

Montana Department of Revenue

**Economic Impact Statement
Proposed New Rule and Rule Amendments
in MAR Notice 42-2-846**

Description and Purpose of Proposed New Rules and Rule Amendments

The Department of Revenue has proposed in Notice 42-2-846 one new rule and amendments to three existing rules. With the exception of one item, the purposes of this proposed set of rules are as follows:

1. To place established practices and procedures of the department with regard to centrally assessed property in rule form to comply with judicial interpretations of MAPA.
2. To make information on department valuation methodologies and procedures publicly available in an authoritative reference document.
3. To reduce taxpayer uncertainty about and misunderstanding of definitions and procedures, and
4. To reduce time and money spent and uncertainty and risks associated with re-litigating settled issues.

The purposes of the proposed amendment replacing the biennial review of default percentages for intangible personal property deductions with an open process for taxpayer recommendations are as follows:

1. To provide for greater taxpayer flexibility, convenience and clarity in submitting information or proposals to the department with regard to intangible personal property default percentages, and
2. To bring the existing rule into alignment with department practice.

The proposals in this notice do not change any department practices or decisions concerning property assessments for any centrally assessed taxpayer and therefore would not have changed any assessments issued since 1999. Thus, the proposals do not have a direct effect on property assessments for any taxpayer.

The proposed rule and amendments can be divided into five distinct changes.

Change 1

The proposed new rule would adopt the 2009 Western States Association of Tax Administrators – Committee on Centrally Assessed Properties appraisal handbook and the National Conference of Unit Valuation States standards.

For years, the department has followed the methods and standards in the latest versions of these documents in valuing centrally assessed property. The proposed rule formalizes and makes public this existing department policy. The department's assessment methods and standards have been affirmed by a number of court and State Tax Appeals Board decisions. (See, for example, Montana Department of Revenue v. PPL Montana, 340 MT 124 (2007) and Qwest Corporation v. Department of Revenue, STAB No. SPT-2008-2.)

Change 2

The proposed amendments to ARM 42.22.101 and 110 clarify the definition of "intangible personal property" in 15-6-218(2), MCA and the application of that definition. The proposed amendment to ARM

42.22.101 defines the term “goodwill” and adds details to the definition of “intangible personal property” in 15-6-218(2), MCA. Section 15-6-218, MCA exempts intangible personal property from property taxation. ARM 42.22.110 gives default percentages of centrally assessed companies’ property that is assumed to be intangible personal property and a process for a company to propose a higher percentage. Proposed new subsection (4) in ARM 42.22.110 specifies that in this rule, the term “intangible personal property” has the meaning given in 15-6-218(2), MCA and the proposed amendment to ARM 42.22.101.

The definitions in the proposed amendments embody established department practice and have been affirmed by the State Tax Appeals Board (See *Qwest Corporation v. Department of Revenue*, STAB No. SPT-2008-2). When department practices have been litigated, and STAB has either affirmed those practices or directed the department to change its practices, the department often places those practices in rule. The department’s rules then give taxpayers a single authoritative reference for these settled practices.

Change 3

The proposed amendment to ARM 42.22.105 clarifies reporting requirements for centrally assessed companies. Section 15-23-103, MCA and other sections require owners of centrally assessed property to make annual reports to the department. The department’s long-standing procedure is for centrally assessed companies to file annual reports to the department’s central office in Helena rather than to file reports with each county. The proposed amendment clarifies that it is the department’s determination that a company’s property is centrally assessed, subject to confirmation based on the information received, that triggers this reporting requirement. The amendment also specifies that a taxpayer that disagrees with the department’s determination that its property is centrally assessed must continue to meet the reporting requirements for centrally assessed property while it seeks an informal review or appeals the department’s determination.

The proposed amendment places this established procedure in rule.

Change 4

Existing ARM 42.22.110(2) states that, for railroad property valued using the method set out in 15-23-205, MCA, the default deduction for intangible personal property is 5%. The proposed amendment clarifies that the default deduction for railroad intangible personal property is 5% regardless of the valuation method used.

Section 15-23-205, MCA gives detailed directions for how railroad property is to be assessed, using the previous year’s value and formulas for calculating an annual change factor. However, there are situations where other methods must be used. Another method must be used for a new railroad. Also, Subsection 15-23-205(6) directs the department to adjust assessments for unusual operating events or one-time financial changes. This requires using other information and valuation methods in addition to or instead of the ones given in 15-23-205, MCA.

This amendment reflects current department practice. If the proposed amendment is adopted, ARM 42.22.110 will still give taxpayers the ability to suggest changes to the default percentage or to make the case that the actual percentage for their property is higher than the default percentage.

Change 5

The proposed amendment replacing existing 42.22.110(3) with new 42.22.110(5) replaces the requirement for biennial meetings to review default percentages for intangible personal property deductions with an open-ended process for taxpayer recommendations.

From 1999, when 42.22.110(3) was adopted, until 2009, the department did not consistently hold the meetings it requires. The department did hold an industry meeting on June 12, 2009, at the request of Qwest and other telecommunication providers. The department’s standing process is to discuss the

intangible personal property exemption provision with each taxpayer upon a taxpayer request. For many of the large multi-state taxpayers this discussion occurs annually.

As noted above, the purpose of the proposed amendment is to make the rules and department practice consistent and to provide taxpayers with flexible, convenient and clear opportunities to suggest changes to default intangible percentages.

Changes 1 through 4 would place existing department procedures and currently-used definitions in rule. The impacts of these proposed changes are considered together. The impacts of Change 5 are considered separately.

► ***The class of persons affected by the proposed rule, including classes that will bear the costs of the proposed rule and classes that will benefit from the proposed rule. (2-4-405(2)(a), MCA)***

All proposed changes in this notice will directly affect owners of centrally assessed property and indirectly affect other property tax payers and taxing jurisdictions. There are 129 centrally assessed property taxpayers. The proposed rule will benefit 498,400 other property taxpayers and the more than 1,800 local governments and school districts by reducing the fiscal uncertainty associated with the re-litigation of settled issues in centrally property taxation. All property taxpayers, including centrally assessed property taxpayers, and local governments will benefit from clear and certain rules for the administration of property taxes in this area.

Alternatives Considered for This Economic Impact Statement

Proposed Changes 1 - 4

No action:

In addition to no action, the department considered other methods for informing taxpayers of existing procedures and terminology. The alternatives considered are

- Explain methodologies and procedures in meetings with individual taxpayers
- Publishing taxpayer guidance in a pamphlet and on the state web-site

Proposed Change 5

The alternatives considered are

- Hold meetings every two years as required by the rule
- No action: Continue to hold meetings only as requested by taxpayers without changing the rule

Alternatives Not Considered for This Economic Impact Statement

Under the law governing economic impact statements, alternatives that are outside the purposes of a proposed rule are not subject to analysis in the statement. Notice 42-2-846 fulfills the department's duty to place established practices into rule form and, thus, does not propose any changes to existing department procedures or methodologies. If this notice were proposing substantive changes to department methodologies, it would be appropriate to consider alternative changes, along with the option of leaving procedures and methodologies unchanged. However, since no substantive changes are proposed, alternatives involving substantive changes were not considered for this economic impact statement.

Other options for getting information to taxpayers were briefly considered and discarded because they would be less effective, more expensive, or both.

Comparison of Alternatives: Proposed Changes 1 - 4

► A description of the probable economic impact of the proposed rule upon affected classes of person, including but not limited to providers of services under contracts with the state and affected small businesses, and quantifying, to the extent practicable, that impact. (2-4-405(2)(b), MCA)

The proposed rule changes will not affect the department's assessment of any taxpayer's property or the state and local property taxes on that property because the proposed changes simply place existing assessment practice into rule.

Compared to no action, each of the alternatives could reduce the probability that taxpayers would waste resources on unsuccessful appeals or procedural moves. They could reduce appeals that are based on uncertainty about department methodologies and procedures and they could reduce appeals that are based on the hope of overturning established methodologies and procedures.

A taxpayer's cost of unsuccessfully appealing an assessment is largely determined by the taxpayer. It will depend on the complexity of the appeal, the staff and outside consultant time the taxpayer devotes to the appeal, and how far the taxpayer pursues the appeal. For a complex appeal that is pursued through STAB and the courts, fees for legal representation and expert witnesses can run into the hundreds of thousands of dollars.

It is impossible to quantify the likely reduction in resources wasted on unsuccessful appeals because it depends on future taxpayer actions. Based on history, it is likely that some owners of centrally assessed property will appeal their assessments each year regardless of which alternative is adopted. However, the alternatives may have different effects on the number of unsuccessful appeals. This makes it possible to rank the alternative's likely effects.

Publishing information in rules does not guarantee that taxpayers will initially be exposed to it or understand it, but does give taxpayers a permanent reference document they can consult at any time. In addition, rules convey information with greater force and authority than the other alternatives. For example, a taxpayer knows that a definition in rule has the force of law. A taxpayer may or may not know that a definition conveyed in some other format is backed by a STAB or court decision.

Most owners of centrally assessed property with a significant amount of property in the state meet with the department at least annually. Spending additional time explaining department procedures and methodologies in these meetings could do the most to increase taxpayer knowledge in the short run. These meetings would give the department the opportunity to explain its methods and procedures in detail and give taxpayers the opportunity to ask questions. On the other hand, these meetings may cover many topics, and taxpayers may not absorb all of the information they hear. Over time, the knowledge transferred in these meetings is likely to decay, as people change jobs or simply forget. Also, taxpayers may be less willing to take information provided informally as authoritative and may be more willing to challenge established procedures in an appeal if they are not in the rules.

Publishing information in a pamphlet mailed to all owners of centrally assessed property and on the department website would not guarantee that taxpayers would be exposed to it or understand it. This alternative would give taxpayers a permanent reference source, but taxpayers may be less likely to know how to find it than if it were in rule. Taxpayers also would be less certain that the information is authoritative. When the department, and other states' revenue agencies, publishes taxpayer information documents, it generally is to explain the law and rules in a general and non-technical way, not as a replacement for rules.

Compared to no action, all of the alternatives could reduce the wasting of taxpayer resources through unsuccessful appeals. Providing additional information on department procedures and methodologies in meetings with taxpayers may do more to reduce taxpayer uncertainty about those methodologies and procedures in the short run for taxpayers who meet with the department. However, not all taxpayers

appear to be interested in meeting with the department on a regular basis, and this alternative would not provide any information to those who do not. The proposed rule changes will do more to inform taxpayers in the long run.

The proposed rule change would do the most to reduce unsuccessful appeals due to taxpayer's continuing to re-litigate issues that have already been decided by STAB or the courts.

None of the alternatives will deter taxpayers who appeal as a matter of course.

Placing the department's assessment methodologies and procedures in rules would reduce the risk that future STAB or court decisions would depart from precedent and overturn existing department methodologies and procedures. A STAB or court decision overturning established methodologies could result in significant, unexpected shifts of property taxes between groups of taxpayers. Small businesses and other taxpayers will benefit from this reduction in risk. The other alternatives will not result in this risk reduction.

None of the alternatives will affect state contracts or directly affect businesses with state contracts in their role as state contractors.

► *The probable costs to the agency and to any other agency of the implementation and enforcement of the proposed rule and any anticipated effect on state revenue. (2-4-405(2)(c), MCA)*

No Expected Fiscal Impacts

None of the alternatives, including the proposed rules and no action, will affect the department's valuation of any property. Because they would not affect assessments, they are not expected to affect state or local property tax revenue.

Difference in Fiscal Risks

One of the purposes of the proposed rules is to reduce re-litigation of settled issues. When parties continue to bring forward the same issues, STAB and the courts generally follow precedent. In rare cases, they do not. This can have unexpected consequences for all parties.

Placing definitions and procedures in rule gives them the force of law and further reduces the chance that STAB or the courts will depart from precedent, with potentially large consequences for all taxpayers and taxing jurisdictions. Adopting the proposed rules would increase stability and certainty in tax administration. The other alternatives would not have this effect.

Differences in Department of Revenue Costs

The alternatives differ in their cost of implementation.

The cost of filing rules with the Secretary of State's office is \$50 per page. When formatted, the proposed rule is likely to be four or five pages, for a filing cost of \$200 to \$250. Development of the proposed rules involved time from a number of department staff. Staff involved did not track their time on this project separately, but on the order of 50 to 100 hours were spent on these rules. The average compensation of staff involved, including benefits, was no more than \$30 per hour. The cost of staff time was therefore on the order of \$1,500 to \$3,000.

Spending extra time in periodic meetings with taxpayers explaining department procedures and valuation methodologies would have a cost in terms of diverting staff resources from other uses, but would not have a direct monetary cost. Staff time can be valued at average compensation, including benefits, which is a little less than \$30 per hour. If department staff spent an additional 100 hours per year explaining department procedures and methodologies, the cost would be about than \$3,000. At a discount rate of 5%, the present value of incurring this cost indefinitely would be less than \$60,000.

Publishing and distributing 500 copies of a taxpayer information pamphlet and putting an additional page on the department website would cost about \$530. In following years, updating the pamphlet and web page and mailing 500 pamphlets would cost about \$530. Mailing the pamphlet with no updates would cost about \$320. At a discount rate of 5%, the present value of annual mailings and maintaining a web page would be between about \$6,600 and \$10,600, depending on how often the taxpayer information pamphlet and web page were revised.

► An analysis that determines whether there are less costly or less intrusive methods for achieving the purpose of the proposed rule and an analysis of any alternative methods for achieving the purposes of the proposed rule that were seriously considered by the agency and the reasons why they were rejected in favor of the proposed rule (2-4-405,(2)(e), MCA) and an analysis of any alternative methods for achieving the purpose of the proposed rule that were seriously considered by the agency and the reasons why they were rejected in favor of the proposed rule. (2-4-405(2)(f), MCA)

Neither of the other alternatives would accomplish all of the purposes of the proposed rules.

All alternatives considered would provide information to taxpayers, and hopefully reduce the waste of resources on unsuccessful appeals due to taxpayers not knowing or not understanding department procedures and assessment methodologies.

Only the alternative of placing information in the department's rules provides taxpayers with an authoritative reference document and has the potential to reduce the waste of resources re-litigating settled issues.

► An analysis comparing the costs and benefits of the proposed rule to the costs and benefits of inaction. (2-4-405(2)(d), MCA)

Benefits

To some extent, all of the alternatives may result in fewer resources being wasted on unsuccessful appeals of centrally assessed property valuations. This benefit cannot be precisely quantified because it depends primarily on future taxpayer choices. It could be very small or it could be up to hundreds of thousands of dollars per year.

Differences in benefits between alternatives cannot be quantified, because they depend on taxpayer's future choices. All of the alternatives could reduce appeals caused by taxpayers not knowing or misunderstanding assessment methodologies and procedures. The proposed rules may also reduce appeals attempting to re-litigate settled issues.

Costs

The process of developing, adopting, and publishing the proposed rules would have a one-time cost to the department of no more than \$3,000. Interested parties' costs of participating in the process would probably be of the same order of magnitude. Total costs are likely to be less than \$10,000.

Additional time spent explaining assessment methodologies and procedures in meetings with taxpayers would have an annual cost in department staff time of \$3,000 or less. The cost of additional time for taxpayer representatives would be in the same range. Total annual costs would be \$6,000 or less. The present value of spending extra time explaining methodologies and procedures to taxpayers indefinitely would be \$120,000 or less.

Publishing a taxpayer guide, distributing it annually, and posting it on the department website would have annual costs between \$320 and \$530. Taxpayers who study the taxpayer guide annually might spend about as much time on it as they would spend having the information explained in person, but some

would probably spend little or no time on it. The present value of department and taxpayer costs of pursuing this option indefinitely would be between about \$7,000 \$70,000.

Risk

Adopting the proposed rules would reduce the risk that STAB or a court would overturn precedent and direct the department to change existing methodologies and procedures. If this happened, assessments, and therefore taxes, could decrease or increase for the directly affected property owners. This would shift local property taxes from one group of taxpayers to another and either reduce or increase total state property taxes. There would be a redistribution of benefits and costs, but no net change in the total. The benefits to taxpayers whose taxes were reduced would be offset by the cost of higher taxes on other property and the change in either services provided by public schools and the university system or non-property tax funding of education.

► A determination as to whether the proposed rule represents an efficient allocation of public and private resources. (2-4-405(2)(g))

None of the alternatives would be likely to affect taxes paid by any taxpayer or state or local property tax revenue. Where they differ is in the public and private costs incurred in reaching the same outcome and in the risks they impose on state and local revenues and other taxpayers. The proposed rules have lower present value of costs than the other alternatives and may do more to reduce the waste of public and private resources on unsuccessful appeals of property values based on lack of information, misunderstanding, or the desire to keep litigating settled issues. The proposed rules are the only alternative that promotes stability and certainty in taxation by reducing the risk that established procedures and valuation methodologies will be overturned.

Comparison of Alternatives: Proposed Change 5

► A description of the probable economic impact of the proposed rule upon affected classes of person, including but not limited to providers of services under contracts with the state and affected small businesses, and quantifying, to the extent practicable, that impact. (2-4-405(2)(b), MCA)

None of the alternatives would affect tax assessments or taxes on any centrally assessed property.

If the department began holding the biennial meetings required by the existing rule, taxpayers who chose to attend would incur additional costs. Staff, and possibly consultants, would spend time in the meetings. Many of them would have to travel to Helena, and some would need to stay overnight in Helena. Time for consultants and some employees would represent an additional financial cost. The cost for other employees would come from diverting their time from other duties.

As an example of possible costs, suppose fifty industry representatives attended the meeting. Suppose that, on average, they spent eight hours attending the meeting and traveling to and from Helena, that their average compensation was \$75 per hour, and that their average travel cost was \$200. Then, participating taxpayers would incur costs of \$40,000 to attend the meeting.

Actual costs would be higher or lower depending on how many taxpayers participated and who represented each taxpayer at the meeting. If only a few taxpayers participated, the cost could be a few thousand dollars. If most taxpayers participated and many sent multiple representatives, the cost could be a few hundred thousand dollars.

► The probable costs to the agency and to any other agency of the implementation and enforcement of the proposed rule and any anticipated effect on state revenue. (2-4-405(2)(c), MCA)

None of the alternatives would affect state or local revenue.

No action would have no direct costs. It would expose the state to an unknown risk from the fact that the department is not following a procedure that is in rule.

Holding the meetings required by the existing rule would involve some costs for the department. The biennial meetings probably would be held in a state facility. If expected attendance were too large for any state-owned meeting rooms, the department would need to rent a facility. Several department staff would need to attend the meeting and spend time preparing for it. Staff time would also be spent on reviewing any information submitted at the meeting. Depending on the amount and type of information submitted staff time could vary from insignificant to requiring a significant amount of analysis and research time. Facility and staff costs would be absorbed in the existing department budget, and the cost would take the form of diverting staff time from other uses, and possibly the cost of renting a facility.

While the rulemaking process has some costs, the cost of adding this proposed change to a notice containing other changes is minimal.

► An analysis that determines whether there are less costly or less intrusive methods for achieving the purpose of the proposed rule and an analysis of any alternative methods for achieving the purposes of the proposed rule that were seriously considered by the agency and the reasons why they were rejected in favor of the proposed rule (2-4-405(2)(e), MCA) and an analysis of any alternative methods for achieving the purpose of the proposed rule that were seriously considered by the agency and the reasons why they were rejected in favor of the proposed rule. (2-4-405(2)(f), MCA)

The no-action alternative would not achieve the purpose of making the rule and department practice consistent.

Both the proposed rule and the alternative of holding the biennial meetings required by the existing rule would make the rule and department practice consistent. Holding the biennial meetings would have additional costs of thousands to hundreds of thousands of dollars every two years.

► An analysis comparing the costs and benefits of the proposed rule to the costs and benefits of inaction. (2-4-405(2)(d), MCA)

Both the proposed rule and holding the meeting required by the existing rule would have the benefit of reducing risk associated with having department procedures that are not consistent with department rules. This benefit has not been quantified in money terms.

The cost of adding the proposed amendment to a notice including other proposed rule changes is minimal.

The cost of holding the biennial meetings required by the current rule would be in the thousands to low hundreds of thousands of dollars. Most of these costs would be incurred by taxpayers who participated in the meetings.

► A determination as to whether the proposed rule represents an efficient allocation of public and private resources. (2-4-405(2)(g), MCA)

Of the alternatives considered, the proposed rule accomplishes the goal of making department procedures and the rule consistent while continuing to give taxpayers the opportunity to suggest changes to default intangible percentages at the lowest cost to the department and interested taxpayers.

► Quantification or description of the data upon which subsections (2)(a) through (2)(g) are based and an explanation of how the data was gathered. (2-4-405(2)(h), MCA)

Costs of providing information to taxpayers were estimated by the department's Communications Officer based on the cost of recent mailings and web-site development. Department staff time required for the rule-making process was estimated by the department's rules coordinator. Hourly staff costs were provided by the department's budget analyst. The range of potential department and taxpayer costs of participating in property tax appeals were estimated by department Centrally Assessed Property staff based on department costs of recent cases, including hourly fees for expert witnesses and outside counsel.