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15 **MONTANA FOURTEENTH JUDICIAL DISTRICT COURT, MEAGHER COUNTY**

16 *****

15 **CHARLES B. LUCAS; LUCAS RANCH,**)
16 **INC.; MONTANA FARM BUREAU**)
17 **FEDERATION; and THE MONTANA**)
18 **TAXPAYERS' ASSOCIATION,**)

19 Petitioners,)

20 vs.)

21 **MONTANA DEPARTMENT OF REVENUE**)

22 Respondent.)

23 **CAUSE NO. DV-10-02**

24 **AFFIDAVIT OF DALLAS REESE**

25 **STATE OF MONTANA**)
26 : ss.
27 **County of Lewis and Clark**)

28 **EXHIBIT A**

29 Dallas Reese, being first duly sworn on his oath, states and alleges as follows:

30 1. I am a Montana Department of Revenue's ("DOR") Management Analyst for the

1 DOR's Property Assessment Division ("PAD"), and I make this affidavit based upon my
2 personal knowledge and in support of DOR's opposition to the Petitioners' Motion for Class
3 Certification.

4 2. I have been a DOR PAD Management Analyst since December 2004.

5 3. My principle duties include, but are not limited to, overseeing the
6 agricultural/forest reappraisal (Class 3 and Class 10 property as defined in sections 15-6-133
7 and 143, MCA); reviewing requests submitted by taxpayers asking for review of their valuations
8 by AB-26 forms filed or by filing valuation appeals directly with county tax appeal boards;
9 training of PAD staff in the counties regarding these processes; data analysis relative to Class
10 3 and Class 10 properties; drafting manuals, instructions and proposed Rules related to Class 3
11 and Class 10 properties; testifying before the Legislature; conducting public hearings or
12 meetings to share information and responding to taxpayer concerns.

13 4. I was a Tax Policy Analyst with DOR's Tax Policy and Research ("TPR") from
14 August 1999 to December 2004.

15 5. I was an appraisal specialist with PAD from about May 1990 to August 1999. As
16 an appraisal specialist, my principle duties were virtually the same as the Management Analyst
17 but with less testimony and reappraisal activity.

18 6. I began my career with PAD in Havre in March 1988 as a residential/agricultural
19 appraiser.

20 7. For the most recent Montana cyclical reappraisal, approximately 280,000
21 agricultural parcels were evaluated. This reappraisal process for agricultural property was the
22 most comprehensive and detailed in almost 45 years. In one manner or another, each parcel
23 was analyzed. This would have included either or a combination of a: field review, desktop
24 review by appraisers, aerial photograph parcel review, and soil survey reviews of the parcels.
25 In addition, DOR considered any and all owner supplied information. For example, from

1 December 10, 2008 through March 1, 2009, DOR conducted a "map" mailing to property
2 owners. This process consisted of mailing aerial photographs that depicted DOR's most recent
3 information of the respective parcels' classification and productivity as known by DOR. Owners
4 were requested to correct any errant classification and/or productivity information relative to the
5 parcel's classification and production and return the maps to DOR. If the maps were not
6 returned, DOR presumed the information was accurate. DOR accepted owner responses to
7 the map mailing into November 2009. Approximately ten (10%) percent of the owners returned
8 the maps with corrected information.

9 8. In determining the 2009 Class 3 property values multiple steps were undertaken
10 pursuant to the valuation formula and processes set out in Title 15, Chapter 7, Part 2. The
11 process is one of determining an income for the land that is derived from agricultural
12 productivity and then translating that income to a property value through the use of a rate
13 divisor. For agricultural land, the initial administrative steps were to identify the land use
14 (classification).

15 9. Classification is based on the land's actual use and how that use fits into one of
16 five classification categories used by DOR. The five classifications are: (a) grazing land; (b)
17 non-irrigated summer fallow farm land; (c) irrigated land; (d) non-irrigated continuously cropped
18 hay land; and (e) non-irrigated continuously cropped farmland.

19 10. After determining the classification, productivity (yield) for each of the
20 classifications is ascertained. For the 2009 valuation, the United States Department of
21 Agriculture Natural Resource Conservation Service (USDA NRCS) soil survey was used as an
22 objective, scientific and statewide source of data. The Governor's Agricultural Land Advisory
23 Committee ("GALAC") recommended that DOR use the NRCS soil survey. Information
24 pertaining to the Committee's recommendation for the use of the NRCS soil survey for
25 agricultural land productivity was presented to various Revenue and Transportation Interim

1 Committees beginning in 2007 and to the Select Committee on Reappraisal during the 2009
2 Legislative Session.

3 11. For each of the five land classification, production information specific to each
4 land classification is captured from the NRCS soil survey and is assigned to each acre of land.
5 Since Montana conducts its property tax appraisals on a statewide basis (as opposed to county
6 by county as is done in most other states) a crop or carrying capacity must be applicable to all
7 landowners across the state. As a result, GALAC have recommended the use of the following
8 crops for determination of crop production or grazing land carrying capacities.

- 9 a. For non-irrigated summer fallow farm land and non-irrigated continuously
10 cropped farm land the crop used to determine productivity is the number
11 of bushels of spring wheat that an acre of land can produce. Spring wheat
12 can be grown in all locations of Montana. It may not be grown as a matter
13 of individual economic decisions but it is the only small grain crop that can
14 be grown across the state.
- 15 b. For irrigated land and non-irrigated continuously cropped hay land the
16 base crop is the number of tons of alfalfa hay that can be produced per
17 acre. Alfalfa hay is the predominant crop grown on irrigated land in the
18 state and is generally included as either the predominant crop or as a part
19 of the hay production associated with non-irrigated hay production. For
20 irrigated land the base crop is the tons of alfalfa hay that may be grown
21 under irrigation practices. For non-irrigated hay land the base crop is the
22 number of tons of non-irrigated alfalfa hay that can be grown per acre.
- 23 c. For grazing land the carrying capacity is expressed as the number of
24 animal unit months per acre (AUM/ac) that the land can support. Carrying
25 capacity should reflect the ability of the land to support grazing activity
without injurious effect to the vegetation.

Following the determination of productivity from the NRCS soil survey, adjustments are made
to reflect "average management" per 15-7-201(7)(e), MCA. For summer fallow farm land and
continuously cropped farm land, the soil survey spring wheat productivity is adjusted by a 12
year countywide average production for spring wheat obtained from Montana Agricultural
Statistical Services. This adjustment was a recommendation by GALAC. For irrigated land an
adjustment factor is applied to the soil survey estimate of the tons of irrigated alfalfa production
per acre. The irrigated adjustment factor is determined through information provided by

1 producers in each county. While the irrigated adjustment factor is generally a countywide
2 adjustment, there are circumstances where DOR discovered information provided in the
3 landowner responses that indicated the irrigated adjustments should be more localized. In
4 those counties multiple adjustment factors were determined and were applied to the
5 appropriate areas within the county.

6 For non-irrigated hay land DOR used a "step through" approach as recommended by
7 GALAC. This approach works as follows: The base crop used for productivity on non-irrigated
8 hay land is "alfalfa hay." When alfalfa hay information wasn't available in the soil survey, DOR
9 used "grass hay" production information from the soil survey. If neither alfalfa hay nor grass
10 hay were available, DOR used "grass legume" hay production information from the soil survey.
11 When none of those three were available, DOR used the pounds of air-dry herbage from the
12 soil survey and divided by 2,000 pounds to convert that figure to tons/acre. If none of those
13 were available, DOR defaulted to a state-wide minimum production figure of .07 tons/acre for
14 non-irrigated hay.

15 The most recent GALAC undertook a study of grazing land carrying capacity in the state
16 and, based on the results of the study suggested an approach to determining the carrying
17 capacity of grazing land. The Committee felt that the carrying capacity of grazing land would
18 not change significantly over time and their recommended approach was an attempt to ensure
19 that significant changes did not occur.

20 12. Section 15-7-201(3), MCA, requires that the value of agricultural land be based
21 on its "productive capacity" as opposed to actual productivity.

22 13. Section 15-7-201 (4), MCA, identifies the valuation formula that is to be used in
23 the determination of agricultural land values. In this regard, DOR is required to determine the
24 value on a per-acre basis. Mont. Code Ann. § 15-7-201(4)(a) and 4(b).

25 ///

1 14. Section 15-7-201(5)(a) states that "[N]et income must be determined separately
2 in each land use based on production categories."

3 15. After determining the classification and productivity, the productivity was
4 multiplied times a seven year Olympic average (2001-07) commodity price determined by
5 Montana agricultural statistical data from sources set out in section 15-7-201(5), MCA. This
6 produces a "gross income" per acre. The data source for all commodity price information is the
7 Montana Agricultural Statistical Service, an office of the USDA National Agricultural Statistical
8 Service. Commodity price information for the 2009 appraisal cycle are the seven (7) year
9 Olympic average (15-7-201-(5)(d) prices for:

- 10 a. Price per bushel of spring wheat: \$4.58 per bushel. This price includes a
11 \$0.59 influence from the Federal Agriculture Improvement and Reform
12 Act of 1996 (1996 Farm Bill) and Farm Security and Rural Investment Act
13 of 2002 (2002 Farm Bill)
- 14 b. Price per ton of alfalfa hay: \$63.04 per ton. Per 15-7-201(5)(c) the price
15 per ton of alfalfa hay has been reduced to 80% of the average price.
- 16 c. Price per animal unit month of grazing: \$15.72 per animal unit month
17 ("AUM").

18 By multiplying the productivity by the commodity price, the result is a "gross income" per acre.

19 16. After determining gross income per acre, different approaches are used to arrive
20 at "net income" per acre. The approaches DOR uses to determine net income have been
21 recommended to DOR by GALAC and have been in place since 1993. DOR has a proposed
22 administrative rule which covers this determination.

23 For grazing land, a 25% reduction to the gross income is allowed to reflect landowner
24 costs for maintenance. After the 25% reduction, the remaining income is considered the net
25 income. Once net income is determined, DOR calculates the net income per acre by
multiplying the productivity from the NRCS soil survey (expressed on a per-acre basis) times
the net income. This calculation yields the net income per acre for grazing land.

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1 17. For all other classifications, a "crop share approach" is used to determine net
2 income.

3 For non-irrigated summer fallow farm land, the typical crop share of 25% of gross
4 income received by the landowner is considered the net income. The remaining 75% is the
5 tenants' share of income and includes all farming expenses. For non-irrigated summer fallow
6 farm land as defined by DOR and per the recommendation of GALAC, the crop share used in
7 the determination of per-acre net income is 12.5%. This crop share recognizes that income
8 from non-irrigated summer fallow farm land, as defined by DOR, is being received every other
9 year.

10 For irrigated land, the crop share used by DOR is 25% of the income to the landowner
11 and 75% to the tenant. The typical crop share arrangement for irrigated land is 33% to the
12 landowner and 67% to the tenant. However, the various Agricultural Land Advisory
13 Committees reduced the typical crop share by an additional 25%, yielding a 25% crop share for
14 irrigated land. The 25% crop share is atypical for irrigated lands but is an attempt by GALAC to
15 recognize unexplained but acknowledged "other expenses" associated with irrigated land
16 production. From the landowners 25% crop share an additional expense allowance for the
17 application of water to the irrigated land is also allowed. The additional water expense includes
18 statutorily defined base costs and labor costs (15-7-201-5(b)(iii) and 5(b)(A), MCA). In addition,
19 an expense allowance is granted for the landowner specific per-acre energy costs needed to
20 apply the water to the lands. After deducting the allowable water costs, the resulting income is
21 considered the net income per acre.

22 For non-irrigated continuously cropped hay land, the recommended crop share is 25%,
23 with the remaining 75% considered to be the tenants' share which includes the production
24 expenses. The 25% crop share is the net income per acre.

25 ///

1 For non-irrigated continuously cropped farm land the recommended crop share is 25%.
2 DOR's definition of non-irrigated continuously cropped farm land recognizes that income from
3 this farm land is received every year so no further adjustment is included. The 25% crop share
4 is considered the net income per acre.

5 Once the determination of net income per acre has been determined for each particular
6 classification, the net income per acre is divided by the statutorily established (MCA
7 15-7-201(4)(c) capitalization rate of 6.4% to determine the per acre value or "assessed value
8 per acre". The number of acres of a particular production category are multiplied by the per
9 acre value to determine the value for the acres in that particular production category. All values
10 from all production categories are added together to get the total value for that particular land
11 classification, i.e. the assessed value for that particular land classification.

12 18. After determining the total assessed value for any particular land classification,
13 and totaling the assessed values of all land classifications for the parcel, the total assessed
14 value is multiplied by the current taxable percentage to yield the taxable value for the parcel.
15 For Class 3 property the taxable percentage is the same as the Class 4 rate. Mont. Code Ann.
16 §§ 15-6-133 and 134.

17 19. Once the current appraisal cycle assessed value is determined for the affected
18 classes of property, a phase in process is mandated by statute to mitigate the impact of
19 changes in assessed value that have occurred over the six year assessment cycle. MCA
20 15-7-111. DOR has rules with respect to how this determination of the phase in value is
21 accomplished. MAC 42.20 part 5. The determination of the phase in value requires judicious
22 application because many valuation changes result from processes other than the simple
23 accretion of price over time. For example, an owner of a large home may convert its use to a
24 bed and breakfast. Other residential property may be modified by significant additions of floor
25 space. A farmer may apply irrigation to a formerly dry parcel. These tangible changes and

1 their attendant change in value are not the result of periodic reappraisal but occur by action of
2 the owner changing the productive use of the property and should not, in fairness, be subject to
3 the phase in. Changes in dollar values - such as the market value of a house (separate from
4 physical changes) or of the value of agricultural commodities have been phased-in over the
5 length of reappraisal cycles. Both statute and administrative rules acknowledge this procedure
6 and provide a process for this calculation. In contrast, physical changes are not phased-in
7 pursuant to statute and administrative rule. When DOR discovers a change to the physical
8 characteristics of any property that result in a classification change, that change in classification
9 is implemented immediately in the year following discovery. The property is classified as it
10 existed at the time of discovery. A professional appraiser can only value what is actually,
11 physically present in total at the time of discovery. The physical characteristics of the property
12 are either grazing land or irrigated farm land, either a two-bedroom home or a four-bedroom
13 home; the appraiser cannot pretend that the property is some mixture or combination. A
14 reclassification is not subject to phase-in provisions, neither by statute nor by administrative
15 rule. This is how DOR has consistently and historically administered these issues. The
16 manner of this administration and its interpretation affects how the base value is determined for
17 the phase in process. Regardless of the means to its determination, this base value is called a
18 value before reappraisal ("VBR").

19 Another example germane to this case is as follows: two farmers with neighboring
20 parcels as noted in DOR's files based upon 1967 data. Same size and soils. One is growing
21 100 acres of sugar beets and one uses his 100 acres for grazing. Since 1967, Farmer One is
22 taxed on sugar beets (classified as irrigated land by DOR); Farmer Two is taxed on grazing
23 (substantially lower per acre value). In 1969, however, Farmer Two decided to plant sugar
24 beets instead of using his land for grazing. Because no comprehensive agricultural reappraisal
25 was done over the ensuing years, Farmer Two continued to be taxed on grazing land instead of

1 sugar beets.

2 In 2009, based upon the comprehensive agricultural reappraisal described earlier, DOR
3 determines that Farmer Two is raising sugar beets. Both Farmer One and Farmer Two's
4 property are now taxed as sugar beets. In 2008 sugar beets were taxed at a productive value
5 of \$100 per acre. Grazing land was taxed at a value of \$10 per acre. In 2009 sugar beets are
6 taxed at \$110 per acre. Grazing land is taxed at \$20 per acre.

7 DOR phases in the change in value of Farmer One's land using the 2008 value as the
8 starting point. The amount phased-in is the difference in the value of 100 acres of sugar beets
9 in 2009 and 100 acres of sugar beets in 2008 ($(\$110 \times 100 \text{ ac} = 11,000) - (\$100 \times 100 =$
10 $\$10,000) = \$1,000 \times .1666 = \$167$ each year over the six year cycle).

11 Petitioners would have DOR phase in the difference in the value of Farmer Two's
12 grazing land as of 2008 ($\$10 \times 100 \text{ ac} = \$1,000$) and his land at the value of sugar beets in
13 2009 ($\$110 \times 100 = \$11,000$). This means DOR would phase in the change in value of \$10,000
14 over the cycle at \$1,667 per year ($\$10,000 \times .1666$). This has the effect of "transitioning"
15 Farmer Two's from grazing to sugar beets over the length of the cycle even though it has been
16 sugar beets for years. Under this scenario, Farmer Two benefits from being under assessed
17 from 1969 to 2014, when the change is fully phased-in. During this same 45 years, Farmer
18 One and all other tax payers whose properties have been properly valued and assessed bear
19 the burden of Farmer Two's under assessment.

20 DOR normal process would be to calculate a 2008 value to use as the starting point for
21 phase-in. The calculated value would be the value of sugar beets in 2008 multiplied by the
22 number of acres ($\$100 \times 100 \text{ ac} = \$10,000$). The amount to be phased in would be \$1,000 -
23 the difference between the value of 100 acres of sugar beets in 2009 and in 2008 - the same as
24 Farmer One. Under this scenario then: in 2008 Farmer One would be taxed on a value of
25 \$10,000. In 2009 he will be taxed on a value of \$10,167. Farmer One would see a minimal

1 increase in taxes in 2009. In 2008 Farmer Two would be taxed on a value of \$1,000. In 2009
2 he will be taxed on a value of \$10,167. Farmer Two would see a substantial increase in taxes
3 in 2009, but would be put on equal footing with Farmer One for the remainder of the cycle.

4 20. If a property is in the same class and subclass of property and no material
5 changes occur to the property that are reflected in the current year taxable value but not in the
6 prior year's taxable value as reflected in the assessment, the prior year's taxable value (which
7 is the fully phased-in value from the prior six year assessment cycle) is the VBR. When
8 changes occur that are reflected in the current year taxable value that are not in the prior year's
9 taxable value the VBR is a calculated taxable value determined on the basis DOR ascertains
10 best isolates the naturally occurring value changes (which should be subject to the phase-in)
11 from the value changes occurring by actions other than natural price changes.

12 21. For the 2009 reappraisal, DOR calculated VBR rather than the 2008 full
13 reappraisal, however, since Rule 42.20.502 was not administratively amended as done in
14 previous reappraisal cycles (1997 and 2002); DOR, by its own rule, was required to use the
15 prior year VBR for the current year VBR during 2002 or subsequent tax years for Class 3
16 property that contains a productivity only or grade change. The proposed actions were needed
17 to address three questions associated with the 2009 agricultural land appraisal: (a) the rule
18 change would impact the versions of administrative rules in effect at the time, and needing
19 update for the 2009 appraisal cycle, due to an appearance of conflict between Rules
20 42.20.501(25) and 42.20.502(3) stating different approaches to the determination of the VBR
21 for properties with a productivity only change; (b) they would resolve the question of whether
22 DOR should consider productivity as a material, physical change to the property characteristics;
23 and (c) it would make the Rules consistent with DOR's understanding of the intent of section
24 15-7-111-(2) MCA. DOR updated its agricultural manual for the 2009 reappraisal cycle based
25 upon the anticipated administrative rule amendment (Ex. 1). DOR did not, however, timely

1 update ARM 42.20.502. Therefore, the calculated VBR resulted in an incorrect application of
2 phase-in for properties with productivity only changes. By adopting the proposed new rule (Ex.
3 2), DOR will be correcting the phase-in for these properties to comport to the requirements of
4 ARM 42.20.502(3), as amended in 2002.

5 22. Under the proposed Rule, DOR will correct the VBR productivity error as follows:

6 a. If the taxpayer timely filed an AB-26, County Tax Appeal Board (CTAB)
7 appeal, State Tax Appeal Board (STAB) appeal, or District Court action relating
8 to the 2009 assessment DOR will:

8 (1) replace the calculated VBR with the prior year VBR of the prior grade;

9 (2) issue a revised assessment notice for 2009 showing the correct VBR;
10 and

11 (3) provide the county the information necessary to allow the county to
12 issue a new tax bill.

13 b. If the taxpayer did not timely file an AB-26, CTAB appeal, STAB appeal,
14 or District Court action relating to the 2009 assessment DOR will correct the VBR
15 calculation beginning in tax year 2010.

16 c. DOR will correct the VBR and adjust the taxable values each year for the
17 subsequent five years of this reappraisal cycle by one-fifth of the difference in
18 taxable value.

19 (1) The difference in taxable value is the amount that DOR either under
20 or over assessed in 2009.

21 (2) The adjusted taxable value will be used by the counties to apply mill
22 levies to determine taxes owed.

23 23. There are roughly 90,000 parcels that have "productivity only" changes in the
24 2009 reappraisal cycle. Each parcel property owner is assigned an assessors code associated
25 with the property in the identified taxing jurisdiction. An assessors code is used to consolidate
and combine the owner's parcels within that taxing jurisdiction into one assessment notice. The
assessors codes help local government distribute property tax dollars to the appropriate taxing
jurisdiction. Therefore, an owner with multiple parcels in multiple taxing jurisdictions can and/or
will have multiple different assessors codes assigned to him/her/it.

1 24. To date, DOR has identified 2,085 unique assessors codes as being affected by
2 technical administrative calculation error "productivity only" changes in 2009. These were the
3 assessors code where the Orion system had a code for a timely AB26/CTAB in 2009. The
4 2,085 figure includes 445 assessors codes with an estimated +/- \$5.00 tax impact. Under the
5 proposed Rule, these 2,085 assessors codes would receive revised 2009 assessment notices
6 indicating a new 2009 phase in value based on the use of the actual 2008 value as the VBR.
7 However, those tax payers with a revised assessment resulting in a +/- \$5.00 impact, no tax
8 would be owed under section 15-16-102(7), MCA.

9 25. There are an additional 47,291 assessors codes that would be affected in 2010
10 under the proposed Rule. These assessors codes did not have an indication in the Orion
11 system that a timely AB26/CTAB or other action had been filed. This figure includes 14,468
12 with a +/- \$5.00 estimated tax impact.

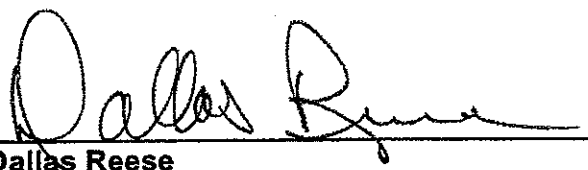
13 26. At this time, there are 34,423 assessors codes that will be adjusted under the
14 proposed Rule and section 15-16-102(7), MCA. This is not to say there are 34,423 affected tax
15 payers. In this regard, DOR believes there are approximately 500-600 taxpayers, who have
16 timely protested, including Mr. Lucas and Lucas Ranch, Inc., whose assessments will be
17 adjusted under the proposed Rule to correct the technical administrative rule calculation error
18 relative to the productivity-only phase-in, and another 10,000 taxpayers whose assessments
19 will be adjusted for the 2010 tax year, throughout the remainder of the cycle.

20 27. Going back to the previous beet farmers example, under the proposed Rule,
21 Farmer 1 would be one of the properties affected by a "productivity only" change. DOR would
22 use the 2008 actual VBR and the proposed Rule will result in a new 2009 revised assessment
23 to Farmer 1. Farmer 2, however, has property with a classification change and the VBR will
24 continue to be a calculated VBR. There is no impact to Farmer 2 from the proposed Rule
25 change.

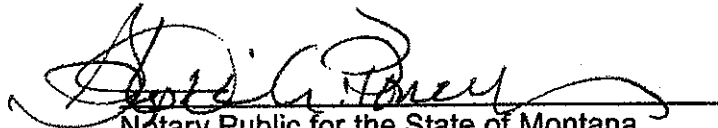
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28. The respective county treasurers are the only sources of information regarding the amount of protested tax dollars (paid under protest, released for some reason or still in the protest fund). In this regard, some individuals would have paid their taxes under protest but did not submit any other documentation or appeal on file and then the protested amount would have been released to the county after the 90-day statutory time period.

Dated this 26th day of April 2010.


Dallas Reese

SUBSCRIBED AND SWORN to before me this 26th day of April 2010.


Notary Public for the State of Montana
Printed Name: Stephanie A. Powell
Residing at Helena, Montana.
My Commission expires 9-11-2010

(SEAL)

**Department of Revenue
Administrative Rules Notification**

Requesting Process: Property Assessment _____
Contact Person: Debbie Jurcich _____
Phone No.: 444-0499 _____
Date of Request: 10/14/09 _____
Priority Level: High _____ (High, Medium, Low)

Subject or Title of Rule: Phase-In Values Chapter 5 _____

Request for Meeting

Proposed Team Members: _____

Chief Legal Counsel Only:

Staff Attorney Assigned: _____

TPR Process Lead Only:

TPR Staff Member Assigned: _____

Proposed Action

_____ Adopt new rules Amend existing rules _____ Repeal rules

Justification for needs: The department is proposing to amend Chapter 5 Phase-In Values to clarify the process used for the reappraisal cycle beginning January 1, 2009.

Legislative Impacts (if applicable):

Requesting Process Approval: _____ Date _____
Administrator

Rule Notification Approved: _____ Date _____
(Policy and Rules Officer)

Rule Notification Rejected: _____ Date _____
(Policy and Rules Officer)

(FOR RULES OFFICE USE ONLY)

Date Received: _____
Tracking Started: _____

Form: Legal RULES 603/02

42.20.501 DEFINITIONS The following definitions apply to this subchapter:

- (1) "2002 2009 tax year value" means the market value of a property which appears on the 2002 2009 property tax record of that property.
- (2) "Annual appraisal trend factor class five" means a factor used to annually reappraise class five qualifying air and water pollution control property, new industrial property, gasohol facilities, qualifying research and development firms, and electrolytic reduction facilities real property by trending their cost values up or down based on accepted cost indices.
- (3) "CDU rating" means a composite rating of the overall condition, desirability, and usefulness of a structure, used nationally as a simple, direct, and uniform method of estimating accrued depreciation.
- (4) "Comstead exemption" means the percentage of phase-in value of commercial property that is exempt from taxation pursuant to 15-6-222, MCA.
- (5) "Current year phase-in value" is the difference between the reappraisal value and the value before reappraisal (VBR) times the phase-in percentage, added to the VBR. The current year phase-in value is the amount subject to tax each year, and is determined by the following formula:

$$\text{Current year phase-in value} = [(\text{Reappraisal (REAP) value} - \text{VBR}) \times \text{phase-in \%}] + \text{VBR}$$

- (6) "Destruction" means the removal or deletion of improvements, buildings, living areas, garages, and out-buildings caused by burning, razing, or natural disaster.
- (7) "Dwelling unit" is defined as a building or portion of a building that contains living facilities with provision for sleeping, eating, cooking, and sanitation for one or more persons.
- X (8) "Full reappraisal to taxable value conversion factor for class four commercial property" is the total taxable value of class four commercial property divided by the total reappraisal value of the same class four commercial property.
- X (9) "Full reappraisal to taxable value conversion factor for class four residential" is the total taxable value of class four residential property divided by the total reappraisal value of the same class four residential property.
- (10) "Homestead exemption" means the percentage of phase-in value of residential property that is exempt from taxation pursuant to 15-6-222, MCA.
- (11) "Improvement grade change" means a change in the quality of construction of an improvement. Each improvement grade signifies a different level of construction quality. Examples of improvement grades include, but are not limited to, the following:
 - (a) 1F-1 = cheap construction;
 - (b) 1F-5 = average construction; and
 - (c) 1F-9 = superior construction.
- (12) "Land productivity change (grade change)" means a change in the productive capacity or yield of agricultural or forest land. In a land productivity change, the land use does not change; rather, the land as currently used simply becomes more or less productive. For example, a productivity change in grazing land may occur when it is discovered that the productivity potential has decreased due to a new saline seep on the land. Because the land continues to be used as grazing land, the department shall continue to classify the land as agricultural grazing land, but the grade productivity of the grazing land may be changed to reflect its lessened potential to support livestock productivity.

(13) "Land reclassification" means changing the use of land from one type of agricultural use to a different type of agricultural use. For example, a land reclassification occurs when agricultural land that was previously used as grazing land is converted to irrigated land. In a land reclassification, the land is dedicated to agricultural purposes both before and after the change in land use. It is this characteristic that distinguishes a land reclassification from the more general land use change.

(14) "Land split" means the division of a single property into two or more properties for the ultimate purpose of conveying one or more of the properties to a new owner or owners.

(15) "Land use change" means the conversion of a current use of land to a different, alternate use. Land splits shall be considered land use changes. Examples of land use changes contained in this definition include, but are not limited to, the following:

- (a) agricultural land converted to tract land;
- (b) forest land converted to tract land;
- (c) forest land converted to agricultural land; or
- (d) land that is converted to another use due to a subdivision of real property.

(16) "Living area" means any room or group of rooms designed as the living quarters of one family or household, equipped with cooking and toilet facilities, and having an independent entrance from a public hall or from the outside.

^{MODEL AREA} (17) "Neighborhood (NBHD) group percentage" means the percent of change in value from the total 2002 2008 tax year value to the total 2003 2009 reappraisal value, excluding properties with new construction, for those homogeneous areas within each county or between counties that are a portion of, or all of a defined model area, ~~have been defined as a neighborhood group~~. The neighborhood group percentage is determined by using the following formula:

$$\text{Neighborhood Group Percentage} = \frac{\text{Total 2003 2009 NBHD Model Area REAP Value} - \text{Total 2002 2008 NBHD Tax Year Model Area Value}}{\text{Total 2002 2008 NBHD Tax Year Model Area Value}}$$

(a) Individual neighborhood group model area percentages will be determined for residential land, commercial land, residential improvements, and commercial improvements.

(18) "New construction" means the construction, addition, or substitution of improvements, buildings, living areas, garages, and outbuildings; or the extensive remodeling of existing improvements, buildings, living areas, garages, outbuildings, land reclassification, and land use changes.

(19) "New construction trend factor for industrial property" means a factor used to adjust reappraisal values and VBRs (values before reappraisal) in instances where the property has new construction or destruction. The factor will be derived from nationally accepted cost indices.

(20) "Phase-in percentage" for tax years 2003 2009 through 2008 2014 is 16.6% per year. The phase-in percentage accumulates annually.

(21) The "previous year tax revenue" means the product of multiplying the previous tax year total taxable value for each taxing jurisdiction by the previous year mill levy for that taxing jurisdiction.

(22) "Reappraisal (REAP) value" means the full 2003 2009 value determined for the current reappraisal cycle pursuant to 15-7-111, MCA, adjusted annually for new construction or destruction. The 2003 2009 reappraisal value reflects a market

value of the property on ~~January 1, 2002~~ July 1, 2008. A current year REAP value is the same as the ~~2003~~ 2009 reappraisal value of the property if there is no new construction, destruction, land splits, land use changes, land reclassifications, land productivity changes, improvement grade changes, or other changes made to the property during ~~2003~~ 2009 or subsequent tax years.

(23) "Subdivision of real property" means the first sale of a land parcel that results in the land being taxable as class four as described in 15-6-134, MCA, or nonagricultural land as described in 15-6-133(1)(c), MCA.

(24) "Taxable market value" means that portion of the total market value subject to taxation after the total market value has been adjusted, if applicable, for the phase-in of value, and the homestead/comstead exemption.

(25) "Value before reappraisal (VBR)" means the ~~2002~~ 2008 tax year value adjusted for any new construction or destruction that occurred in the prior year. The VBR for the ~~2003~~ 2009 tax year and subsequent years is the same as the ~~2002~~ 2008 tax year value if there is no new construction, destruction, land splits, land use changes, land reclassifications, land productivity changes, improvement grade changes, or other changes made to the property during ~~2002~~ 2008 or subsequent tax years. For 2009 only, classes three and ten will have the VBR calculated due to changes in the method of determining productivity.

AUTH: 15-1-201, 15-7-111, MCA;

IMP, 15-6-222, 15-7-111, 15-10-420, MCA;

REASONABLE NECESSITY: The department is amending the definitions to clarify the process for the reappraisal cycle beginning January 1, 2009.

42.20.502 DETERMINATION OF VALUE BEFORE REAPPRAISAL (VBR), EXCLUDING INDUSTRIAL PROPERTIES (1) For property that contains no new construction, destruction, land splits, land use changes, land reclassifications, land productivity changes, improvement grade changes, or other changes made to the property during ~~2002~~ 2008 or subsequent tax years, the current year VBR will be the same as the prior year VBR.

(2) For 2009 for class three property, the VBR will be calculated for all class three land due to the change in method of identifying the productivity of land through the use of NRCS soil survey information.

(a) The VBR will be calculated by taking the current classification and productivity acreage of the class three land and using the ~~2008~~ ²⁰⁰⁶ valuation formula information determine the ~~2008~~ ²⁰⁰⁶ valuation per acre for that productivity and classification.

(2) (3) For tax years 2010 and forward, class three property that contains a land reclassification, or a land use change, the current year VBR will be calculated as identified in (2)(a) the prior year VBR of the new classification or land use change.

(3) (4) For tax years 2010 and forward, class three property that contains a productivity or grade change, the current year VBR will be the calculated VBR as determined in (2)(a) prior year VBR of the prior grade.

(4) (5) For class four property (excluding industrial property) that contains new construction, the current year VBR is determined by dividing the reappraisal value by one plus the percent of neighborhood group change. The following formula illustrates that calculation:

MODEL AREA

$$\text{VBR} = \text{Reappraisal value} / (1 + \text{NBHD group percentage})$$

Value before reappraisal

Reappraisal

DECEMBER 21,

(5) (6) Land which has been reclassified as residential or commercial land after January 1, 2002 ~~January 1, 2008~~, will have the VBR determined by comparing other 2002 ~~2008~~ market values of similar residential or commercial land, and determining a comparable VBR for the new residential or commercial land.

(6) (7) For class four property (excluding industrial property) that has been either partially or wholly destroyed, the current year VBR is calculated by first determining what percent of the property has been destroyed. That percent is multiplied by the prior year improvement VBR to determine a value amount that is attributed to the destruction. The current year VBR is then the difference between the prior year VBR and the value attributed to the destruction. The following formula illustrates that calculation:

Current year VBR =
Prior year VBR -
(Percent of property destroyed x prior year improvement VBR)

(8) For 2009 for class ten property, the VBR will be calculated for all class ten land due to the change in method of identifying the productivity of land through the use of the productivity model developed by the University of Montana College of Forestry and Conservation.

(a) The VBR will be calculated by taking the current classification and productivity of the class ten land and using the 2008 valuation formula information to determine the 2008 valuation per acre for that productivity and classification.

(7) (9) For tax year 2010 and forward, class ten property that contains a land reclassification or a land use change, the current year VBR will be calculated as identified in (8)(a) the prior year VBR of the new classification or land use change.

(8) (10) For tax year 2010 and forward, class ten property that contains a productivity or grade change, the current year VBR will be the calculated VBR as determined in (8)(a) prior year VBR of the prior grade.

(9) (11) The only instances when the current year VBR will be less than the prior year VBR are:

(a) in the case of class four improvements that have been partially or wholly destroyed;

(b) when the neighborhood group percentage change is negative and there is new construction; or

(c) when land use changes have occurred.

(10) (11) In all other situations, the current year VBR will be the greater of the value determined through application of the formula in (4) or the prior year VBR.

AUTH: 15-1-201, 15-7-111, MCA;

IMP, 15-7-111, MCA

REASONABLE NECESSITY: The department is proposing to amend ARM 42.20.502 to reflect the statutorily required reappraisal beginning January 1, 2009. For class three the change to the VBR calculation is required due to the changes in methodology that the department will be using in valuing agricultural land for property tax purposes for reappraisal cycles beginning January 1, 2009. These amendments were recommended by the 2006 – 2008 Governor's Agricultural Land Valuation Advisory Committee. As a result, there will no longer be valuation schedules as in the past. Rather, each acre of agricultural land will be valued according to the productivity of the specific soil make-up for that acre, for the agricultural land use to which the acre is classified (i.e. grazing, irrigated farm land, non-irrigated summer fallow farm land, nonirrigated continuously cropped farm land or nonirrigated continuously cropped hay land). The formula for determining the

value of each acre of agricultural land is defined in 15-7-201, MCA. For class ten property the VBR calculation is required to comply with the statutes implemented for the 2009 reappraisal of forest land.

42.20.503 DETERMINATION OF CURRENT YEAR PHASE-IN VALUE FOR CLASS THREE, CLASS FOUR, AND CLASS TEN PROPERTY (1) For tax years

~~2003 2009~~ through ~~2008 2014~~, the department is required to determine the current year phase-in value for each property in class three, class four, and class ten annually. The current year phase-in value is determined by subtracting the ~~2002 2008~~ VBR from the ~~2003 2009~~ reappraisal value multiplied by the applicable phase-in percentage, the product of which is added to the ~~2002 2008~~ VBR value. The calculations of the phase-in values are represented by the following formula:

~~2003 2009~~ Phase-in =

$$[(\text{~~2003 2009~~ reappraisal value} - \text{~~2002 2008~~ VBR value}) \times 16.66\%] + \text{~~2002 2008~~ VBR}$$

~~2004 2010~~ Phase-in =

$$[(\text{~~2003 2009~~ reappraisal value} - \text{~~2002 2008~~ VBR value}) \times 33.32\%] + \text{~~2002 2008~~ VBR}$$

~~2005 2011~~ Phase-in =

$$[(\text{~~2003 2009~~ reappraisal value} - \text{~~2002 2008~~ VBR value}) \times 49.98\%] + \text{~~2002 2008~~ VBR}$$

~~2006 2012~~ Phase-in =

$$[(\text{~~2003 2009~~ reappraisal value} - \text{~~2002 2008~~ VBR value}) \times 66.64\%] + \text{~~2002 2008~~ VBR value}$$

~~2007 2013~~ Phase-in =

$$[(\text{~~2003 2009~~ reappraisal value} - \text{~~2002 2008~~ VBR value}) \times 83.30\%] + \text{~~2002 2008~~ VBR value}$$

~~2008 2014~~ Phase-in =

$$\text{~~2003 2009~~ reappraisal value}$$

AUTH: 15-1-201, 15-7-111, MCA;

IMP, 15-7-111, MCA;

REASONABLE NECESSITY: The department is proposing to amend 42.20.503 to reflect the reappraisal cycle beginning January 1, 2009.

42.20.504 NEW CONSTRUCTION DETERMINATION (1) The following criteria will be used to identify new construction and destruction:

- (a) all residential or commercial structures, out-buildings, and mobile homes that were built, remodeled, or destroyed in the preceding year;
 - (b) properties with new, attached garages built in the preceding year;
 - (c) properties which had any land reclassification or land use changes; or
 - (d) properties with out-buildings built in the preceding year.
- (2) The following will not be considered new construction or destruction:

*Phase down
by class code
by land +
bldg separate
Dallas - class 3, 4, 10
10 example*

- (a) properties with square footage changes due to correction of measurements or sketch vectoring, or due to coding corrections for story heights, such as story with full finished attic to 1.5 stories;
- (b) properties with improvement grade changes;
- (c) properties with condition, desirability, and usefulness (CDU rating) changes;
- (d) properties with changes in heat or air conditioning;
- ~~(e) residential dwelling units with changes in square footage of living area of 100 square feet or less;~~
- ~~(f) properties with changes in effective year, or~~
- ~~(g) properties with changes in finished basement areas.~~ (History: 15-1-201, 15-7-111, MCA; IMP, 15-7-111, MCA; TEMP, NEW, 1997 MAR p. 1593, Eff. 9/9/97; AMD, 2002 MAR p. 3424, Eff. 12/13/02.)

REASONABLE NECESSITY: The department is proposing to amend 42.20.503 to reflect the reappraisal cycle beginning January 1, 2009. Because the department has converted all property to the ORION computer system, actual new construction on a property is identified within the system by capturing the year the change was made.

42.20.505 ASSESSMENT NOTICES AND VALUATION REVIEWS (1) As required by 15-7-102, MCA, the assessment notice shall include:

- (a) current reappraisal value;
- (b) current year taxable value ~~phase-in value~~;
- (c) total amount of mills levied against the property in the prior year;
- (d) statement that the notice is not a tax bill; and
- (e) a notification to taxpayers regarding the Property Tax Assistance Program (PTAP), Disabled American Veterans Exemption (DAV), and Extended Property Tax Assistance Program (EPTAP) amount of appraised value exempt from taxation under 15-6-222, MCA.

(2) A taxpayer may seek a department review of any of the required valuation items set forth in (1)(a), ~~and (b), and (e)~~ of this rule. Additionally, a taxpayer may request a review of any of the methods used to determine those values which are shown in (1)(a), ~~(b), and (e)~~.

AUTH: 15-1-201, 15-7-111,
MCA; IMP, 15-6-201, 15-7-102, 15-7-111, 15-6-222, MCA

REASONABLE NECESSITY: The department is proposing to amend 42.20.505 to reflect the changes in 15-6-222, MCA in the 2009 legislative session. The previous assessment notice was confusing to taxpayers. The simplified assessment notice provides the taxpayer with the information that they should be comparing, the previous reappraisal and current reappraisal values along with the previous actual taxable value and current taxable values.

42.20.514 DETERMINATION OF TOTAL TAXABLE VALUE OF ELIMINATED PROPERTY (1) ~~The total taxable value of eliminated property is determined by compiling the actual total value of properties that have been eliminated from a particular taxing jurisdiction. In cases where the actual values have not been compiled, the department will use a statewide average rate of 0.12% (.0012) to multiply by the previous year total taxable value in the taxing jurisdiction,~~

~~to calculate an estimated value of eliminated property. (History: 15-1-201, 15-7-111, MCA; IMP, 15-10-420, MCA; NEW, 1999 MAR p. 2006, Eff. 12/17/99.)~~

REASONABLE NECESSITY: The department is proposing to repeal this rule as a housecleaning measure. The statutory requirement for the department to report eliminated property was removed by the 2001 legislature through Senate Bill 504, House Bill 124, and House Bill 37. The administrative rule should have been repealed at that time.

BEFORE THE DEPARTMENT OF REVENUE
OF THE STATE OF MONTANA

In the matter of the adoption of New Rule I) NOTICE OF PUBLIC
relating to value before reappraisal for 2009) HEARING ON PROPOSED
agricultural land) ADOPTION

TO: All Concerned Persons

1. On May 10, 2010, at 11:00 a.m., a public hearing will be held in the Third Floor Reception Area Conference Room of the Sam W. Mitchell Building, at Helena, Montana, to consider the adoption of the above-stated rule.

Individuals planning to attend the hearing shall enter the building through the east doors of the Sam W. Mitchell Building, 125 North Roberts, Helena, Montana.

2. The Department of Revenue will make reasonable accommodations for persons with disabilities who wish to participate in this public hearing or need an alternative accessible format of this notice. If you require an accommodation, contact the Department of Revenue no later than 5:00 p.m., May 3, 2010, to advise us of the nature of the accommodation that you need. Please contact Cleo Anderson, Department of Revenue, Director's Office, P.O. Box 7701, Helena, Montana 59604-7701; telephone (406) 444-5828; fax (406) 444-3696; or e-mail canderson@mt.gov.

3. The proposed new rule does not replace or modify any section currently found in the Administrative Rules of Montana. The proposed new rule provides as follows:

**NEW RULE I CORRECTION OF VALUE BEFORE REAPPRAISAL (VBR)
FOR 2009 AGRICULTURAL LAND** (1) For those properties that experienced productivity only changes for tax year 2009, the department will correct the VBR as follows:

(a) If the taxpayer timely filed an AB-26, County Tax Appeal Board (CTAB) appeal, State Tax Appeal Board (STAB) appeal, or District Court action relating to the 2009 assessment the department will:

(i) replace the calculated VBR with the prior year VBR of the prior grade;
(ii) issue a revised assessment notice for 2009 showing the correct VBR; and
(iii) provide the county the information necessary to allow the county to issue a new tax bill.

(b) If the taxpayer did not timely file an AB-26, CTAB appeal, STAB appeal, or District Court action relating to the 2009 assessment the department will correct the VBR calculation beginning in tax year 2010.

(c) The department will correct the VBR and adjust the taxable values each year for the subsequent five years of this reappraisal cycle by one-fifth of the difference in taxable value.

(i) The difference in taxable value is the amount that the department either under or over assessed in 2009.

7-4/15/10

MAR Notice No. 42-2-828

EXHIBIT 2

(ii) The adjusted taxable value will be used by the counties to apply mill levies to determine taxes owed.

AUTH: 15-1-201, 15-7-111, MCA

IMP: 15-7-111, 15-7-201, MCA

REASONABLE NECESSITY: The department is proposing to adopt New Rule I because the department adopted ARM 42.20.502 in 1997, and amended it in 2002. ARM 42.20.502 directed the department to use the prior year VBR for the current year VBR during 2002 or subsequent tax years. ARM 42.20.502 specified the VBR for class three property. For class three property that contains a productivity or grade change, the current year VBR will be the prior year VBR of the prior grade.

The new reappraisal cycle began January 1, 2009, pursuant to 15-7-111, MCA. The department updated its agricultural manual for this new reappraisal cycle. The department did not timely update ARM 42.20.502. The updated agricultural manual required a calculated VBR rather than the 2008 full reappraisal value. The calculated VBR resulted in an incorrect application of phase-in for properties with productivity only changes. By adopting New Rule I, the department is correcting the phase-in for these properties to comport to the requirements of ARM 42.20.502, as amended in 2002.

4. Concerned persons may submit their data, views, or arguments, either orally or in writing, at the hearing. Written data, views, or arguments may also be submitted to: Cleo Anderson, Department of Revenue, Director's Office, P.O. Box 7701, Helena, Montana 59604-7701; telephone (406) 444-5828; fax (406) 444-4375; or e-mail canderson@mt.gov and must be received no later than May 14, 2010.

5. Cleo Anderson, Department of Revenue, Director's Office, has been designated to preside over and conduct the hearing.

6. An electronic copy of this Notice of Public Hearing is available through the department's site on the World Wide Web at www.mt.gov/revenue, under "for your reference"; "DOR administrative rules"; and "upcoming events and proposed rule changes." The department strives to make the electronic copy of this Notice of Public Hearing conform to the official version of the notice, as printed in the Montana Administrative Register, but advises all concerned persons that in the event of a discrepancy between the official printed text of the notice and the electronic version of the notice, only the official printed text will be considered. In addition, although the department strives to keep its web site accessible at all times, concerned persons should be aware that the web site may be unavailable during some periods, due to system maintenance or technical problems.

7. The Department of Revenue maintains a list of interested persons who wish to receive notices of rulemaking actions proposed by this agency. Persons who wish to have their name added to the list shall make a written request, which includes the name and e-mail or mailing address of the person to receive notices

and specifies that the person wishes to receive notices regarding particular subject matter or matters. Notices will be sent by e-mail unless a mailing preference is noted in the request. Such written request may be mailed or delivered to the person in 4 above or faxed to the office at (406) 444-4375, or may be made by completing a request form at any rules hearing held by the Department of Revenue.

8. The bill sponsor contact requirements of 2-4-302, MCA, do not apply.

/s/ Cleo Anderson
CLEO ANDERSON
Rule Reviewer

/s/ Dan R. Bucks
DAN R. BUCKS
Director of Revenue

Certified to Secretary of State April 5, 2010