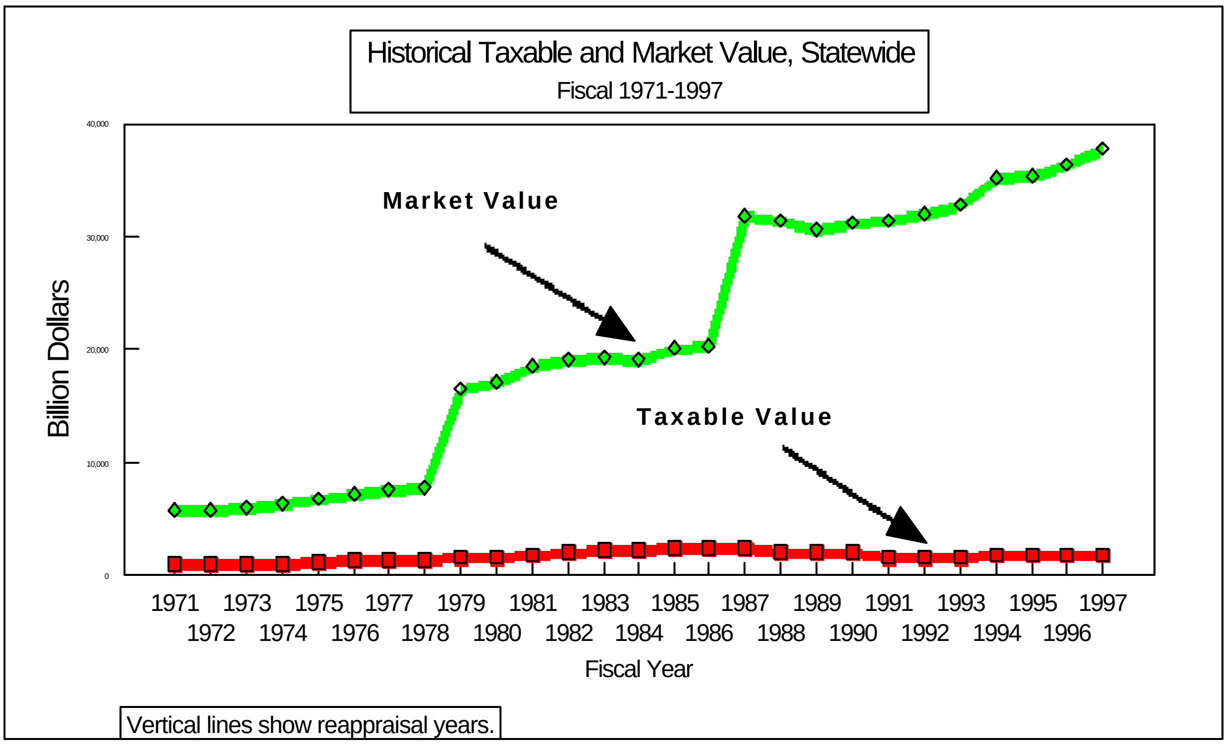

Historical Taxable Value, Statewide
Fiscal 1971-1997
Million Dollars
2500
2000
1500
1000
500
0
1971
1972
1973
1974
1975
1976
1977
1978
1979
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
Fiscal Year

Chart 3

Changes in Statewide Market Value

At the public hearing in Great Falls in June 1998, an insightful citizen commented with some amusement that in 1997, the total market value of property in Montana, at ±$38 billion,



represented approximately 70% of the estimated $54 billion net worth of Microsoft founder Bill Gates.[10]

Chart 4 illustrates the 25-year transition of the tax base, comparing the composition of market values of property categories in 1972 to 1997.

A quick perusal of the chart reveals that 50% of the state's total market value in 1972 was composed of agricultural and timber lands, a proportion that had shrunk to only 12% by 1997.[11] Conversely, the slice of pie labeled "other real" (representing residential and commercial realty) expanded from only 20% of the base in 1972 to over 60% by 1997--more than tripling in the 25-year period.

Also noteworthy is the change in the relative importance of business equipment, labeled "Personal" on the chart. In 1972, business equipment accounted for nearly one-sixth of the state's market value. By 1997, business equipment's share of the total had diminished to less than one-tenth of the total.

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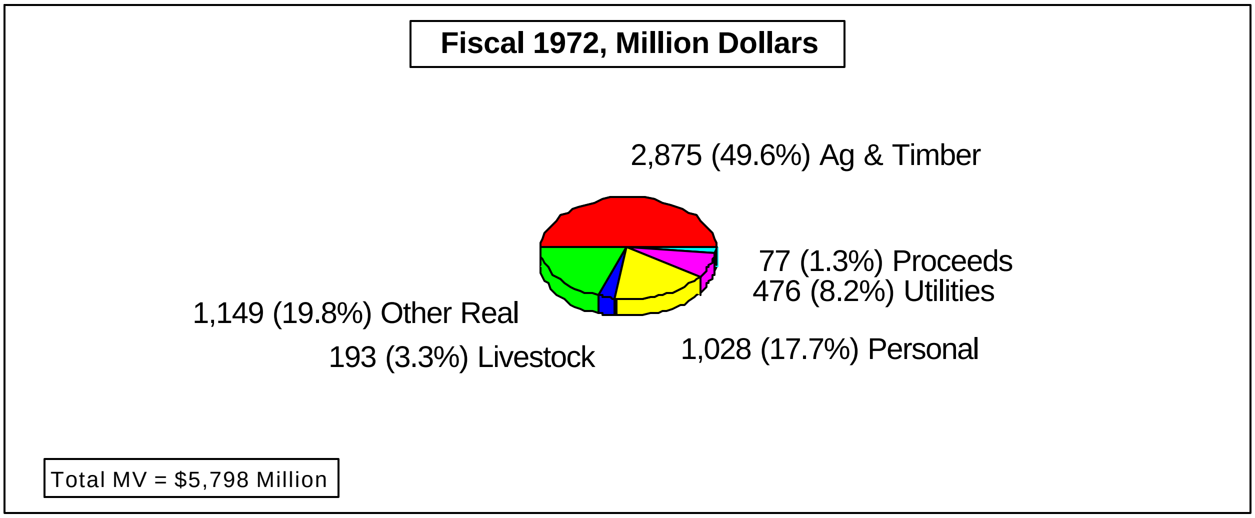
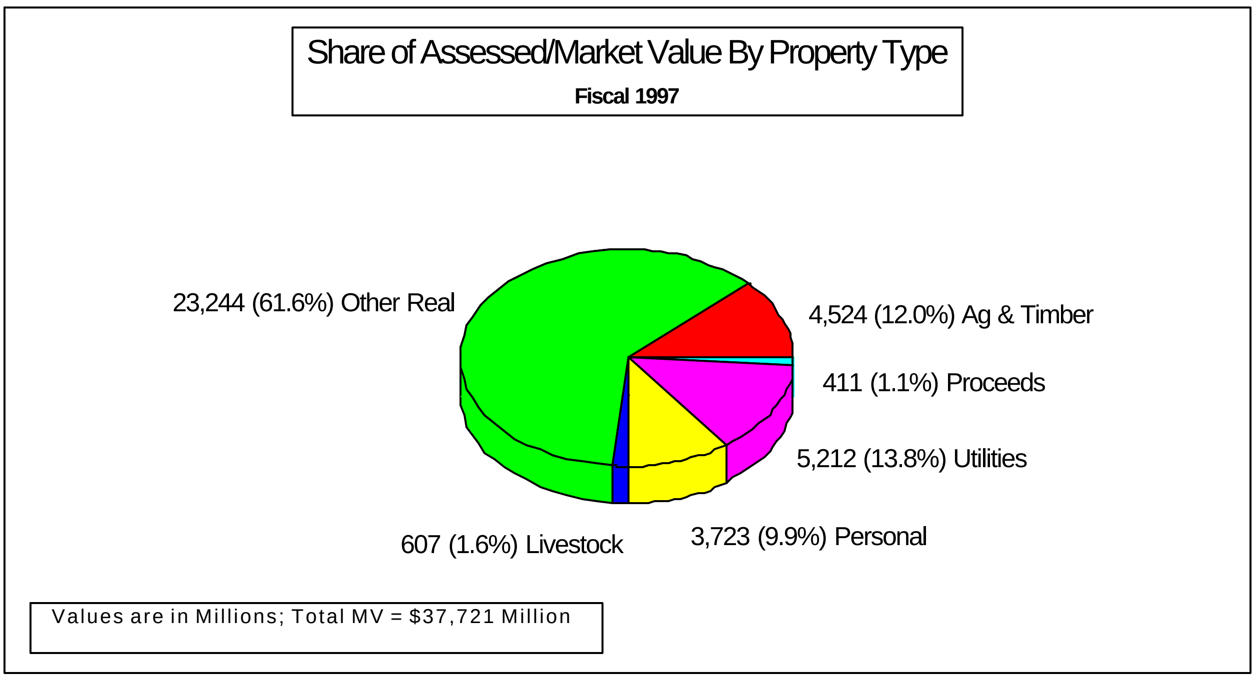
[10] Based on the figures, Bill Gates could buy all of the taxable property in Montana and have some $16 billion left over. Invested in securities returning a moderate 6% annually, the $16 billion remaining would allow Mr. Gates to not only pay the ±$800 million in the annual taxes on the property, but he'd also have an additional $160 million left over to make ends meet.

[11] This reduction in proportionate share is not due to actual depreciation in the value of ag and timber land, but to the fact that the increases of value in ag and timber lands were at a much slower rate than the addition of and increases in the values of all other types of property subject to taxation over the same 25-year period.

Chart 4





Important, but not immediately obvious from the information in chart 4, is the fact that the "size" of the market value pie expanded greatly between 1972 and 1997. The total market value of property subject to mill levies in 1972 was $5.798 billion, but had increased to $37.721 billion by 1997, an average annual growth rate of nearly 7.4%.

That trend manifests differently for individual slices of the total market value pie, however. For example, again using agricultural and timber lands: the proportionate share of property value represented by agricultural and timber lands decreased from nearly 50% of the total pie in 1972 to only about 12% of the total by 1997. But while the proportionate share was shrinking, the nominal (not adjusted for inflation) amount of property value attributable to "ag and timber" land actually expanded by 57%, from $2.875 billion in 1972 to about $4.524 billion in 1997, or an average annual growth rate of just under 1%.

As discussed previously with the total state and local tax pie in Chart 1, this phenomenon occurs because the rate of growth in the value of agricultural and timber land (1% annually) was less than the overall rate of growth in total market value (7.4% annually).

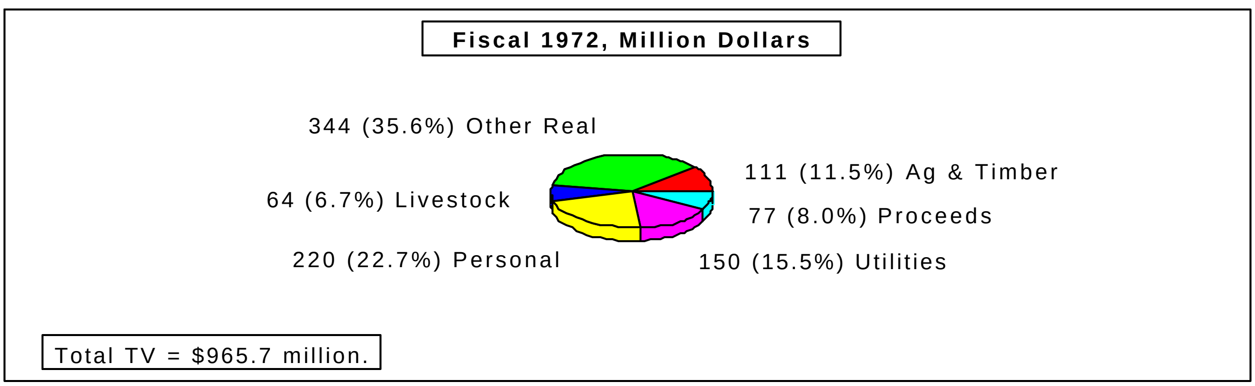
Changes in Statewide Taxable Value

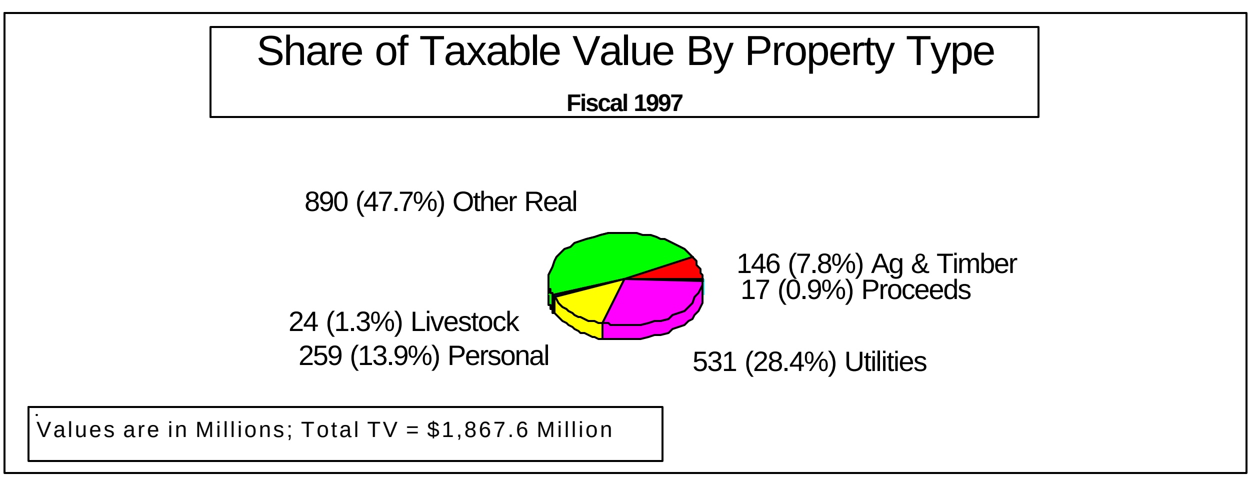
Chart 5 begins to refine and better delineate the shifting burden in property taxes over the past 25 years. Because the taxable value of property is the basis against which mills are levied, changes and shifts in taxable value are more directly related to changes and shifts in actual property taxes (than are changes in market value).

Chart 5

In relative terms, the share of taxable value represented by utilities--power companies, railroads, pipelines, and other similar enterprises---increased the most, almost doubling from 15.5% of the total in 1972 to 28.4% of the total in 1997. The share represented by “other real” (again, residential and commercial realty) also increased substantially, from about one-third of the total taxable value in 1972 to nearly one-half of the total in 1997. Between the two categories, what was about 50% of the total in 1972 had increased to over 75% of the total by 1997.

The taxable value for each of the other categories of property shown in Chart 5 declined between 1972 and 1997, most notably the shares represented by "proceeds” (natural resource





production) from 8% in 1972 to less than 1% in 1997 and “personal” (business equipment) from nearly 23% in 1972 to 14% in 1997.[12]

Changes in Tax Burdens

Somewhat in parallel to changes in taxable valuation shown in the previous chart, Chart 6 illustrates changes in the proportionate shares of property taxes paid, by property type, between 1972 and 1997.

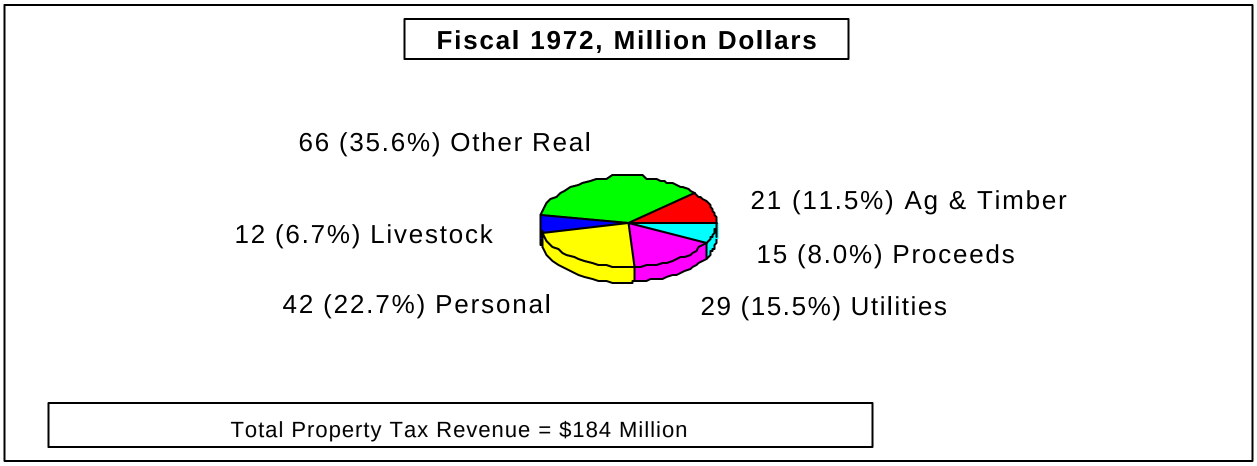
Changes in proportionate share of taxes paid echo changes in proportionate shares of taxable value. The “utilities” share increased from 15.5% of total property taxes paid in 1972 to 23.8% in 1997, an increase of some 50% over the 1972 base year. The share for “other real” grew from 35% of the total to 53% of the total, another increase of 50%.

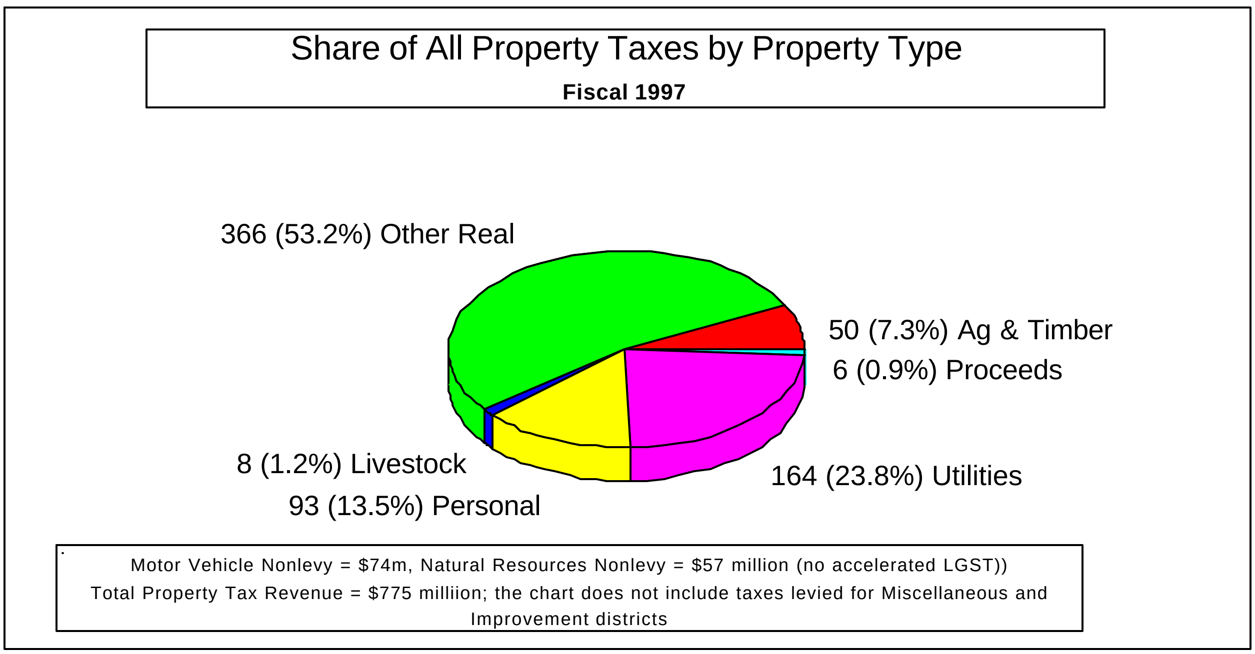
The “taxable value to taxes paid” echo reverberates for other types of property as well, with the proportionate shares of “ag and timber”, “proceeds”, “personal”, and “livestock” all declining significantly from 1972 to 1997.[13]

Chart 6

[12] Importantly, changes in “proceeds” is not sufficiently descriptive to tell the whole story. True, the decline from 8% to 1% is accurate, but it ignores the fact that some $57 million in production taxes was paid on “proceeds” in 1997 that was not even assessed in 1972. Also, the components included in “personal” in 1972 changed dramatically between 1972 and 1997 with significant exemptions (e.g., household goods) being instituted as well as property class consolidations and rate restructuring.

[13] It is again important to stress that, due to such actions as property tax exemption, the 1972 and 1997 “slices” of the pie are not necessarily composed of identical property . For example, business inventories were taxable in 1972 but exempted after 1981 and automobiles, subject to mill levies in 1972, are now exempted from mill levies but the ±$75 million in light vehicle taxes paid in 1997 are accounted for by other means known as “nonlevy” revenue.



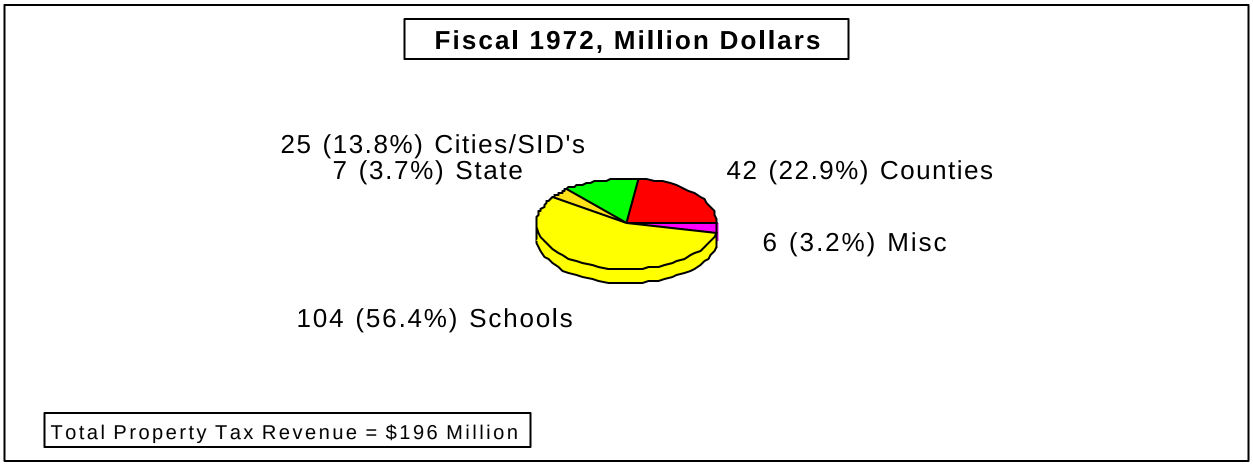


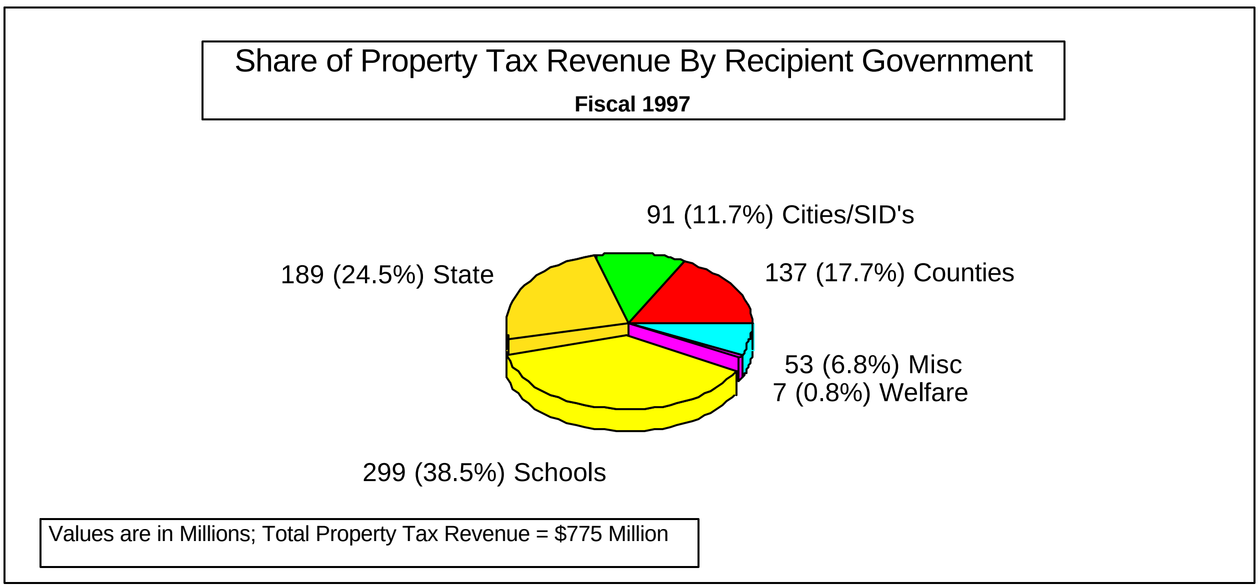
Disposition of Property Taxes

The purpose of levying and collecting taxes is to provide for public services and programs. Partially because the mix of programs and services has changed significantly in the past quarter century, Chart 7 identifies the jurisdictional destination of property taxes: education, cities, counties, and miscellaneous.

As universally recognized, "education" was and is the largest recipient of property tax revenue.[14] Twenty-five years ago, education received just over 60% (three-fifths) of all property tax revenue. In 1997, education's share remained essentially the same at 63.8%.

Chart 7





The share allocated to cities declined slightly, from 13.8% of the total to 11.7% of the total, while counties saw a somewhat steeper decline, from nearly 23% of the total to under 18%.

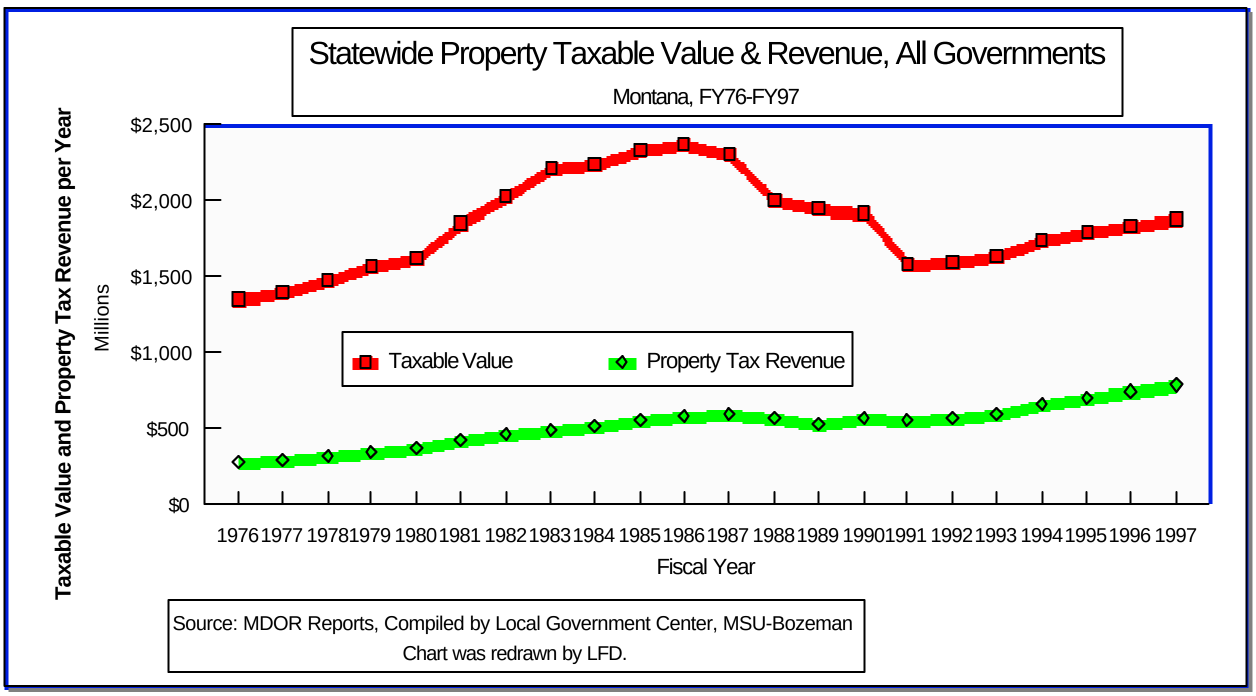
[14] As used here, "education" includes property taxes expended on elementary and secondary schools and the amount derived from the 6-mill levy for the Montana University System.

Due in part to the passage of Initiative No. 105 in 1986, the state has seen considerable growth in entities known generically as “special districts”, represented by “misc” in the chart. The share for these entities increased from 3.2% of the total pie in 1972 to some 6.8% of the pie in 1997.

A Relationship Between Taxable Value and Revenue

Even without looking at statistical evidence, Montanans instinctively perceive that property taxes have increased over the past 20 years. Chart 8 graphically illustrates that perception to be accurate, but probably oversimplifies the situation. Clearly, the total taxable value of property in Montana increased from 1976 to 1997. Property taxes also increased over the same period of time. Beyond that, assumptions about an individual property or even a class of property become somewhat risky because, while the directions of these changes are inherently predictable, the magnitude of the changes are not.

Chart 8



The lower line in Chart 8 represents total property tax collections, beginning in 1976 and continuing through 1997. Over that interval, total collections nearly tripled from about $260 million in 1976 to about $775 million in 1997.[15] Over the same span, the taxable value of the state--represented by the upper line on the chart--increased by less than one-half (44%), from about $1.3 billion to about $1.87 billion. From those figures and employing simple arithmetic division, the statewide average mill levy in 1976 was about 200 mills compared to a statewide average levy in 1997 of about 414 mills.[16]

Mostly as a result of the levy increases alone, property owners saw their property taxes virtually double in 20 years. To the extent than an individual residential or commercial property appreciated at a rate greater than the statewide average, the individual's taxes would have increased by more than double between 1976 and 1997.

As straightforward or obscure as the trends seem, the property tax puzzle is more complex than meets the eye. Even knowing, for example, that the statewide average mill levy doubled between 1976 and 1997, determining what changes occurred among the different types (classes) of property requires additional investigation and, moreover, there are significant jurisdictional and regional variances to boot.

Support of Services From Property Taxes

It is widely perceived that schools, county governments, and municipalities rely heavily on property taxes to support the array of programs and services provided at the local level. Chart 9 traces changes over the past dozen years in these entities' relative reliance on property taxes.

For schools, property tax reliance has been heavy and changing. In 1987, schools depended on property taxes for about 60% of total budgets. Following the passage of I-105 (1986) and school funding equalization reforms in the late 1980s and early 1990s, that reliance dipped to a low of about 45% in 1990, but is again approaching the 60% level in the late 1990s.

Cities and counties, due in principal part to I-105, have relied less and less heavily on property taxes. From a property tax reliance level of about 45% of budgets, cities' reliance declined to nearly 30% (1995), and counties are approaching that level as the century draws to a close.

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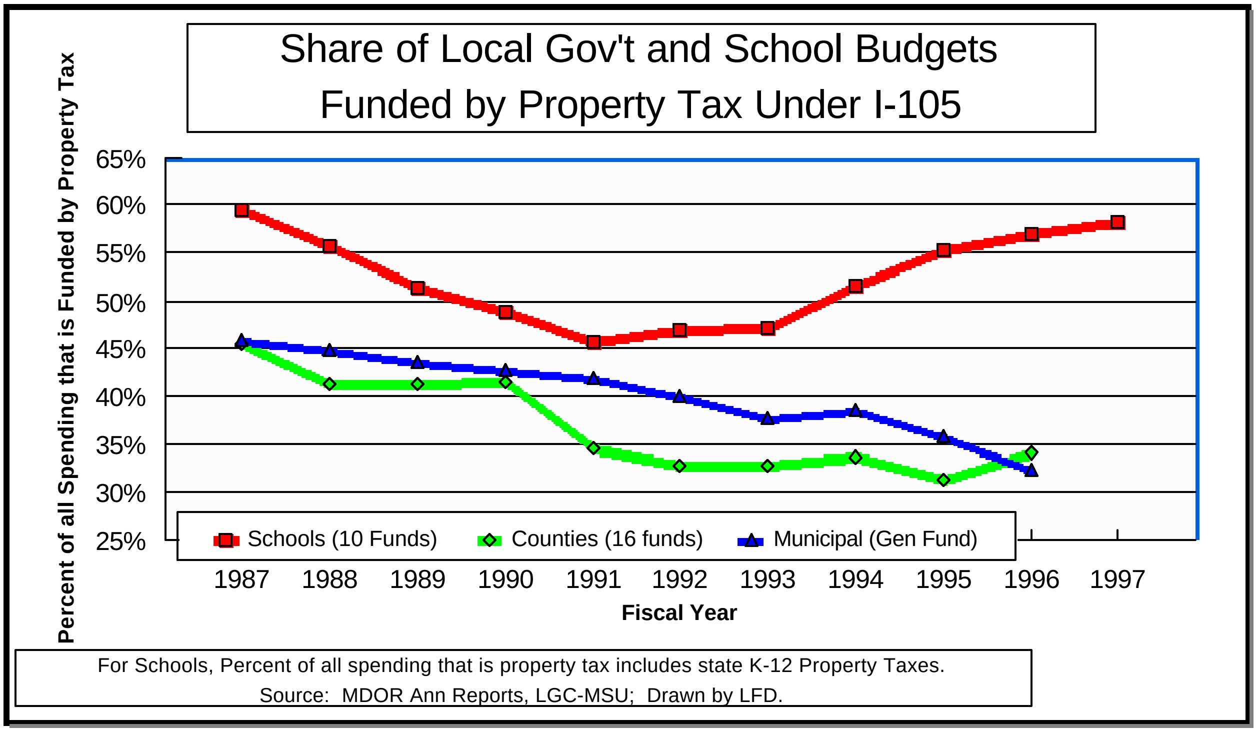
[15] The $775 million collected in 1997 does not include two significant sources of nonlevy revenue, i.e., approximately $75 million in automobile license taxes and $57 million in natural resources production taxes.

[16] It is widely known among folks who work with property taxes and tax policy that mill levies in incorporated municipalities are generally much higher than in suburban and rural areas. For purposes of comparison, it is common for total levies within cities and towns to exceed 500 mills, even approach 600 mills. In contrast, total levies of 350 mills or less are often the norm in suburban and rural areas. Consequently, comparable properties having equal, $100,000 market values could be taxed at highly differing rates, perhaps upwards of $1,900 in town and about $1,350 outside of town.

Chart 9



Is Something Missing?

Much of the information presented heretofore might cause a reader to question what the problem with property taxes is, if there is a problem. A quick review of the charts reveals:

- property taxes make up a smaller portion of total state and local taxes in 1997 than they did in 1972: 40% now versus 50% then;
- from 1972 to 1997, growth in total personal income averaged about 6.6% annually and CPI inflation averaged about 4.4%. On an individual basis, *per capita* incomes in Montana increased at an annual average of about 5.4% over the period.
- the growth in the state's total market value was over 600% between 1972 and 1997, but corresponding growth in the state's taxable value was less than 100%;
- the property tax base changed dramatically over the past 25 years, with homes, businesses, and utilities accounting for a much higher proportion of total statewide market and taxable values and with business equipment, natural resource production, livestock, and agricultural and timber lands each comprising a much lower proportion of total market and taxable values;

< in near lock step with changes in valuation, homes, businesses, and utilities bear larger shares of the property tax burden in 1997 than they did in 1972. As taxes have shifted onto those types of property, the beneficiaries have been ag and timber lands, business equipment, natural resource production, and livestock.

< schools consume the lion's share of property taxes, just over 60%, a proportion that has remained remarkably stable for the past 25 years;

< although statewide taxable value has swelled and declined periodically over the past 20 years, property tax collections have steadily increased, but at about 5.3% annually, more slowly than total personal income at about 6.6% annually and more slowly than per capita income at 5.4% annually;

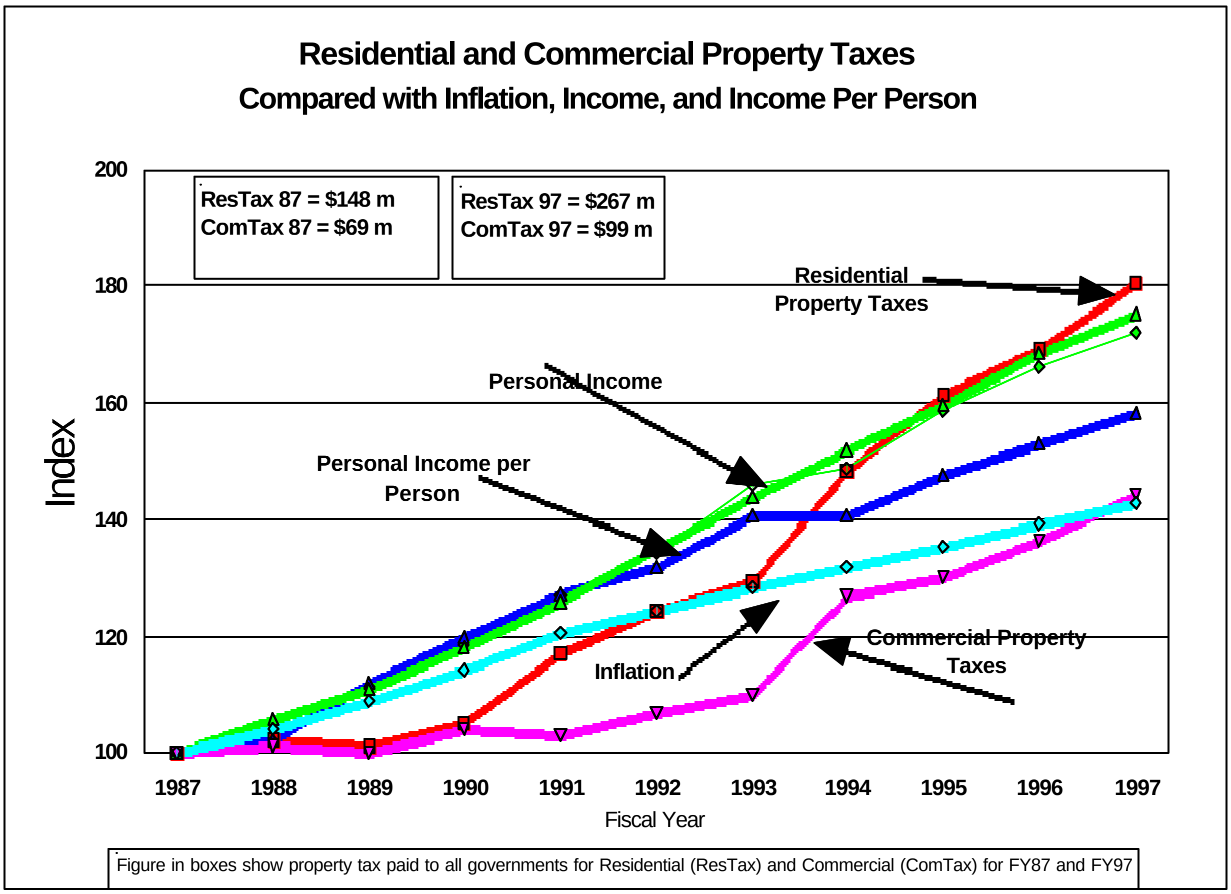
< K-12 schools rely on property taxes for about $3 of every $5 in their budgets. Cities and counties are not as dependent on property taxes, counting on levies for only about one-third of their respective budgets in 1997, down significantly from a 45% reliance in 1987.

Chart 10

So Where Is the Crisis?

Chart 10 tells part of the story. By building on information presented in Chart 2, the underlying reasons for property taxpayers', particularly home owners', disillusionment with property taxes begin to become apparent.

In short, property tax collections from residential property have increased faster in the past



10 years than has per capita income or total personal income. Moreover, the rate of change in

property taxes collected on homes has increased at virtually double the rate of inflation and at double the rate that property taxes collected on commercial realty increased.

To compare in another way, property tax collections from commercial realty increased by about 43% between 1987 and 1997, some 3.7% annually. Tax collections from residential property, however, increased by about 80% over the decade or just over 6% annually. The average annual rate of change in taxes collected on residential property was more than 50% greater than the rate of change in taxes collected on commercial realty.[17]

Intuitively, home owners perceive that they are bearing a heavier burden than they used to. Empirically, they are bearing a heavier burden.

Importantly, the aggregate "collections" referred to here are composed of three principal factors: (1) the net appreciation in value of existing properties; (2) the net addition of new properties, including improvements made to existing properties; and (3) net changes in mill levies. (Changes in the nominal or statutory tax rate could also have been a factor, but that rate has remained essentially static for the past 10 years.) In combination, the three principal factors have resulted in significant growth in aggregate collections.

Note, however, that while the rate of change in *aggregate* collections from residential and commercial property has exceeded rates of change in personal income and inflation over the same period of time, there are wide differences in changes in taxes paid experienced by *individual* residential and commercial taxpayers. Among this group, many have experienced changes in taxes on their own property that most likely have been less than the rates of change in inflation or statewide personal income. This situation results from formal and informal caps on property tax increases established in statute (primarily Title 7 and Title 20) and I-105 (Title 15, chapter 10, part 4) and from tax and spending policies followed at both the state and local levels.

CURRENT EVENTS

Aside from the historical overview, the Committee members were continually involved in adding to their individual knowledge and understanding. Additionally, "life goes on", and that fact eventually affected the focus and actions of the Committee, if not directly, at least indirectly.

Getting an Education

[17] To appreciate the longer-term effect of the difference in rates of change, compare a $20,000 annual income increasing by 3.7% annually between 1998 and 2008 to the same income increasing by 6% annually. At 3.7% growth the $20,000 income in 1998 becomes $28,700 while at a 6% rate income rises to $36,000. Over the next 5 years, the income growing at 3.7% would become $34,400, but the one growing at 6% becomes $48,400. In the first 10 years alone, the cumulative benefit of the 6% rate is some $34,000; over the 15-year period, the cumulative benefit balloons to over $87,000. Such is the magic of compounding.

Initially having at least a rudimentary understanding of property taxation in general, Montana's tax system, and the recent history of state and local taxes, the Committee endeavored to become more knowledgeable about processes and techniques employed by the Department of Revenue (DOR) staff in valuing property for tax purposes.

At the Committee's third meeting of the interim, in October 1997 in Dillon, DOR staff conducted a seminar in the fundamentals of property appraisal. During the 2-hour training session, the DOR staff and Committee members discussed comparable sales techniques and the income approach to valuation. Committee members challenged the DOR staff on matters ranging from "obsolescence" to the accuracy of sales data to changing markets to personal knowledge and integrity among DOR appraisers. By the end of the seminar, Committee members had greater understanding of DOR methods--if not greater faith in the application and outcomes of those methods.

Building on the value of the first seminar, the Committee also called upon DOR staff to conduct similar seminars: in December in Hamilton on the valuation of centrally assessed property, primarily utility and interstate transportation property; and in Havre in May on valuing agricultural lands.

At the January meetings in Lewistown, the Committee was also exposed to an intensive, 1-day seminar on the concept of "acquisition valuation" and the experience in California since Proposition 13 was adopted in 1978. The issue remained visible on Committee agendas for the remainder of the interim and received frequent attention in subsequent Committee discussions and in comments received at public hearings around the state.

By the end of the study, Committee members had invested numerous hours investigating the processes and substance of property appraisal for taxation purposes. Assuredly, the members now are more knowledgeable and have greater understanding of the property tax system than they did when the study began.

In another aspect of the curriculum, what might be referred to as a "public education", the Committee was also informed about taxes by the citizenry. Relying on a variety of facts, issues, situations, circumstances, anecdotes, speculation, analysis, and personal observations and experiences, residents enlightened the Committee to the way things really are for real people in the real world. After perhaps 100 hours or more of testimony, the members were "reeducated" and likely developed a broader and perhaps keener notion of the sentiments of the public--or at least the sentiments of those willing to share their insights and ideas.[18]

A Taxpayer Says "Bully!"

[18] Public testimony was summarized at the beginning of the report. For a more complete rendition of comments, a copy of the minutes of each Committee meeting, including testimony, is available at the Legislative Library, Room 102, State Capitol, Helena, MT, 59620.

The legislation that created the Committee, SB 195 (1997), was controversial from the start. Proponents lauded its principal effect, the virtual freeze in individual's residential and commercial property taxes at 1996 levels. Opponents criticized purported inequities and speculated that constitutional challenges--easily avoidable by pursuing different means of revision--would be mounted and succeed. Rhetoric aside, nearly everyone took comfort in the understanding that the "virtual freeze" solution was intended to be only temporary.

Within only 6 months of passage, provisions of SB 195 were challenged through the tax appeal process, including eventual appeal to the judiciary.[19] As fate would have it, the solution may be somewhat more temporary than intended. In August 1998, Tenth Judicial District Judge John Christensen of Lewistown ruled in *Roosevelt v. Department of Revenue*[20] that portions of SB 195 were unconstitutional, perhaps rendering the "virtual freeze" void. In September, the DOR filed a notice of appeal to the Montana Supreme Court, and in October, the parties to the appeal filed briefs on the case. Thus, with a decision on the appeal anticipated prior to final adjournment of the 56th Legislature, the matter of what to do with the most current (1996) appraisals may again have to be considered--and resolved.

Home on the Range

It can frequently be heard these days that, "Montana has been discovered". Translated into practical parlance, "discovery" has led to a growing population, growing demand for (certain) public services, changes in demographics, and changing landscapes.

Among the manifestations of recent growth have been the creation of numerous suburban tracts, "ranchettes", and "trophy homes".[21]

Philosophical differences articulated between developers and conservationists reached new heights, perhaps, in the early 1990s as the state's subdivision laws were assailed by the former for stifling economic development and by the latter for promoting urban sprawl and carving up of

[19] See, e.g., *Potter v. State Tax Appeal Board* and *Glacier Motor Inn v. State Tax Appeal Board*. Available at Montana State Tax Appeal Board, Helena, Montana, 59620.

[20] See Roosevelt v. Department of Revenue, DV-98-50. The plaintiff in this case was Theodore Roosevelt IV, the great grandson of President Theodore Roosevelt.

[21] The term "ranchette" is typically invoked in reference to a parcel of land that is at least 5 acres in area and is probably capable of sustaining a horse. The expression "trophy homes" has been introduced only recently into the lexicon and, with wide variation, refers to expansive residential structures constructed from unique plans and specifications by custom builders for mid-six-figure dollar amounts or more. Often, trophy homes are built on ranchettes in areas that have been relatively remote prior to development.

Montana's cherished open spaces. By the end of the 53rd Legislative Session a mostly acceptable compromise had been reached through the legislative process.

Through the debates over subdivision, it became apparent that subdivisions were also having significant effects in the tax arena, some of which were, of course, unintended. Among the unintended effects was the appraisal for tax purposes of subdivided parcels of relatively large size (20 to 160 acres). By law, these parcels were often reclassified and, hence, revalued as residential property rather than as agricultural land. The tax implications were dramatic as residential land was, and is, typically valued at multiples of 10 times higher than equal-sized parcels of agricultural land.

Over the past 10 years and for any number of reasons, numerous developer-assisted farmers and ranchers had created or were in the process of creating ranchettes, typically the 20-acre variety, and offering the parcels for sale as residential or "recreation" property. Because the land was no longer actively devoted to agricultural pursuits, the DOR by law reclassified and revalued the property for tax purposes at its significantly higher value as Class Four residential property. Thus, many Montanans who had historically paid taxes on their agricultural enterprises at preferential agricultural rates that were reasonably based on "productive capacity value" were suddenly confronted with the shocking reality of "market value" and so were unwary purchasers of the newly created parcels. Of course, such practices and the resulting increases and shifts would not withstand legislative scrutiny for very long. In 1993, Montana law was changed to provide special tax treatment for these 20- to 160-acre tracts, beginning in January 1994.[22]

Over the course of the study and in nearly every public hearing venue, the Committee encountered testimony regarding other unintended consequences of past legislative actions. Among the points made was the "incentive" to subdivide, unintentionally provided by the tax treatment of 20-plus-acre ranchettes. While speakers admonished the Committee that "something should be done", nothing in particular was mentioned as a solution.[23]

Generating Controversy

An obvious trend in public policy of the 1990s has been the deregulation of commercial activity. Following deregulation of the transportation and freight industries in the 1970s and 1980s was the deregulation of telecommunications in the 1980s and 1990s. During the 55th Legislative Session, it seemed to be the appropriate time to contemplate and effect the deregulation or

[22] See Section 1, Chapter 627, Laws of 1993.

[23] The matter of ranchettes and subdivisions and the tax implications of them were first touched upon in Livingston in March 1998 and frequently at meetings thereafter. At the Committee's final meeting, September 14, 1998, in Helena, Senator Laurents Grosfield (who was not a member of the Committee) reiterated his concerns and pledged to work with any Committee willing to confront the issues and to work towards better solutions.

“restructuring” of the electric and natural gas industries in Montana. After the dust settled, Senate Bill No. 390 (Ch. 505, L. 1997) provided for the transition from some 100 years of regulation to the 21st century and open competition.

Controversial as the restructuring legislation was, its anticipated consequences had not included the outright and nearly imminent sale of the electricity-generating facilities of the Montana Power Company, announced by the company in late 1997. Because of the nature of Montana’s property tax system, particularly property classification, the tax implications from restructuring and the pending sale of generating property became a focal point of inquiry.

The legislative Revenue Oversight Committee (ROC) was commissioned to study and make recommendations on the “utility taxation” piece of the property tax puzzle. Throughout 1997 and 1998, the ROC examined potential implications of restructuring, generally, and specifically the sale of electricity-generating assets.

Because the ROC will publish a full rendition of its activities, findings, conclusions, and recommendations regarding restructuring and the sale of MPC’s generating assets, only a summary of the study is provided here.[24]

The short of it is that the property tax landscape has changed. Where regulated utilities were historically saddled with disproportionately high property tax burdens,[25] unregulated utilities will not be able to compete effectively under traditional property tax schemes in an unregulated and competitive environment.

To accompany the changes towards market competition, options under consideration by the ROC and the affected industries call for a general and substantial reduction in property tax rates, from 12% currently to 6% (or less) in the near future, and the imposition of new or increase of existing taxes on consumption, generation, or use of energy or telecommunications.

The Grass Is Always Greener, or Is It?

Speaking of competition, a common thesis espoused by legislators, lobbyists, editorial writers, citizens, and others is that Montana’s tax structure is noncompetitive with neighboring states. Although the Committee attempted to test the premise, they found it formidably difficult

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[24] *Competition and the Taxation of Electric and Natural Gas Utilities and Telecommunications Services and Other Issues Before the Revenue Oversight Committee*, Legislative Revenue Oversight Committee, November 1998. Available from the Legislative Services Division, Room 138, State Capitol, Helena, MT 59620-1706.

[25] Perhaps to a greater extent than any other enterprise, regulated utilities shouldered a property tax burden that was higher than most commercial activities, although the burden was, arguably, only superficial to the economic interests of the industry. That was the case in the regulated environment because property taxes were allowed, through the rate structuring process, to be automatically distributed among utility customers. As a result, a utility was merely a property tax collector, acting as an inconspicuous agent on behalf of governmental entities.

to draw any definitive conclusions. What was discovered is that Montana's taxes are high and low, progressive and regressive, increasing and decreasing, equitable and punitive. Whatever the "facts" are, it is probably safe to say that most Montanans roundly perceive the state's tax system to be less than optimal.

Conversely, there is considerable risk in simplistically comparing taxes between states or between other jurisdictions, for that matter. As Hal Hovey, editor of *State Policy Reports*, observes:

> . . . comparing property taxes is much more difficult [than comparing sales or income taxes] because the decisions on property tax rates are made independently by tens of thousands of local governments which often overlap each other. The resulting rates and practices in determining assessed values of properties vary sharply within states, so no one is able to calculate and compare statewide averages without spending on research that has not been forthcoming from any source.[26]

Some of the obstacles encountered in attempting valid comparisons include:

< fundamentally different systems, including different mixes of major taxes (income, sales, property);

< significantly different nominal rates;

< significantly different tax bases;

< significantly different interrelationships among taxes within and between jurisdictions, such as the different effects of exemptions, exclusions, deductions, deferrals, credits, etc.;

< varying types and levels of public services provided; and

< fundamental differences in demographics (is the population expanding/contracting; aging or growing younger), geography (is there access to an ocean port), economics (history and trends in economic base, incomes, etc.), and so on.[27]

Even with these caveats and others, however, comparisons are bound to and, in fact, did happen during the Committee's study of Montana's property tax system.[28] For what it's worth, here are some data that are sure to cloud the issues.

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[26] *State Policy Reports*, Vol. 14, issue 17, p. 12 (Sept. 1996).

[27] Perhaps ironically, comparing Montana's own tax system over time is fraught with challenges quite similar to those identified above. For example, the nominal (statutory) tax rate on homes declined from 30% in 1972 to 8.55% in 1978, 3.86% in 1987, 3.838% in 1997, 3.816% in 1998, and a projected 3.794% in 1999. Based on nominal rates alone, substantial reduction in residential property taxes is implied. At the same time that rates were reduced, however, market values were changing as were mill levies--but, between jurisdictions, not necessarily at the same rates or even in the same direction! Therefore, drawing a conclusion about residential property taxes over the past 25 years based solely on the nominal tax rate would almost assuredly result in a false result.

[28] See Minutes, Interim Property Tax Committee, October 30, 1998; available at Legislative Services Division, Room 138, State Capitol, Helena, MT 59620.

- For calendar year 1995, the effective tax rate (taxes paid divided by full market value) on a typical suburban home in Montana was 1.16%, which ranked Montana 19th highest among the 50 states. Montana's 1.16% rate compared to a national high of 2.32% in New Jersey and to a national low of 0.16% in Hawaii. Regionally, some other states were (by percent and by rank): South Dakota, 1.69%, 9th; North Dakota, 1.14%, 20th; Oregon, 1.07%; 25th; Washington, 0.96%, 26th; Idaho, 0.89%, 29th; Colorado, 0.75%, 36th; Utah, 0.54%, 46th; Wyoming, 0.53%, 47th.[29]

- The average effective tax rate in Montana on Class Four property (homes *and* business realty) in 1996 was about 1.63% (property taxes paid divided by market value of property). In Missoula (city), the effective rate in 1996 was about 2.16%. Those effective rates compared to a 1995 U.S. mean average effective rate of 1.78% and a U.S. median average effective rate of 1.59%. Regionally, some other states were: Sioux Falls, SD, 2.55%; Fargo, ND, 2.06%; Boise, ID, 1.82%; Portland, OR, 1.80%; Billings, MT, 1.66%; Seattle, WA, 0.98%; Cheyenne, WY 0.76%.[30]

- For fiscal year 1995, total state and local *property* taxes in Montana, as a percentage of total personal income, were 5.01%, ranking Montana 6th highest nationally. Nationally, the average rate was 3.6%. New Hampshire's 6.2% ranked highest and Alabama's 1.21% lowest. Regionally, some other states were (by percent and by rank): Wyoming, 4.69%, 11th; Nebraska, 4.38%, 12th; South Dakota, 3.99%, 17th; Oregon, 3.92%, 18th; Washington, 3.63%, 24th; Colorado, 3.34%, 25th; North Dakota, 3.34%, 26th; Utah, 3.05%, 34th; Idaho, 3.04%, 35th.[31]

- For fiscal year 1995, state and local *property* taxes in Montana, on a *per capita* basis, were $879 per person, ranking Montana 15th highest nationally. Nationally, the average amount per capita was $774. New Jersey ranked highest at $1,540 and Alabama lowest at $216. Regionally some other states were: Wyoming, $948, 12th; Nebraska, $903, 14th;

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[29] *State Policy Reports*, Vol. 14, issue 17, p. 13 (Sept. 1996). Even here comparisons are misleading, however. Just with the effects of SB 195 alone, "market values" were virtually frozen at CY 1993 levels. DOR analysis showed that market values had risen across the state by 43% on average by 1996. Using the 43% increase in market value figure and holding mill levies constant, Montana's effective rate would have been about 43% less than the 1.16% calculated for CY 1995, a substantial reduction to 0.66%, a level sufficient to drop Montana in the rankings from 19th highest all the way down to 37th and below all of its neighbors except Wyoming (0.53% & 47th.)

[30] *Tax Rates and Tax Burdens in the District of Columbia: A Nationwide Comparison*, District of Columbia Department of Revenue and Finance, June 1996.

[31] *State Policy Reports*, Vol. 16, issue 16, p. 7 (Aug. 1998)

Washington, $805, 18th; Oregon, $789, 19th; South Dakota, $774, 20th; Colorado, $728, 25th; North Dakota, $618, 33rd; Idaho, $545, 36th; Utah, $513, 39th.[32]

L In 1976, the nominal tax rate applicable to homes and businesses was 12% of market value and the statewide average mill levy was about 200 mills. From that, the average effective tax rate (ETR) in 1976 in Montana for homes was about 2.4%. As noted previously, by 1995 the average ETR had declined to 1.16% on a typical suburban home. By 1998, with the effects of SB 195 accounted for, the ETR had declined to about 0.66%--less than one-third of the average ETR 20 years earlier.[33]

In making interstate or intrastate, interjurisdictional comparisons, reasons underlying most significant differences can be ascertained on a case-by-case basis. For the most part, differences in burdens are due to differences in tax philosophy (communicated through tax law) and differences in the consumption of publicly provided goods and services. Regardless of variations, what might seem obvious at first blush may, in fact, be specious.

From Assimilation to Integration

As the Committee members began to assimilate information gathered through observations, experience, reading, studying, and listening to and conversing with Montanans, they also began to search, intellectually at least, for solutions to perceived problems. Although agreement among the members as to the problem(s) to be solved was not unanimous, there was general agreement in certain respects.

< Home owners felt that their property taxes were too high, had been increasing, and were likely to increase further.

< The owners of virtually every “class” of property believe that the property taxes they pay are overly burdensome. For nonresidential property owners, a common theme was that high property taxes are a significant impediment to economic competitiveness and, hence, to economic development.

< Changes in property taxes and the factors underpinning property taxes were not uniform across the state and would not likely become uniform. For example, market values have been and will continue to change at markedly different rates.

[32] Ibid. See also, Table A6 in “Michigan School Funding Switch Analyzed” in *State Tax Notes*; Vol. 15, No. 17; Oct. 26, 1998, pp. 1061-1083. (Tax Analysts, pub., 6830 N Fairfax Drive, Arlington, VA, 22213)

[33] Author’s calculations, based on Department of Revenue and Legislative Fiscal Division reports.

< To significantly reduce property taxes--"significantly" meaning something on the order of $500 million annually--would require another source of revenue. The only source of revenue of that magnitude remaining untapped in Montana is a statewide, general retail sales tax at about 4%.

< Due to the decision in *Roosevelt v. Department of Revenue*, the "temporary" nature of SB 195 may be more temporary than hoped for in 1997. A different approach to the taxation of Class Four property may be necessary prior to adjournment of the 56th Legislature.

< The specter of CI-75 looms large. If adopted, CI-75 may preclude many of the options historically available to policymakers. Even if CI-75 fails, the initiative process may be used again in the future to attempt reforms that the Legislature has been unable to achieve or even unwilling to consider.[34]

< If there is a way to say it in a nonpejorative manner, there is substantial ignorance and misunderstanding about Montana's tax system.[35]

Even with some common agreement on underlying problems, the Committee faced the dilemma confronting the whole Legislature and, in fact, all of Montana: How can the "problems" be solved simply, legally, equitably, uniformly, and quickly?

SOLUTIONS

It may be human nature to solve problems. Isaac Newton invented calculus to solve equations proving gravity. Jonas Salk inoculated himself with the polio vaccine to solve the medical questions about the efficacy of his theories. Marc Andreesen invented or at least perfected hypertext markup language or "html" in his Netscape browser so that lay people could communicate effectively and easily over the Internet. In their own way, each of these people saw a "problem" and went about creating a solution.

In a similar vein, members of the Interim Property Tax Committee identified "problems" in the state's approach to tax policy, particularly property taxes. Because it was the Committee's charge to "solve" the property tax dilemma and because the members of the Committee were, inherently, problem solvers, the outlines of solutions began taking shape quite early in the study process. After hours of discussion, examination, and reflection, individual members of the Committee began proposing alternatives early in 1998. Some of the solutions were confined to narrow aspects of property taxation; others called for totally new approaches or for comprehensive overhaul. The following is a summary of alternatives considered by the Committee.

[34] As noted in the Prologue, CI-75 was adopted by the electorate on November 3, 1998.

[35] As Will Rogers said, "We're all ignorant, just on different subjects."

Minor Options

Alternatives that were proposed and considered but rejected included the following options:

Increase the Penalty and Interest Provisions for Delinquent Property Taxes.

The initial theory was that taxpayers would be more likely to pay their property taxes in a timely manner if the financial disincentives for not paying were enhanced. After closer examination, it was determined that current penalty and interest provisions were sufficient.

Authorize Local Government to Impose a Local Option Bed Tax, Analogous to the Statewide "Accommodations" Tax.

With local governments struggling under the restrictions of I-105 and SB 195, the hypothesis was that providing an alternative source of revenue to local governments could result in decreased property tax burdens. Moreover, the alternative revenue would come mostly from persons not already burdened with property taxes within the jurisdiction imposing the optional levy. Support for and opposition to the alternative were both lukewarm and, as a result, the alternative was discarded.

Alternatives that were proposed, considered and forwarded to the 56th Legislature for further deliberation included the following options.

Authorize Local Option Sales Taxes.

Patterned after the "resort tax" concept, this alternative was intended to allow local officials and citizens to alleviate some of the local property tax burden by self-imposing a local sales tax. The local option sales tax alternative includes a requirement for a favorable vote by the local electorate.

Highlights of the local option sales tax alternative include:

< The maximum rate of local option tax is capped at 3%.

< At least 5% of local option tax revenue must be used to reduce local property taxes.

< The tax may be applied to goods and services sold by the following establishments:

- hotels, motels, and other lodging or camping facilities;
- restaurants, fast food stores, and other food service establishments;

- taverns, bars, night clubs, lounges, and other public establishments that serve beer, wine, liquor, or other alcoholic beverages by the drink;
- destination ski resorts and other destination recreational facilities; and
- establishments that sell luxuries, loosely defined as any gift item, luxury item, or other item normally sold to the public or to transient visitors or tourists. "Luxuries" do not include food purchased unprepared or unserved, medicine, medical supplies and services, appliances, hardware supplies and tools, or any necessities of life. (See Appendix A, LC-SS-1A.001.)

Circuit Breaker Enhancement Alternative

Montana has at least three different methods by which lower-income home owners and elderly home owners may reduce their property tax burdens. First, a direct reduction in property taxes is available for all lower-income home owners under 15-6-134, MCA.

- For tax year 1998, the maximum income thresholds will be just under $17,000 for singles and just over $22,640 for marrieds or heads of households. The proposal would increase the thresholds to at least $20,000 for singles and to at least $25,000 for marrieds or heads of households.
- The minimum reduction would remain at 30% of property taxes assessed, and the maximum reduction would remain at 80% of taxes assessed.

An indirect reduction in property taxes through an income tax credit mechanism is available to lower-income elderly home owners and renters under 15-30-171, et seq., MCA.

- For tax year 1998, the maximum income threshold is $12,000 of "household income" (which means income from all sources received by everyone in the "household" less $6,300).
- The maximum credit available is limited to $1,000.

Under the alternative considered by the Committee, "social security" and "railroad retirement" income would be excludable from "household income" and the maximum available credit would be increased to $1,500.

Finally, there is a type of reverse annuity mortgage available for certain lower-income, elderly home owners through the Montana Department of Commerce. Employing the reverse annuity mortgage allows low-income seniors to use the equity in their home to pay for normal living expenses, including property taxes on the home. Without specifically recommending any revisions to the reverse annuity mortgage program, the Committee recommended that the Department of Revenue and the Department of Commerce do more to make eligible taxpayers aware of this program. (See Appendix A, LC9997.)

Business Equipment Exemption

The “business equipment” tax applies generally to the personal property owned by commercial enterprises in Montana. Currently, property taxes on business equipment are determined by multiplying the market value of property (typically determined through national appraisal guides or through depreciated value techniques) by a 6% statutory tax rate. The resulting “taxable value” is multiplied again by the jurisdictional mill levy.

For example, business equipment having a *market value* of $100,000 would have a *taxable value* of $6,000 that would be subjected to the jurisdictional mill levy, e.g., 420 mills, resulting in a tax bill of $2,520. Measured another way, the effective tax rate (i.e., taxes paid divided by the market value of the property) on the equipment in this example would be 2.52%

Under the proposed alternative, the first $25,000 or less of market value of Class Eight business equipment would be exempt from property taxation, thereby relieving, in total, a substantial number of small, main street businesses from the business equipment tax. Depending on the amount of business equipment owned by businesses and industrial enterprises, effects of the exemption to individual property owners would range from absolute exemption to minimal impact.

Under this option and using the figures from the above example, the $100,000 of business equipment would be reduced by $25,000, leaving $75,000 in market value. That amount would be multiplied by the 6% rate, resulting in a taxable value of $4,500. Applying the jurisdictional mill levy of 420 mills concludes in a tax bill of $1,890. The resulting effective tax rate of 1.89% compared to the prior 2.52% rate is a full 25% lower.

Comparatively, an enterprise with $1 million of business equipment would also receive the $25,000 exemption. Currently, by applying the same assumptions used previously, this entity would have business equipment with a *taxable value* of $60,000 (the $1 million time the 6% rate). The $60,000 in taxable value would be multiplied by the local mill levy, 420 mills in this example, resulting in a tax bill of $25,200. Thus the current effective tax rate would again be 2.52%.

Under the proposed $25,000 exemption, the $1 million in business equipment would receive the $25,000 exemption, thus leaving $975,000 in market value. That market value multiplied by the 6% statutory rate results in a taxable value of $58,500. Following through by applying the mill levy of 420 mills, the tax bill would be $24,570 for an effective tax rate of 2.457%, a reduction of 2.5%

Any enterprise having business equipment with a total market value of $25,000 or less would have a 0% effective tax rate and a 100% reduction from current practice.

<u>Major Options</u>

Several alternatives that could probably be referred to as “major” were proposed and considered but were rejected, either overtly or passively. These proposals included the following options.

A Tax on Consumption

Mr. John Pester from Havre promoted to the Committee a plan that would significantly reduce property taxes by replacing property tax revenue with revenue generated from a tax on the consumption of goods and services. Although Mr. Pester provided considerable explanation of his proposal, detail and clarity was lacking. The Committee did not consider a formal proposal incorporating Mr. Pester’s plan.

A Tax on Transactions

State Representative Paul Bankhead of Heron advanced an idea for a tax of 1% on all “transactions” between buyers and sellers, limited to the final sale or purchase. It was Representative Bankhead’s contention that a 1% transaction tax would generate sufficient revenue to eliminate the state individual income tax (±$400 million annually) ***and*** all property taxes (±$800 million annually). Representative Bankhead also provided to the Committee extensive explanation of his proposal, but detail and clarity was lacking here as well. The Committee did not consider a formal proposal incorporating Representative Bankhead’s proposal; consequently, his proposal will not be forwarded to the 56th Legislature for further consideration.

Just Stop Spending

Mr. Wes Higgins of Kalispell asserted that high taxes were merely a result of high spending. Therefore, his suggestion to the Committee was to “just stop spending”. [36] In response to a question about what programs and services should be cut or eliminated if his “just stop spending” admonition was implemented, his answer was that nothing would have to be curtailed or eliminated. Mr. Higgins did not provide a written delineation of his proposal. The Committee did not consider a formal proposal containing Mr. Higgins’ ideas; consequently, his proposal will not be forwarded to the 56th Legislature for further consideration.

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[36] See Minutes, Interim Property Tax Committee, May 15, 1998, on file at Montana Legislative Services Division, Room 138, State Capitol, Helena, MT 59620-1706.

Three other major alternatives were considered by the Committee and will be forwarded to the 56th Legislature for additional consideration, debate, refinement, and possible adoption. The major alternatives are outlined below.

Acquisition Value Alternative

California, in 1978, was the first state to adopt “acquisition value” as the basis for the taxation of property. Since then, Florida and Michigan, at least, have adopted some form of “acquisition value” for property tax purposes.

Under the “acquisition value” approach, real property, such as a home, a business, or an industrial plant, is valued for tax purposes at its market value as of some base year or, if the property has sold since the “base year”, the value at which it was acquired by a new owner; thus, the term “acquisition value”.

In states that have adopted some form of acquisition value for property tax purposes, there is commonly some annual, nominal change allowed in the base value. For example, in California, the annual rate of change in base value for tax purposes is inflation (measured by the consumer price index or CPI) or 2%, whichever is less. In Florida, the maximum change is the lesser of 3% or CPI. In either state, the “assessed” value of property, i.e., the “base value” calibrated by the annual adjustment factor, cannot exceed the “market” value of the property.

While an acquisition valuation system results in similar property being taxed at highly different levels, the literature indicates that the method has ample support among taxpayers within jurisdictions that have adopted the policy.

Highlights of this proposal include:

< The alternative forwarded by the Committee would apply the acquisition value method to both residential and commercial real estate and improvements, but not to agricultural land.

< The “assessed value” would be adjusted annually at the lesser of CPI inflation or 1%.

< At implementation, the “base value” would be “assessed value” for tax (calendar) year 1993 unless:

- the property was bought or sold after January 1, 1993. If bought or sold after January 1, 1993, the base value would be the price at which the new owner acquired the property.
- improvements were made to the property. All improvements would be valued at their market value as of the date of the improvement. The value of the improvement would be assessed, in each year, separately from the base value of the property and from other improvements.

- the use of the property changed. For example, if residential property was converted to commercial property after January 1, 1993, the property would be appraised at its value as commercial property as of the date of the change in use.

By the time this alternative could be implemented, January 1, 2001, at the earliest, the 1993 "base values" would all have been adjusted by 1% for each year 1994 through 2000, inclusive. Thus, a property with a "base value" of $100,000 in 1993 would have an assessed value of $108,285 for tax year 2001.

Another significant highlight of this alternative is that commercial and residential property are initially treated the same *vis-a-vis* base value and annual adjustments. However, if a commercial property has not been bought or sold by January 1, 2013, the Department of Revenue is required to appraise the property at the then-current market value and record the newly determined value as the "assessed value" for property tax purposes. This process for revaluing commercial property would apply to any commercial property that had not been bought or sold or otherwise revalued within the most recent 20-year period, i.e., 1993-2013; 1994-2014; 1998-2018.

In contrast, a residential property with a 1993 "base year" value would retain the 1993 value (adjusted) until the property was bought or sold or otherwise improved.

This alternative is dependent upon the adoption of a constitutional amendment, without which it is questionable whether or not an acquisition value approach to property valuation for tax purposes would be legal. (See Appendix A, LC-AE-1A.001 and LC-AE-3A.002.)

Combination Alternative

An alternative combining several previously considered options was considered and forwarded by the Committee. Referred to as the "combination alternative", this option, as considered by the Committee, would:

- implement for 1999 the most recent (1996) market valuations for Class Four property, basically, homes and businesses;
- exempt from property taxation 25% of the first $100,000 or less of market value of a single-family residence occupied by the home owner for at least 8 months per year;
- reduce the statewide equalization levy for K-12 school equalization from 40 mills to 37 mills;

C reduce the statutory nominal tax rate on homes and businesses from 3.816% (1998) to 3.25% (1999 and thereafter).

This alternative focuses on providing substantial and immediate property tax relief to home owners but could provide significant relief to most commercial property as well. There would be no reduction in the amount of property taxes collected in the aggregate. Instead, taxes currently paid by home owners would be reduced and shifted to commercial, industrial, utility, and other taxpayers. It is implementable immediately, i.e., for tax year 1999.

The shifting that would occur under this option would accrue to different types (classes) of property in different ways. Home owners would gain the most relief, and commercial property could also gain significantly. Utility property, business equipment, and centrally assessed transportation property (railroads, airlines, etc.) would bear a somewhat higher proportion of the burden than they now do.

Different geographical areas of the state would also fare differently, some areas getting more (or less) relief than other areas, and some types of property in some areas benefiting more (or less) than the same types of property in other areas.

As proposed, this alternative would significantly mitigate the effects of the 1996 statewide reappraisal for most home owners in the state. However, like any solution to be applied statewide, individual home owners would likely experience some change in their actual property tax liabilities. (See Appendix A, LCSWAN-3.002.)

Comprehensive Reform Alternative

An option for extensively revising property taxes has been forwarded by the Committee for consideration by the 56th Legislature. As proposed, a 4% general, retail sales tax, capped constitutionally, would be imposed statewide and the revenue from the sales tax would be used to:

< reduce property taxes by about $500 million annually, which taxes are currently committed primarily to K-12 schools and the university system by:
- exempting business equipment and livestock from property taxation (about $80 million); and
- replacing approximately $400 million of property-tax-funded K-12 school costs with a like amount of state funding for K-12;

< provide sales tax rebates to certain (lower-income) individual income taxpayers;

< reduce the flat tax rate on automobiles and light trucks from 2% to 1.5% of value (about $20 million annually); and

< replace certain other revenue from eliminated property taxes.

The proposal would also:

< provide home owners an exemption from property taxation of 65% of the first $50,000 or less of market value of an owner-occupied residence;

< simplify the property tax system by eliminating the various statutory, nominal rates applied to the various classes of property for tax purposes and assessing all property subject to property taxation at 100% of value for tax purposes;

< limit future increases in property taxes;

< revise county classifications and debt limits for budgeting purposes; and

< repeal the remaining provisions of Initiative No. 105.

While the Legislature and the Governor could, conceivably at least, pass and approve this alternative, there is general agreement among policymakers and pundits that such a far-reaching proposal must be referred to the public.[37] Consequently, if the electorate approved the measure, it would be unlikely that this alternative could be implemented before January 1, 2000. More likely, implementation would be in mid-2000 or later. (See SB 258, 1997.)

SUMMARY AND CONCLUSION

Property taxes have been, are now, and likely will continue to be a matter of public and private discussions and concern, even irritation. Although commonly perceived to be a fairly simple matter, property taxation in its own right is a complicated matter. In the context of the state, local, and national tax systems, property taxation and its underlying policies are truly complex.

To the natural complexities of the interrelationships of tax bases, public desires, legal requirements, and fiscal capacities at the individual and macro levels must be added the unknowns of changes in demographics, economics, and public preferences in the future.

The Interim Property Tax Committee, composed of 12 diligent and committed legislators, was assigned a devilish task. The challenge of preparing a menu of alternatives for "reforming" the state's property tax system was not particularly difficult in and of itself. The greater challenge was in attempting to identify "reforms" that are simple, legal, equitable (whatever that means), and implementable within a very short timeframe.

Historical data contradict a number of common and widely held perceptions, including:

C Property taxes as a share of all state and local taxes have decreased significantly in the past 25 years, from about 50% of the total to about 40% of the total.

C The total of state and local taxes as a percentage of total personal income has remained remarkably stable over the past 25 years and is less now than it was 25 years ago.

[37] Under CI-75, now Article VIII, section 17, of the Montana constitution, the alternative would have to be segregate and referred to the electorate.

C Growth in both total personal income and in per capita income has exceeded growth in property tax collections, especially in recent years.

C In the context of total property tax collections, agricultural land, timber land, natural resources, and business equipment each bear a substantially smaller share of the burden now than 25 years ago.

In contrast, several other commonly and widely held perceptions are borne out by historical data, including:

C In recent years, particularly since 1987, property tax collections on residential and commercial realty have accounted for an ever larger share of total property tax collections. The same may be said for utility property, especially centrally assessed electric and telephone property.

C Also since 1987, the rate of growth in property tax collections on residential and commercial realty has exceeded the growth rate in personal income, both total and per capita.

Throughout the interim, the Committee was regularly and consistently informed by citizens, especially home owners, that property taxes were too high. Simultaneously, the Committee was also admonished to “do something” to mitigate the burden. Some of the citizens noted the complexity and difficulty of effecting change; others, however, seemed to assess the process of reform as a simple one if legislators would “just do it”.

In the final analysis, the Committee settled upon alternatives that have been considered repeatedly over the decades. Among the major alternatives, all three have been attempted during the 1990s--the comprehensive reform option in 1993 (SB 235); the acquisition value option in 1995 (CA 28); and alternatives considered in 1997 (but rejected) and consolidated in the combination option. For good or ill, each of the attempts failed.

With the convening of the 56th Legislative Session in January 1999, state senators and representatives will again visit the issues associated with property taxes and tax policy generally. The effort exerted by the Interim Property Tax Committee over the 1997-98 interim should help to raise the level of discourse.

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APPENDIX A
DRAFT LEGISLATION

The Interim Property Tax Committee considered a number of alternatives for reforming Montana's property tax system and forwards the concepts contained in the following bill drafts for consideration by the 56th Legislature. None of the draft bills was specifically sanctioned by the Committee, but each of the drafts garnered sufficient Committee support to be included on the "menu of alternatives" required by the enabling legislation, Senate Bill No. 195 (Ch. 463, L. 1997).

Nature of Draft Legislation	Identifier
Local option sales tax	LC-SS-1A.001
Enhancing circuit breakers	LC 9997
Business equipment exemption	LC 9996
Acquisition value: constitutional amendment	LC-AE-1A.001
Acquisition value: enabling legislation	LC-AE-3A.002
Combination option	LCSWAN-3.002

In discussing the "comprehensive reform" option, the Committee relied on and referred to Senate Bill No. 258 (1997) as a guide. As drafted, SB 258 would have enacted a 4% statewide, general retail sales tax and would have used the revenue to overhaul the property tax system and reduce property taxes in a variety of way. SB 258 was a lengthy bill and is not reprinted here, but copies are available at the Legislative Services Division, Room 138, State Capitol, Helena, MT 59620.

APPENDIX B
TAXATION GRAPHICS

The charts contained in this appendix formed the core of presentations made at the beginning of each of the Committee's public hearings. Charts 1 through 10 in the body of the preceding narrative were extracted from the charts presented in this appendix.

Most of the data for the charts in this appendix were compiled by and formatted by Jim Standaert, Senior Fiscal Analyst, Legislative Fiscal Division, Room 105, State Capitol, Helena, MT 59602. The Local Government Center, Montana State University-Bozeman, also provided some of the information in the charts.

APPENDIX C
CHRONOLOGY OF PROPERTY TAXATION STATUTES
1972 - 1997

The material contained in this appendix provides an overview of changes in property tax statutes since 1972. The statutory structure changes over the 12-year period due to class consolidations and proliferation, recodification, and other factors. Because of these changes, it is essential for the reader to recognize that the component types of property in any class of property may be different from one year to the next or one decade to the next.