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**Revenue and Transportation Interim Committee**

**60th Montana Legislature**



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TO: Members of the House Bill 488 Subcommittee

FROM: Jeff Martin, Legislative Research Analyst

SUBJECT: Subcommittee Discussion of Alternatives Dealing with Property Reappraisal

Rapidly rising property values (particularly for residential property) and expanded local government services over the last several decades have led most states, either through the legislative process or by taxpayer initiative, to adopt measures to limit property taxation. The House Bill 488 Subcommittee has been reviewing how Montana and other states have dealt with rising property values and have provided targeted property relief to lower-income residential property owners or to the elderly, or both. Targeted property tax relief measures are designed to help property taxpayers regardless of what may be happening to housing values.

The purpose of this memorandum is to highlight property tax limitations and targeted property tax relief measures and to list some alternatives for mitigating changes in market values of residential property because of reappraisal that the Subcommittee may want to consider for further review and analysis. The Subcommittee may also want to discuss targeted property tax relief programs.

## PROPERTY TAX LIMITATIONS

All but a handful of states have adopted some sort of property tax limitation. These limitations include tax rate limits; assessment limits; revenue rollbacks; expenditure limits; or property tax freezes.[1]

Tax rate limits have been adopted by most states. California and Washington limit property taxes to 1% of market value. Under tax rate limits, property taxes may still increase in areas of rapidly increasing values unless tied to assessment limits.

Assessment limits restrict how much property values may increase in a year for tax purposes. Washington limits property tax increases to 1% a year, while California limits increases in taxable value to 2% a year (based on acquisition value). Michigan limits the growth in taxable value to 5% a year, while Oregon limits increases in market value to 3% a year. Assessment

[1] "A Guide to Property Taxes: Property Tax Relief", National Conference of State Legislatures, November 2002.

limits restrict the growth in taxable value in areas of rapidly increasing property values. To be effective, assessment limits should be tied to tax rate limits.[2] In addition, assessment limits often treat similarly situated taxpayers differently and may discourage people from changing residences because doing so may result in a much higher tax bill.

Revenue rollbacks require taxing jurisdictions to reduce mill levies when property assessments increase by more than a certain amount. Revenue rollbacks apply to all taxpayers, but taxpayers whose property values increase by more than the average increase in the taxing jurisdiction will be faced with higher property tax bills.[3]

Only a few states limit property taxes by limiting growth in local expenditures. The limitations have been directed toward school districts, but Arizona, California, and Colorado limit expenditures for all taxing jurisdictions. Expenditure limits may be adjusted for changes in population and inflation.[4]

A property tax freeze generally prohibits property tax increases for a taxpayer who reaches a certain age or whose income falls below a certain level. Only a few states employ property tax freezes. Most other states target property tax relief for older or less well-off homeowners, or both, by targeted property tax relief.[5]

**TARGETED PROPERTY TAX RELIEF**

Residential property tax relief measures generally include homestead exemptions or credits, circuit breakers, and property tax deferral programs.

Almost every state provides for homestead exemptions or credits. Exemptions generally apply to all homeowners, but may provide additional exemptions for older taxpayers that may or may not be tied to income. Some states exempt all or a portion of residential market value from school taxes. Revenue losses from property tax exemptions are typically absorbed by local governments or are shifted to other taxpayers. Some states reimburse local governments for revenue losses attributable to property tax exemptions. Homestead credits are not used as much as homestead exemptions. Homestead credits are state financed but may apply to taxpayers in the same manner as property tax exemptions. Some states provide credits for school property taxes paid.[6]

Property tax circuit breaker programs are more directly targeted to low-income taxpayers and may include renters. Circuit breaker programs prevent overburdening taxpayers. When property

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[2] *Ibid.*

[3] *Ibid.*

[4] *Ibid.*

[5] *Ibid.*

[6] *Ibid.*

taxes exceed a certain level of income, the state provides relief. Circuit breaker programs are tied to income levels of taxpayers and to the amount of property taxes paid, and they are typically phased out as income rises. Montana provides two circuit breaker programs: the property tax assistance program under 15-6-134, MCA, and elderly homeowner and renter credit under the individual income tax law (15-30-171 through 15-30-179, MCA). The property tax assistance program applies to all ages and provides for a tax rate reduction based on income (adjusted for inflation). Unlike most circuit breaker programs, local governments absorb the revenue loss for this program. The elderly homeowner and renter credit is funded by the state and may be claimed by a taxpayer 62 years of age and older.

Property tax deferral programs allow low-income elderly taxpayers to defer payment of all or a portion of their property taxes on their principal residence. Deferred taxes are a lien on the property, and property taxes, including interest, must be paid when the property is sold or the taxpayer dies. Some states provide reimbursement to local taxing jurisdictions for the deferral program, while in other states, local taxing jurisdictions absorb the cost of the program in lost property tax revenue.[7]

**ALTERNATIVES**

There are almost unlimited alternatives that the Subcommittee could consider in developing mitigation strategies to deal with the effects of property reappraisal. The purpose of this part of the memorandum is to outline some alternatives to assist the Subcommittee in focusing on some strategies for future review and analysis.

The first thing the Subcommittee may want to discuss is the pros and cons of adhering to the market value standard versus another approach to property taxation, such as limiting growth in taxable value or some other system of valuation. In considering deviations from the market value standard, the Subcommittee should keep in mind the constitutional changes that may be required.

Under the market value standard there are at least two approaches that the Subcommittee could consider. The first is to proceed as the Legislature has done in the last two reappraisal cycles: phasing in market values, increasing exemption percentages, and phasing in reductions in the class four property tax rate. Under this approach , the tax rate applied to class four property (and agricultural land) would likely fall below 3%. The Subcommittee may want to discuss how to deal with property owners who have "extraordinary" increases in market value by revising 15-6-191, MCA, or by providing mitigation by some other means.

Another approach would be to allow reappraisal values to go into effect immediately. Under current law, the tax rate on class four property would be 3.01% and the exemption amount would be 34% of market value. The Subcommittee could consider increasing the exemption percentage, increasing the exemption percentage but capping the exemption amount, or varying the exemption percentage based on value, with or without a cap. This last approach would provide more relief to lower-valued homes.

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[7] *Ibid.*

There are a variety of approaches under a property tax system that deviates from the market value standard[8]. Several states have limited growth in taxable value (e.g., Florida, Michigan, and Oregon). Limiting growth in taxable value have required constitutional changes to implement because of equal protection. In considering alternatives that deviate from a market value standard, the Subcommittee should consider whether there are features of the alternative that discourage existing homeowners from purchasing a new residence.

In analyzing any alternative, the Subcommittee would have examine the effects on all property taxpayers and on the state and local taxing jurisdictions.

Under any alternative regarding how property is taxed, the Subcommittee could consider revising or expanding targeted property tax relief measures.

Finally, the Subcommittee may want to discuss revising the length of the reappraisal cycle.

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[8] In 1997, the Montana Legislature enacted Senate Bill No. 195 (Ch. 463, L. 1997) to phase in the effects of the 1996 reappraisal cycle. Amendments to 15-10-401, MCA, included the following language: "In order to reduce volatility in property taxation and in order to reduce taxpayer uncertainty, it is the policy of the legislature to develop alternatives to market value for purposes of taxation."