

MINUTES OF THE MEETING
TAXATION COMMITTEE
MONTANA STATE SENATE

April 6, 1983

The sixtieth meeting of the Taxation Committee was called to order by Pat M. Goodover at 9 a.m. in Room 415 of the Capitol Building.

ROLL CALL: All members were present except Senator Towe.

CONSIDERATION AND DISPOSITION OF HOUSE BILL 637: Senator Severson, who chaired the subcommittee appointed to work on this bill, said they had a subcommittee meeting with several agriculturalists last night. There are two sets of amendments-- one, marked "Turnage/Severson amendments" (Exhibit A), and the other marked "Towe amendments" (Exhibit B). He reviewed each set with the committee. We are deciding whether to use the Turnage/Severson amendments or to continue to use the capitalized net income that is in the original bill. The Turnage/Severson amendments delete the capitalized net income approach, and subsection (4) on the Towe amendments is a completely new idea.

Senator Turnage recited a portion of Howard Lord's testimony from the rules hearing on February 17, 1983, specifically, items 1, 2, 3, and 4 on pages 2 and 3 of his testimony, wherein he objected on behalf of several organizations, to the Department of Revenue's proposal. See Exhibit C attached hereto. Senator Turnage said he could understand the Department of Revenue's point of view. The capitalized net income method will simplify the Department's work tremendously. But, as Mr. Lord points out, it can be devastating. The amendments Senators Turnage and Severson talked about are regulations from collateral reference in the greenbelt laws regarding agricultural land. (Turnage/Severson amendment No. 5, subsections 2, 3, and 4).

He said the U.S. Soil Conservation Service has catalogued soil types pretty thoroughly. As to subsection (4), if you paint your house, you shouldn't be taxed on the paint job.

Jo Brunner, representing Women Involved in Farm Economics, said the idea was to give direction to the Department of Revenue on the fairest way to tax this. There was a basis for the evaluation that they used in 1963. She suggested we continue to use alfalfa. It could be valued according to how much is produced.

Senator Severson said he asked for a consensus of opinion, and in the subcommittee, they disagreed. He said he wanted complete directions to the Department of Revenue on what the legislature expected to be done in the re-evaluation process.

Senator Turnage said he didn't see the compromise in it at all. He said Senator Severson was upset about the rules, and he was going to have exactly the same thing with this. It doesn't give guidelines; it just locks into granite what they said in the rules.

Senator McCallum pointed out that a capitalized net income approach can vary from farmer to farmer.

Senator Elliott stated that the capitalized net income approach, in accounting, leaves the door open to the Department of Revenue to come up with whatever rules they want to adopt. It won't reflect what goes on in different counties. The Turnage/Severson amendments will do a better job.

Senator Crippen stated that the capitalized net income approach is used in real estate. The key is the cap rate. The Department of Revenue says this is the method you chose, but the legislature gets to choose the cap rate. It might be of one percentage and okay in Sidney but not okay in another area of the state.

Senator Severson said he understood what Senator Crippen was saying. Howard Lord was a proponent of this. He said it was done on a net income approach in 1963, but it wasn't. It was how much the land produced, not what someone's net income was.

Senator Turnage felt the Department of Revenue would make assumptions statewide, not by individualization.

Senator Eck, referring to the Turnage/Severson amendments, asked if the growing season would also need to be considered on amendment No. 5, subsection (3). Some places may have fewer frost free days than other places. She supposed the Department of Revenue would consider that but thought it should be spelled out so they would have to consider it.

An unidentified witness said the U.S. Soil Conservation land classifications already take growing seasons into account.

Senator Gage noted that Towe's amendment No. 3, subsection (3) was to include the schedules presently being used. Maybe they should even be attached as part of the bill or the statement of intent, he said. He suggested striking subsection (2) of section 1 of the bill and adding a statement of intent. On a net income basis, some lands have a negative value.

Senator Turnage said you could overcapitalize. With a \$1 million irrigation pump on 40 acres, you could come up with a negative figure.

Senator Turnage moved that the Turnage/Severson amendments as amended and attached as Exhibit A be adopted. The motion was seconded and passed unanimously.

Senator Turnage moved that HB 637 BE CONCURRED IN AS AMENDED. The motion was seconded. Cort Harrington, the committee's staff attorney, said no statement of intent would be necessary if subsection (3) of section 1 of the bill were stricken.

A vote was taken on Senator Turnage's motion, and it passed unanimously. Senator Severson will carry the bill on the floor.

CONSIDERATION AND DISPOSITION OF HOUSE BILL 716: Senator Mazurek moved that HB 716 be taken from the table and reconsidered for amendment. The motion was seconded and passed unanimously.

Senator Mazurek said the bill does five things: provides for redemption of bonds at a premium; allows the bonds to be sold at a discount; allows the payment of fees in connection with the sale of such bonds; redefines "serial bonds" as they relate to general obligation bonds; and allows flexibility as to the first interest payment date on all such bonds.

Senator Turnage stated that when you redeem at a discount, the beneficiary is the bonding company. Senator Crippen said suppose the bonds are issued at par. We want to issue new bonds and pay off the old bonds. Senator Turnage said the market will set the pace. Senator Mazurek stated this will allow them to sit on maturity schedules and include in the cost of the bonds the costs of consultant and attorney fees. This bill creates the ability to redeem the bonds at less than par. Senator Turnage noted that a significant change in the bill will add to the cost of the bonds--the subsection relating to consultants' fees and attorneys' fees. Consultant fees are normally the brokerage commissions, he said. They will be able to charge a fee for helping to prepare the issues.

Senator Goodover wondered what the benefit was to the taxpayer. Senator Mazurek said the benefit was the ability to better market the bonds and get better interest rates.

Senator Turnage said bonds are now out at unreasonably high interest rates. If this bill will help pay off in refunding an issue at a better rate, it will be better.

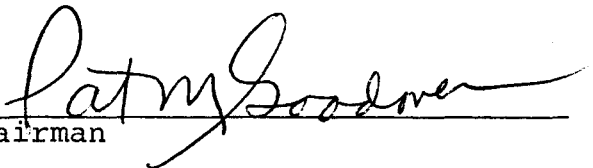
Senator Norman asked, for clarification, if a taxing jurisdiction had bonds out at 12% and was paying them off, and today the interest rate was 9%, then would HB 716 permit the jurisdiction to call in the bonds and reissue them at 9%. Senator Mazurek stated that this would apply more to new issues and to consultant fees and attorney fees for reissues.

Senator Mazurek moved that his amendments, attached as Exhibit D, be adopted. The motion was seconded and passed unanimously.

Senator Eck asked what the reason was for removing the provision that allowed for redemption. Senator Turnage responded that the discount provision will make the bonds easier to sell but it goes to the brokerage firm and not to the taxpayers. He submitted that in the market place, bonds will sell without the 3% that goes to the brokerage firm. Let's say there is a \$5 million bond issue to build a new school. If they can buy at 97 cents on the dollar, they might sell at \$1.05 on the dollar.

Senator Mazurek moved that HB 716 BE CONCURRED IN AS AMENDED. The motion was seconded and passed unanimously. Senator Mazurek will carry the bill on the floor.

The meeting adjourned at 10:10 a.m.


Chairman

ROLL CALL

SENATE TAXATION

COMMITTEE

48th LEGISLATIVE SESSION -- 1983

Date 4/6 /83

NAME	PRESENT	ABSENT	EXCUSED
SENATOR GOODOVER, CHAIRMAN	✓		
SENATOR McCALLUM, VICE CHAIRMAN	✓		
SENATOR BROWN	✓		
SENATOR CRIPPEN	✓		
SENATOR ELLIOTT	✓		
SENATOR GAGE	✓		
SENATOR TURNAGE	✓		
SENATOR SEVERSON	✓		
SENATOR HAGER	✓		
SENATOR ECK	✓		
SENATOR HALLIGAN	✓		
SENATOR LYNCH	✓		
SENATOR NORMAN	✓		
SENATOR TOWE		✓	
SENATOR MAZUREK	✓		

Turnage/Levenson
(presented to sub comm mtg on 4/5)

SENATE TAXATION COMMITTEE
EXHIBIT A
April 6, 1973
House Bill - 637

PROPOSED AMENDMENTS TO HB 637

1. Page 1, line 5.

Following: "a"

Insert: "certain"

Strike: remainder of line 5.

2. Page 1, line 6.

Strike: "methodology"

Insert: "method"

3. Page 1, line 6.

Following: "land"

Strike: remainder of line thru land on line 7.

4. Page 1, line 21.

Strike: remainder of page 1 thru line 4 on page 2.

5. ~~Page 1, line 21.~~

Insert: "(2) Agricultural land shall be classified according to its use which classifications shall include but not be limited to irrigated use, non-irrigated use and grazing use.

(3) Within each class, land shall be assessed at a value that is fairly based on its ability to produce ^{and when applicable using} ~~based on the U.S.~~ ^{Service} ~~several~~ Soil Conservation land classes ~~where~~

(4) Capital costs such as improved water distribution, fertilizer and land shaping that increase productivity shall not be used in determining assessed values."

Towne

SENATE	HOUSE
EXHIBIT <u>B</u>	
<u>April 6</u>	<u>3</u>
<u>House</u>	<u>637</u>

Amend HB 637, Third Reading Copy

1. Title, line 6.
 Following: line 5
 Strike: "METHODOLOGY"
 Insert: "METHOD"

2. Page 1, line ²³ 5.
 Following: "assessment"
 Strike: "methodology"
 Insert: "method"

3. Page 2, line 1.
 Following: "production."
 Insert: "Water cost shall be taken into consideration except that at no time may the resulting value be reduced below dryland production value."

(3) Within each class, land shall be assessed at a value that is fairly based on its ability to produce, which shall be based to the maximum extent possible on the classification system employed by the department on December 31, 1982, provided, in no event may the value be less than grazing value for similar land.

(4) Capital costs such as improved water distribution, fertilizer, and land shaping that increase productivity shall not be used in determining assessed values."

Renumber: subsequent subsections

4. Page 2, line 3.
 Following: line 2
 Strike: "methodology"
 Insert: "method"

5. Page 2, line 4.
 Following: "land based on"
 Strike: "capitalized net income"
 Insert: "the above guidelines"

April 6 3
House - 637

Rep Manual

TESTIMONY BY HOWARD LORD, rancher from Philipsburg, Montana, presented to the Department of Revenue at the February 17, 1983 hearing on agricultural land assessments. My qualifications as a witness on the subject of this hearing are as follows:

1. Masters Degree in Agricultural Economics from Montana State University.
2. Six years of experience at M.S.U. teaching Public Finance and Farm Management and Accounting, and doing research and writing leading to the publication of the following Montana Experiment Station Bulletins:
Inequalities in the Assessment of Montana Farm Lands.
Standards and Procedures for Classification and Valuation of Land for Assessment Purposes.
3. Over thirty years of experience as a farmer and rancher.
4. Six years on the Montana State Board of Equalization.

This testimony is on behalf of the following organizations: Montana Stockgrower Association, Montana Association of State Grazing Districts, Montana Farm Bureau, Montana Wool Growers Association, Western Montana Stockmens Association, Montana Cattle Feeders, and Montana CowBelles.

We appear here in opposition to all of the values proposed for the following classes of land:

1. Grazing land.
2. Wild hay land.
3. Irrigated land.

Reference will be made to specific pages of both the Property Assessment Division proposal to the Department of Revenue and to the Department of Revenue proposal that is the subject of this hearing.

We agree with two aspects of the Department of Revenue proposal:

1. We believe the Department of Revenue should periodically review

agricultural land values and when necessary, propose revisions to comply with the law, if such revisions are supported by correct data, and correct procedures.

2. We agree that legal agricultural values for assessment purposes under Montana law are properly computed by the capitalization formula presented near the top of page 3 of the Department of Revenue proposal.

$$\text{Land Value Per Acre} = \frac{\text{Net Agricultural Income Per Acre}}{\text{Capitalization Rate}}$$

Our objections to these proposals center around the net agricultural income to be capitalized and the capitalization rate used.

Our general objections to this hearing and the proposals presented by the Department of Revenue are as follows:

1. Neither the methodology or the data are adequately documented. Only the source of the data is cited. There is no authentication of the source of breakdown of operating costs so that they may be evaluated. We specifically request a complete breakdown of all operating costs on all classes and grades of land.
2. In view of the lack of adequate documentation of the Department of Revenue proposal, we contend that insufficient time was available to study the source material or assemble counter evidence.
3. We frequently find the data to be inadequate, erroneous or inapplicable to Montana land.
4. We frequently find the methodology to be inadequate or erroneous.

One of the many examples of wrong methodology that might be cited is the use of a constant net return to land over costs for all grades of land in the computation of values for all irrigated and non-irrigated cropland and wild hay land. It is common knowledge and easily demonstrated that in the case of all the above classes of land, the higher the yield the greater the net income per bushel of wheat or ton of hay. That is because

the gross income from the higher yields, as we move upward through the grades of land, increases much faster than the cost. Crop production costs are much more closely related to acreage than to volume of production. In many instances there is little difference between the cost of producing a high yield than a low yield.

The results of this error in methodology is devastating to tax equity since it causes lower producing land to be over assessed and over taxed as compared to higher producing land. The principal object of using capitalized net income values for assessment is to tax land according to its ability to pay. The methodology used in the proposal presented by the Department of Revenue results in discrimination against the lower grades of land and placing a disproportionate share of the burden of property taxes on the land with the least ability to pay.

5. We frequently find the arithmetic in error.
6. Because of all of the above objections, we do not accept the resulting values.

Specific examples of errors or inadequacies in the Department of Revenue proposals follow:

Department of Revenue Proposal - Page 4

Grazing Land

The data presented in support of the Department of Revenue proposal to nearly trebling grazing land assessments are both inadequate and erroneous:

1. The arithmetic in computing the index of gross income on page 7 of the Property Assessment Division procedural paper is obviously erroneous.
2. There is no breakdown of costs per animal unit on page 8 and therefore no basis for judging the reasonableness of the data.
3. Actually only 1979 data were used for either costs of income. The other years are correct only if the index for both income and costs for the

other four years is correct. This is inadequate data and procedure.

4. The index of ranch operating costs are from nation wide farm operating costs that may or may not fit Montana farms and ranches. Certainly the importance of various items of cost would be very different on a Montana ranch compared to a Midwest farm.
5. The mid-points of grazing capacity of all grades of grazing land in the Department of Revenue proposal are all in error and result in erroneously high proposed values.

In summary, we find serious fault with the data, the method, the arithmetic, and the resulting values proposed for grazing land.

Department of Revenue Proposal - Page 5

Wild Hayland

We find no documentation of either the income or costs and hence the net income per acre for this class of land. We find it hard to believe that the margin of profit per ton of hay attributed to the different grades would be constant as this computation suggests. The variable cost would actually be nearly as high per acre on the low producing land as on the high producing land.

Irrigated Land

Variable costs on irrigated land are not adequately itemized or documented. For lack of a stated water cost, it is not possible to compare proposed values with present values.

Variations in water costs do not appear to be considered in the Department of Revenue proposal as in the present irrigated land schedules. These variations can easily make a difference of over \$100 per acre or 100 percent in the real productivity value of an acre of irrigated land. Variations in water costs are far too important to be ignored for tax purposes. Range in water costs need to be even greater than in present schedules because of increased pumping costs and other

operating and maintenance costs.

Property Assessment Division Proposal - Pages 15 and 16

Capitalization Rate

A large error has been introduced into the proposed value schedule by deducting 4.25 percent from the capitalization rate. The alleged rationale for reducing the proposed capitalization rate from .0962 percent to 5.2 percent comes from a theoretical paper. The author is employed by the Federal Reserve Board. A footnote to the article states that the analysis and conclusions are those of the author and do not necessarily reflect the views of the Federal Reserve Board.

This article has serious weaknesses for justifying reducing the capitalization rate used to compute the capitalized net income values of Montana land:

1. It refers to income from all farm production property, including cattle, machinery, etc. - not just income from land as would be proper.
2. It is based on nation wide statistics that may not be applicable to Montana land.
3. While the annual income growth rate is alleged to be 4.25 percent, that tells you little about the actual net return.
4. Actually the paper states that since the mid-1950s the rate of return to farm production assets rose from an average of 3 percent in 1955-59 to 4.2 percent in 1965-69 and 1975-79. The increase, in rate of return from 3 percent to 4.2 percent is a 40 percent increase but the actual rate of return is still relatively low. Too low to permit a farmer or rancher to pay prevailing interest rates on even a modest indebtedness.
5. If there has been a rise in the net income to Montana land, it is properly included in the net income per acre being capitalized. To reflect the alleged rise in income in the capitalization rate also is to erroneously compound the effect of a rise.

6. The present value schedules, now about 20 years old, are based upon a 6 percent capitalization rate. Interest has more than doubled since then, yet the Department of Revenue is proposing values based on a 5.2 percent capitalization rate.
7. Even if there had been increases in net income to land since WW II - to project such increase into the future, as is being done with the 4.2 percent decrease in the capitalization rate, would be speculative, and speculative values for the assessment of agricultural land is specifically prohibited by Montana law.

Property Assessment Division - Page 14

Impact of Proposed Land Values

It appears that the average proposed values are alleged to be 20 to 22 percent of market value. How does this lead to a conclusion concerning the impact of the proposed values on total assessed and taxable values since present values are productivity values and not market values?

Further, to measure the impact of proposed values on taxable values it is necessary to weigh the values of each class and grade by the total number of acres in each grade. The proposed indicated taxable to assessed value percentage of 14 percent, alleged to be necessary to produce the same taxable value as at present, is meaningless.

Further, the 30 percent taxable to assessed value for land is a matter of law, changeable only by the legislature. The duty and authority of the Department of Revenue in this matter is limited to proposing correct capitalized income values.

Department of Revenue Proposal - Paragraph 5

This paragraph states: "These rules are being proposed in order that agricultural lands will be appraised, valued, and classified in conformity with Montana statutory law." We deny that under this proposal that Montana agricultural land would be

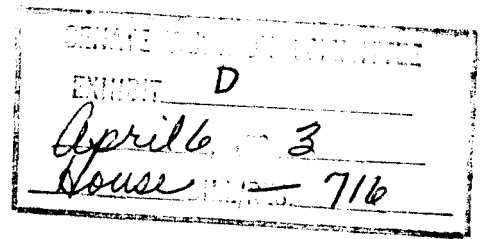
assessed according to Montana law.

The second sentence in this paragraph states, "In addition, they will insure that the methods employed to appraise, value and classify such lands are uniform in nature and equitable in result." We deny that under this proposal Montana agricultural land values will be equitable as between classes and grades of land.

Neither of the above allegations have been proven. Further, we believe our testimony clearly proves that both of the above statements are false and that the proposed values do not comply with Montana law.

4/6

Mazurek amdmnts.



Amend HB 716, Third Reading Copy

1. Title, line 4.
Following: "AN ACT"
Strike: through "AT A DISCOUNT;" on line 8
2. Title, line 13.
Following: line 12
Strike: "7-7-2207,"
Following: "7-7-2254,"
Strike: "7-7-4206,"
3. Title, line 14.
Following: "20-9-408,"
Strike: "20-9-410,"
4. Page 1, lines 18 through 24.
Strike: section 1 in its entirety
Renumber: subsequent sections
5. Page 4, line 9.
Following: "not less than"
Strike: "97% of"
6. Page 5, line 13.
Following: "not less than"
Strike: "97% of"
7. Page 6, line 3.
Following: "than"
Strike: "97% of"
8. Page 6, lines 10 through 16.
Strike: section 5 in its entirety
Renumber: subsequent sections
9. Page 8, line 24.
Following: "not less than"
Strike: "97% of"
10. Page 9, line 25.
Following: "not less than"
Strike: "97% of"
11. Page 10, line 15.
Following: "than"
Strike: "97% of"
12. Page 11, line 19 through page 12, line 9.
Strike: section 10 in its entirety
Renumber: subsequent sections

13. Page 13, line 23.
Following: "not less than"
Strike: "97% of"

14. Page 15, line 3.
Following: "not less than"
Strike: "97% of."

15. Page 15, line 22.
Following: "at less than"
Strike: "97% of"

STANDING COMMITTEE REPORT

April 6

19 83

MR. **PRESIDENT**

We, your committee on **taxation**

having had under consideration **House** Bill No. **637**.....

Manuel (Severson)

Respectfully report as follows: That..... **House** Bill No. **637**.....

third reading copy, be amended as follows:

1. Title, line 5.

Following: "USE A"

Strike: "CAPITALIZED NET INCOME"

Insert: "CERTAIN"

2. Title, line 6.

Strike: "METHODOLOGY"

Insert: "METHOD"

3. Title, line 6 through line 8.

Following: "LAND;" on line 6

Strike: remainder of line 6 through "RULES;" on line 8

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(Continued on page 2)

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4. Page 1, line 21. through page 2, line 4.

Strike: subsections (2) and (3) in their entirety

Insert: "(2) Agricultural land shall be classified according to its use which classifications shall include but not be limited to irrigated use, non-irrigated use and grazing use.

(3) Within each class, land shall be assessed at a value that is fairly based on its ability to produce and where applicable using the Soil Conservation Service land classes under the U.S. Department of Agriculture.

(4) Capital costs such as improved water distribution, fertilizer and land shaping that increase productivity shall not be used in determining assessed values."

5. Page 2, line 6 through line 7.

Strike: ", except the addition of subsection (3) to 15-7-201,"

6. Page 2, line 8.

Strike: subsection (2) in its entirety

And, as so amended

BE CONCURRED IN

10

STANDING COMMITTEE REPORT

..... April 6 19 83

MR. PRESIDENT

We, your committee on taxation

having had under consideration House Bill No. 716

Metcalf (Mazurek)

Respectfully report as follows: That House Bill No. 716

Third Reading Copy, be amended as follows:

1. Title, line 4.

Following: "AN ACT"

Strike: through "AT A DISCOUNT;" on line 8

2. Title, line 9.

Following: "THE SALE OF"

Strike: "SUCH"

Insert: "COUNTY GENERAL OBLIGATION, MUNICIPAL GENERAL
OBLIGATION, AND SCHOOL DISTRICT"

3. Title, line 13.

Following: line 12

Strike: "7-7-2207,"

Following: "7-7-2254,"

Strike: "7-7-4206,"

~~DOXKASXX~~

..... (Continued on page 2)

y.c.

April 6

19 83

4. Title, line 14.

Following: "20-9-408,"

Strike: "20-9-410,"

5. Page 1, lines 18 through 24.

Strike: section 1 in its entirety

Renumber: subsequent sections

6. Page 4, line 9.

Following: "not less than"

Strike: "97% of"

7. Page 5, line 13.

Following: "not less than"

Strike: "97% of"

8. Page 6, line 3.

Following: "than"

Strike: "97% of"

9. Page 6, lines 10 through 16.

Strike: section 5 in its entirety

Renumber: subsequent sections

10. Page 8, line 24.

Following: "not less than"

Strike: "97% of"

11. Page 9, line 25.

Following: "not less than"

Strike: "97% of"

12. Page 10, line 15.

Following: "than"

Strike: "97% of"

13. Page 11, line 19 through page 12, line 9.

Strike: section 10 in its entirety

Renumber: subsequent sections

14. Page 13, line 23.

Following: "not less than"

Strike: "97% of"

15. Page 15, line 3.

Following: "not less than"

Strike: "97% of"

16. Page 15, line 22.

Following: "at less than"

Strike: "97% of"

And, as so amended

BE CONCURRED IN

J.C.