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Revenue and Transportation Interim Committee

61st Montana Legislature

February 11, 2010

TO: Revenue and Transportation Committee

FROM: Jeff Martin, Legislative Research Analyst

SUBJECT: Phasein of Agricultural Land Values

Because agricultural land valuation schedules in Montana had not been updated since the mid-1960s, the Department of Revenue (Department) was concerned that it did not have a legally defensible system for determining agricultural land values. To deal with this potential legal problem, the Department conducted a comprehensive reclassification and revaluation of agricultural land.

Reclassification of agricultural land included land that had been misclassified in previous reappraisal cycles and land that had a change in agricultural use. The Department has determined that a reclassification of agricultural land is not subject to phasein provisions.

For parcels of land that had a change in productivity only, the Department immediately incorporated the change in productivity value in the value before reappraisal (VBR) of the parcels.[1] As such, the phasein amount of a change in value for many agricultural producers was minimal.

The Department has since determined that changes in value because of changes in productivity only will be phased in over the reappraisal cycle.[2] (See below.)

The Department's treatment of reclassified agricultural land and its initial treatment of agricultural land that had a change in productivity only may be at odds with statute, its own rules, and prior legal advice from Department tax counsel.

The remainder of this memo summarizes the statute regarding the phasein of cyclically reappraised property, the advice of tax counsel related to phasing in valuation changes of reclassified agricultural land, and the Department's rules on phasein.

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[1]Memorandum from Dan Bucks to the Revenue and Transportation Interim Committee, "Phase-in Calculation and Value Before Reappraisal (VBR) for Agricultural Property", January 25, 2010, p. 3.

[2]*Ibid*, p. 3.

Section 15-7-111, MCA, provides for the periodic valuation of class three agricultural land, class four residential and commercial land and improvements, and class 10 forest land. With respect to phasing in new reappraisal values, 15-7-111(2), MCA, provides:

> (2) The department shall value and phase in the value of newly constructed, remodeled, or **reclassified** property in a manner consistent with the valuation within the same class and the values established pursuant to subsection (1). The department shall adopt rules for determining the assessed valuation and **phased-in value of new, remodeled, or reclassified property within the same class**. [Emphasis added.]

During testimony on House Bill No. 72 (a bill to revise the method of valuing agricultural land for property taxation), introduced by then-Rep. Jim Peterson, Dan Bucks, Director, Department of Revenue, presented to the House Taxation Committee a memorandum dealing with the question of "whether the Department may phase-in the difference between a property value established by the Department at the beginning of a reappraisal cycle and a revised value that was established mid-cycle after the discovery of a change in use of the property."[3]

For parcels of land that had been classified as grazing land and were reclassified as summer fallow farmland, the memorandum concluded that 15-7-111, MCA, "requires the Department to phase-in 'the value of newly constructed, remodeled, or <u>reclassified</u> property in a manner consistent with the valuation' of other property in the same class. [Emphasis added]. Therefore, in the instant case, the Department is required to phase-in the positive changes in value that result from the Department's reclassification of the subject properties."[4]

The Department has adopted administrative rules for implementing the provisions of 15-7-111, MCA, including how increases in reappraisal values will be phased in.

Administrative Rule 42.20.501 defines the current year phasein value:

> (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:
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> Current year phase-in value = [(Reappraisal (REAP) value - VBR) x phase-in %] + VBR

Administrative Rule 42.20.501 defines the value before reappraisal:

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[3] Memorandum from Michele Crepeau, Tax Counsel, Department of Revenue, to Dan Bucks, "Phase-In of Revised Property Values, January 31, 2005. Exhibit No. 4 (House Bill No. 72), House Taxation Committee, February 2, 2005.

[4] *Ibid.*, p. 2

> (25) "Value before reappraisal (VBR)" means the 2002 tax year value adjusted for any new construction or destruction that occurred in the prior year. The VBR for the 2003 tax year and subsequent years is the same as the 2002 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 or subsequent tax years. [Emphasis added.]

Administrative Rule 42.20.503 provides the general method of phasing in new reappraisal values of property within the relevant classes:

> (1) For tax years 2003 through 2008, 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 VBR from the 2003 reappraisal value multiplied by the applicable phase-in percentage, the product of which is added to the 2002 VBR value. The calculations of the phase-in values are represented by the following formula: [Formula omitted.]

Administrative Rule 42.20.502 provides the specific methods for determining the VBR of the relevant classes of property depending on their status, including land reclassification, land use changes, and productivity changes referred to in Administrative Rule 42.20.501(25):

> (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 or subsequent tax years, the current year VBR will be the same as the prior year VBR.
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> (2) For class three property that contains a land reclassification or a land use change, the **current year VBR will be the prior year VBR of the new classification or land use change**.
>
> (3) 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**.
>
> (4) 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:
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> VBR = Reappraisal value /(1 + NBHD[5] group percentage)
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> (5) Land which has been reclassified as residential or commercial land after January 1, 2002, will have the VBR determined by comparing other 2002 market values of similar residential or commercial land, and determining a comparable VBR for the new residential or commercial land. [Subsections (6) through (10) omitted.]

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[5]Administrative Rule 42.20.501(17): "Neighborhood (NBHD) group percentage" means the percent of change in value from the total 2002 tax year value to the total 2003 reappraisal value, excluding properties with new construction, for those homogeneous areas within each county or between counties that have been defined as a neighborhood group. The neighborhood group percentage is determined by using the following formula:

$$\text{Neighborhood Group Percentage} = \frac{(\text{Total 2003 NBHD REAP Value - Total 2002 NBHD Tax Year Value})}{\text{Total 2002 NBHD Tax Year Value}}$$

Administrative Rule 42.20.502(2) for the 2003 reappraisal cycle states that the current year VBR for reclassified agricultural land is the prior year VBR of the new classification or land use change.[6] The rule requires that the Department ascertain the prior year VBR of the land as if the land had been classified in the prior reappraisal cycle in the same class of land as it is for this reappraisal cycle. The difference between the new reappraisal value and the prior year VBR for the land determines the amount of value that is to be phased in over the 6-year period. To effect this rule the Department would have to determine a VBR for each parcel of agricultural land that was reclassified under the current reappraisal cycle.

The rule related to the reclassification of agricultural land is consistent with 42.20.502(5), in which the VBR of land that has been reclassified as residential or commercial property will be determined by comparing other 2002 market values of similar residential or commercial land and determining a comparable VBR for the new residential or commercial land.

Likewise, in the case of class four 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 (Administrative Rule 42.20.502(4)).

Administrative Rule 40.20.502(3) specifies that the new reappraisal value of agricultural land that experienced changes in productivity (only) is to be phased in based on the prior year VBR of the prior grade.

The Department has determined that it will change the VBR and phasein calculation for agricultural producers who timely requested an informal review of their productivity values arising from a change in productivity only. For agricultural producers who did not timely request a review, the Department will make the adjustment beginning in tax year 2010. The adjustment will include a phasein amount for both tax year 2009 and tax year 2010.[7]

If the Department erred in the determination of the phasein calculation of agricultural land with a change in productivity only, the adjustment to the phasein amount should be made regardless of whether the agricultural producer requested an informal review. The question is whether the adjustment should be made this tax year or next tax year, taking into account impacts on taxpayers and on local governments.

Section 15-7-111, MCA, and the Department's rules provide for the phasein of increased values of all cyclically reappraised property. Cl0425 0041jfqa.

[6] A similar rule (42.20.502(7)) applies to forest land reclassification.

[7] *Op. cit.,* "Phase-in Calculation and Value Before Reappraisal (VBR) for Agricultural Property", p. 3.