Montana Department of Revenue

Dan Bucks
Director

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To: Dan Bucks, Director

From: C. A. Daw, Chief Legal Counsel

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Subject: **Reply to Juras Report**

The premise of the paper by Ms. Juras is that the legislative branch should exercise more control over the Department of Revenue's large taxpayer valuation process to add "predictability and stability" to the tax base. This premise is wrong and actually a diversion from what is clearly intended, which is to signal the Legislature that companies are willing to provide campaign support in exchange for chopping chunks from the large taxpayers' valuations and that the fiscal impact can be disguised by giving the taxpayers a leg up in their litigation with the Department. We are sure that the Legislature will see through this tactic. This tactic is easily observable since the paper largely avoids discussing the straightforward approach built into the law of adjusting class rates and exemptions. It is clear that "stability and predictability" are not the real underlying reason for Ms. Juras' recommendations because this segment of the tax base is already more predictable and stable than any other significant revenue source for the general fund. Every example of changed taxes cited by the centrally assessed companies can be paired with changes in the underlying company through merger, sale, investment, or change in business focus--precisely the things that the company can predict because they are making the changes, and these new situations change the valuations because they change the actual market value of the company.

During the recent past the Department has litigated through trial the valuation of PPL Montana, NorthWestern Energy, Puget Sound Energy, PacifiCorp, and Qwest. Every one of these companies was undergoing a merger or acquisition transaction involving the entire company. Through the discovery process, the Department obtained all of the valuation documents for the transaction, including all the investment banking comparisons. These documents confirmed the validity of the Department's valuations and valuation methodology. Nothing that is being proposed in this process is remotely reflective of the real valuations undertaken by these companies for business purposes; hence they cannot reflect real values or real methods of achieving market values. Ms. Juras went astray because she lacks understanding of the factual history of unit assessment and experience in the actual valuation of real companies. Ms. Juras has not litigated a centrally assessed valuation case of significance in Montana. An overview of where Ms. Juras departed from the path follows.

Ms. Juras begins her paper by implying that unit assessment was tied to rate regulation. This view is not factually consistent with history. Rate regulation was not a basis to unit assessment. Rate regulation was not evident in Illinois when the great unit assessment cases arose. See, *Porter v. Rockford, Rock Island & St. Louis R. R. Co,* 76 Ill. 561 (1875), upholding the 1872 Illinois statute assessing railroads on a unit basis. *Porter's* state law approval lead to federal approval of the Illinois statute and approach in *State Railroad Tax Cases*, 92 U.S. 575 (1875) (*SRTC*). *SRTC* is the judicial foundation of modern unit assessment. Rate regulation is not mentioned anywhere in *Porter* or *SRTC*. In fact, when *Porter* and *SRTC* were decided, railroad rate regulation was yet to be established. A short, ineffective run of state regulation of contracts for

railroads and other agriculture related industries was about to gain a toehold (see, *Granger Cases; Munn v. Illinois,* 94 U.S. 113 (1877)) but that run ended within a decade when states attempted to control prices on interstate contracts and ran afoul of the Commerce Clause. *Wabash, St. Louis & Pacific Railway Company v. Illinois*, 118 U.S. 557 (1886). Although the Interstate Commerce Commission was formed in 1887 as a result of the *Wabash* decision, it was not until *Hope* and *Bluefield* that rate regulation on the basis of cost of service gained acceptance*. Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923); *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). This was long after unit assessment was a settled issue. *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194 (1897).

Ms. Juras also apparently believes that the linear connection of the property is a key to unit assessment, even though she acknowledges that *Adams Express*, *Western Union Tel. Co. v. State Board of Equalization*, 91 Mont. 310, 7 P.2d 551 (1932), and *Dep't of Revenue v. PPL Mont., LLC,* 340 Mont. 124, 172 P.3d 1241 (2007), are to the contrary. She also misses the significance of *Mayre v. Baltimore & O. R. Co*., 127 U.S. 117 (1888), and *Pullman's Palace-Car Co. v. Pennsylvania*, 141 U.S. 18 (1891), which allowed unit assessment of railroad rolling stock and Pullman cars although neither company owned any linear structure in the state where the tax was levied. Rather than a linear assemblage being a key, it turns out that integration of use, finance, and management are the drivers of unit assessment since that integration is what prevents meaningful valuation of pieces and parts. Not only is Montana's property taxation of centrally assessed properties built on this premise, its corporate tax is as well. The basis for Montana's corporate tax combined reporting, unitary treatment, and factor apportioned income calculations all trace back to the precedent of the 19th century unit rule property tax cases. See, *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920), citing *Adams Express*. See also, *Container Corp. v. Franchise Tax Bd*., 463 U.S. 159 (1983). In her inaugural remarks to the Committee when the paper project was announced, Ms. Juras had this precisely backwards, stating that the property tax unitary assessment was derived from corporate unitary taxation.

In her remarks, Ms. Juras noted that she did not agree with the holding in *PPL Montana* with respect to the assessment as an integrated unit leading to a different valuation of the individual components than a regulated company with the same components. This dispute over the meaning of unit assessment and its lineage is critical. Valuation as an integrated unit has been the law of Montana since prior to the turn of the 20th century and has been judicially confirmed since the *Western Union* case in 1932. Over 80 years of settled precedent and defensible administrative practice will be discarded and replaced with a new, untested scheme if Ms. Juras' recommendations become law. Overturning *Western Union* and *PPLM* casts into doubt hundreds of millions of Montana tax dollars. Ms. Juras is just wrong on the validity of the Montana Supreme Court's opinion on *PPLM*. All of the major components of the Colstrip plants and PPLM dams have been subject to merger and acquisition transactions during contemporaneous time periods. All the valuation materials generated during these transactions were presented during their property tax protest actions. The Department's valuations of the properties were not disturbed in any significant respect because they reflected actual market values for the properties. If the result of the Committee is to decree equal assessments for properties that have different market values, equity will suffer and corrective action will be necessary.

Nor can Ms. Juras' recommendations be limited to property tax since corporate tax follows the same precedent. Stability and predictability will be lost while whatever new paradigm is implemented is litigated for an extended period. In contrast, the Department has provided plentiful evidence that centrally assessed property is the least variable of the state tax base. Residential housing, the vast majority of the property tax base, is not done on a pieces and parts basis, but is valued based on comparable sales (with no deduction for intangibles). These market values for residential housing are much more variable than the centrally assessed properties, even though

they are valued on a 6 year periodic cycle and the Legislature has mitigated the changes with phase-ins.

Ms. Juras suggests legislative control of the valuation process is permissible. The examples she cited for legislative control of assessment methodology are weak. First, there is no proof that they are valid because they haven't been challenged. Secondly, it isn't actually a legislative control to direct the Department to use, as a preference, market comparisons for residential property and income valuations for commercial property. These methodologies are acknowledged by all appraisers to be the preferable methods for achieving market value of the specified kind and class of property. Ms. Juras also fails to take into account the limits imposed on legislative valuation directions imposed in *Roosevelt v. Dep't of Revenue*, 293 Mont. 240, 975 P.2d 295 (1999*); Dep't of Revenue v. Sheehy*, 262 Mont. 104, 862 P.2d 1181 (1993); and *Dep't of Revenue v. Barron*, 245 Mont. 100, 799 P.2d 533 (1990). There is inherent tension between legislative dictates on valuation methodology and market value appraisal. In short, no legal precedent supports the declaration that the Legislature can dictate the methods to achieve fair market value. No appraisal text supports the proposition that legislative limits on appraisal judgment improve the valuation quality. The Legislature's authority is to pass exemptions if it determines that a defined class of taxpayers is entitled to exemption. Mont. Const. Art. VIII § 5.

The recommendation that the Department could be made to shoulder the burden of proving the intangible exemption for centrally assessed taxpayers is contrary to good tax administration and defeats equity and uniformity. Jerome R. Hellerstein and Walter Hellerstein, *State and Local Taxation: Cases and Materials*, Ch. 3 (8th ed., 2005). The Department already provided information through the testimony of Brent Eyre that the valuation of intangible property and tangible property in a centrally assessed utility is hopelessly commingled. Ms. Juras acknowledges that Bonbright's treatise is authoritative. Bonbright, *The Valuation of Property (*Columbia, 1937). Had Ms. Juras actually absorbed Bonbright, she would not have made the recommendation. Bonbright's canonical glove example (that it is not possible to accurately value a single glove) proves that Ms. Juras' suggestion is unlikely to succeed. Bonbright, p. 76. As a practical matter, since the taxpayer has all the facts regarding exemption at its disposal, placing the burden on the Department of Revenue only invites a lengthy discovery battle and will make hide and seek the order of the day.

Allowing a centrally assessed taxpayer the choice of assessment methods, as recommended, cannot lead to an actual determination of market value and certainly defeats equity and fairness. Ms. Juras does not note that, in practice, this gives the centrally assessed companies a veto power over any Department assessment and prevents the Department from defending its assessments, regardless of their validity.

Although the centrally assessed properties want to take advantage of unbundled assessments, akin to commercial property, this is not a good basis for comparison. Commercial real property is not special purpose and has a recognizable value in the market to multiple buyers. In contrast, it is hard to find an alternate economic use for transmission towers, railroad rails, airplane transport, rail cars, ballast tampers, and line insulators. Fairness and equalization comparisons to residential property are more relevant since the levy rates are mostly driven by residential housing valuations (with no appreciable contribution from commercial property). In a related issue, Ms. Juras seems to take the position that residential property value has no intangibles associated with it, since location, view, and the like are property "characteristics." This is no more and nothing less than fun with words. Redefining intangible value as a property "characteristic" and then denying the exemption to residential taxpayers exhibits bias and reveals that the goal of the centrally assessed taxpayers is to shift their burden to homeowners without regard for equity or fair play.

Ms. Juras also recommends that the single and continuous qualification be restricted to an explicit list of property types, excising the “including, but not limited to” language in §15-23-101(2), MCA. The straw man put up here is that the change is necessary to keep the Department from expanding this language to centrally assess commercial chains such as Town Pump or Safeway. This argument is a straw man because the Department has never suggested that the listed types of properties can be expanded to commercial chains. Any court construing the language would limit construction to similar types of property. The real utility of the “including” language is that it lessens the chance of listed companies that are actually operating as a unit from escaping unit assessment by claiming that they are some unlisted hybrid. Again, the recommendation seems biased against good tax administration and appears to be made to strengthen Bresnan’s (now Cablevision’s) litigation position that it is a cable company, even though it is clearly engaged in telecommunications.

Finally, it should be noted that the funding for this study was provided by Cablevision (formerly known as Bresnan) which may well explain the clear bias reflected in the Juras report.