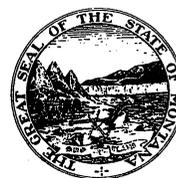




Dan Bucks
Director

Montana Department of Revenue



Brian Schweitzer
Governor

Memorandum

To: Members of the Revenue and Transportation Interim Committee

From: Dan Bucks, Director of Revenue *Dan Bucks*

Date: January 25, 2010

Subject: Phase-in Calculation and Value Before Reappraisal (VBR) for Agricultural Property

For the first time in 46 years, the Department of Revenue conducted a comprehensive reclassification and revaluation of agricultural land. This was the most thorough and detailed reappraisal of agricultural land in the state's history. The Department used the best information and science available to determine land use and productivity. Most importantly, this reappraisal used a rational and uniform methodology and replaced valuation practices lacking in any uniform rhyme or reason. In addition, the Department regularly called upon farmers and ranchers during the process to review their own land information and provide input as part of this process. Indeed, given the scope of the changes undertaken for these properties, agricultural producers had two opportunities to provide input to the Department as opposed to the one provided to all other taxpayers.

Because this reclassification and revaluation process resulted in an overall increase in agricultural land values statewide, the Montana Legislature formulated a tax mitigation strategy that includes, among other things, a six-year phase-in process. This memorandum addresses questions posed to the Department at the December 2009 meeting of the Revenue and Transportation Interim Committee concerning the Department's application of phase-in to agricultural lands.

Background on Phase-In Practices

Since 1997, changes in dollar values—such as the market value of a house (separate from physical changes) or of the value of agricultural commodities have been phased-in over the length of reappraisal cycles. Both statute and administrative rules acknowledge this procedure and provide a process for this calculation.

In contrast, physical changes are not phased-in pursuant to statute and administrative rule. When the Department discovers a classification change (reclassification of the physical characteristics) on any property, that change in classification is implemented immediately, whether it is to make a remodeled home that was a two-bedroom home into a four-bedroom home or a change from grazing land to irrigated farm land. A reclassification is not subject to phase-in provisions, neither by statute nor by administrative rule.

A professional appraiser can only value what is actually, physically present in total. The physical characteristics of the property are either grazing land or irrigated farm land, either a two-bedroom home or a four-bedroom home; the appraiser cannot pretend that the property is some mixture or combination.

Reclassified Lands—2009 Taxable Values are Valid—Change Would Be Invalid Under the Law

When there is a reclassification of agricultural land, for example, a change in the use of that land from grazing land to irrigated farmland, the Department cannot consistently and uniformly calculate a valid VBR for all reclassified lands because there is no comparable baseline starting point for the land as reclassified. In reclassification cases, there is no old yield data that corresponds to the size, shape and use of the new fields. It is not sufficient that the Department might be able to calculate a VBR for some reclassified lands; it must be able to do so for all such land. The matter is further complicated by the lack of any reliable knowledge of how productivity values were established 46 years ago. Without a proper starting point for the calculations, a six-year phase-in of productivity value changes in the case of reclassifications and use changes is simply not consistent with law or logic.

Both Montana statute (Section 15-7-111(2), MCA), and the Department of Revenue administrative rules (42.20.605, ARM) recognize that it would be inaccurate and invalid to calculate a VBR for reclassified land. The rules clearly describe the method to be used to calculate the six-year, phase-in values for agricultural land that experienced land use changes as part of the 2009 reappraisal and reclassification. Land use changes—like remodeling changes that occur when a residential property adds an additional bedroom or bathroom—are reflected in phase-in values by being incorporated in the VBR immediately. So in cases of reclassified lands, the value of a physical change is fully implemented on January 1 of the year immediately following the time the Department understood that these changes occurred.

This confirmation of the treatment of reclassified lands should not be a surprise. The Department requested funding for the new productivity system in the 2005 Legislature. In preparation for those legislative discussions, the Department did a test study during 2004 of the amount of misclassified lands in three eastern Montana counties. The Department presented the results of this test study at a meeting early in the 2005 session with interested legislators and agricultural organizations (the meeting occurred in the basement of Jorgenson's). At this meeting early in this process, the Department explained that when the classification of lands was corrected, the value of that change in use of the land would be fully reflected in the first year of the reappraisal cycle. So, from the very outset of the proposed change and before the funding was secured, the Department explained to affected parties and legislators how the phase-in would work for these lands. Throughout the reappraisal process the Department continued to represent this process consistently.

Therefore, because the Department followed clearly defined statutes and rules when calculating phase-in values for agricultural parcels that have experienced any land use changes as part of the 2009 reappraisal process, there is no known basis for the Department to consider making any changes to the phase-in calculations for these parcels.

Lands with Productivity Changes Only—Change in Phase-In Calculation Warranted

Initially, during the 2009 reappraisal process, the Department calculated phase-in values for agricultural parcels having a change in productivity only, in the same manner as it did for parcels having classification changes.

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That is, any change in value stemming from the productivity change was incorporated immediately in the VBR. The Property Assessment Division did so relying on a direct reading of Section 15-7-111(2), MCA, to the effect that all properties within Class 3 need to be treated in an identical manner in terms of the phase-in process. They also believed that certain 2002 rules (discussed below) regarding phase-in had expired at the end of the previous cycle. Under this interpretation the change in the yield levels were implemented in the same manner as was done for reclassified lands. This is a reasonable interpretation of 15-7-111(2), MCA.

When the issue of the phase-in application method arose, research by the Department's legal staff focused attention on a 2002 rule that specified a VBR calculation for lands with only a productivity change that is different from the VBR calculation for reclassified lands. The rule specifies a calculation that would phase-in over six years the yield level change for lands experiencing only a productivity value change. (Sorting out this issue is made more difficult by the fact that there is a contrary, but less specific, 2002 rule that implies that the six-year phase-in should not apply to these lands with a productivity change only. Further, the 2002 record of rule making is too sparse to provide insight into why the Department at that time adopted two rules that require close reading to reconcile.) The Department has evaluated whether the specific 2002 VBR calculation rule can be reconciled with the language of 15-7-111(2), MCA, and has decided that the language of the statute permits the use of this rule in the 2009-2014 reappraisal cycle. Just as a case can be made for our initial interpretation, a case can be made that a change in value stemming solely from a change in productivity may be reflected in phase-in values, not by incorporating the change in value immediately in the VBR, but by allowing that change in value to be phased in over the reappraisal cycle as well.

Therefore, I have instructed Department staff to use the statutory process for informal reviews of property valuation to take the following steps:

1. For the approximately 2,000 affected agricultural producers that have timely requested an informal review of their productivity values by filing an AB-26 form in response to their 2009 reappraisal assessment notice, department staff will change the VBR and phase-in calculation so that changes in value stemming from a change in productivity only are phased in over the six-year reappraisal cycle.
2. For the remaining agricultural producers with a change in productivity only who did not request an informal review in 2009, and for whom there is more than a *de minimis* impact on tax liability, department staff will make a similar adjustment, but do so beginning with tax year 2010. This adjustment will include a phase-in amount covering both 2009 and 2010, thus making these taxpayers whole during the six-year cycle.

There are approximately 27,200 agricultural producers in this category who will experience a decrease in taxable value, and about 3,600 producers who will experience an increase.

3. For taxpayers whose annual tax impact is \$5 or less, the statutory *de minimis* established by 15-16-101, MCA, no change in assessments will be made. There are approximately 14,500 taxpayers in this category.

The fact that about 3,600 agricultural producers will experience an increase in taxable value is noteworthy. Those advocating a phase-in of productivity values have mistakenly assumed that such a phase-in will only decrease taxes. However, that is not the case.

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The 3,600 producers will experience an estimated annual increase in taxes of about \$24 per year. For producers expected to experience a decrease, that amount is estimated at about \$77 per year.

The net fiscal impact of this phase-in change for taxpayers with productivity changes only is approximately \$2.1 million. Please note that this phase-in issue for these taxpayers is less than the \$3.4 million tax increase that farmers and ranchers experienced due to the impact of the HB 658 tax reductions for residential class 4 properties and by the impact of the Supreme Court decision in the Omimex case, as not fully mitigated by SB 489.

Because these combined residential and pipeline tax shifts of \$3.4 million to farmers and ranchers are concentrated in only a portion of the counties, the average impact per producer is increased. Any farmers and ranchers surprised by their tax bill should be advised of the role that these residential and pipeline tax shifts have played in their taxes.

c. Senator Bob Story, President of the Senate
Representative Bob Bergren, Speaker of the House