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The Economics of Property Tax Policies

Part 5 of a Series on Property Taxation in Montana

In this fifth installment of the series on property taxation in Montana, I analyze recently proposed property tax policies and one already enacted policy that has significantly impacted taxes.

- Policy 1: Reductions in taxable rates.
- Policy 2: Homestead/Comstead/Agstead Exemptions.
- Policy 3: Reduction to the mills of the 95-Fixed Mill Levy.
- Policy 4: Property Tax Rebate Program

This analysis builds on foundational property tax concepts. If you're unfamiliar with property tax terms, I encourage you to review Parts 1-4 of this series for a deeper understanding.

Policy 1: Reductions in Taxable Rates

When property values shift, the resulting changes in tax burden can disproportionately affect certain taxpayers. One way to mitigate these shifts is by reducing taxable rates for specific property classes whose values have increased relative to others. In Montana, the Department of Revenue (DOR) must set value-neutral taxable rates for residential, commercial, and agricultural properties statewide before each reassessment cycle that maintains the tax burden *between property classes*.

For the 2023 property value reassessment cycle, the DOR estimated that significant reductions in taxable rates would be necessary to maintain a consistent tax burden between property classes. As shown in Table 1, residential properties would require a reduction of 0.41 percentage points, commercial properties a reduction of 0.27 percentage points, and agricultural properties a reduction of just 0.01 percentage points.

Table 1: Estimated Value-Neutral Taxable Rates

Property Type	Current	Value-Neutral	Difference
Residential	1.35%	0.94%	-0.41 PP
Commercial	1.89%	1.62%	-0.27 PP
Agricultural	2.16%	2.15%	-0.01 PP

Note: pp refers to percentage points. For the 2023 reassessment cycle. Source: MT DOR.

Key Insights into Value-Neutral Taxable Rates Tax Policy:

- Revenue Stability: Tax revenue remains consistent between the 2022 and 2023 tax years.
- Inter-Class Burden Consistency: The tax burden *between property classes* remains balanced, preventing one class from shouldering more taxes while another pays less.
- Intra-Class Burden Consistency: The tax burden *within the property class* is proportional, ensuring that properties in the same class are taxed consistently.
- Prevention of Tax Burden Shifts: Prevents tax burden shifts that could occur *between property classes* due to changes in property values.
- Simple and Transparent: The tax policy adjustment is straightforward, easy for the public to understand, and cost-effective.

Policy 1 is highly versatile, simple to understand, transparent, and cost-effective. It offers flexibility in crafting tax policy that balances efficiency and equity while addressing diverse needs and circumstances.

Policy 2: Homestead/Comstead/Agstead Exemptions

Governor Greg Gianforte tasked the Property Tax Task Force with recommending strategies to reform Montana's property tax system, including its political subdivisions, without imposing a statewide sales tax. The Tax Fairness subcommittee recommended enacting Homestead, Comstead, and Agstead exemptions. Governor Gianforte expressed support for this proposal.

The Proposal

The Homestead/Comstead/Agstead Exemptions Proposal is a tiered taxable rate structure for residential, commercial, and agricultural properties, with adjustments based on the owner's residency, property use, and property value. Unlike rate mitigation, which lowers taxable rates across the board (Policy 1 above), this proposal creates preferred property groups. Initially, the proposal only applied to residential and commercial properties but was later amended to include agricultural properties (though specific details regarding agriculture were not provided).

Table 2: Proposed Property Value Taxable Rates for 2024

Property Type	Current Rates	Proposed Rates	Change from Current Rates
Residential (preferred)	1.35%	1.1%	-19%
Residential (non-preferred)	1.35%	1.9%	41%
Commercial (preferred)	1.89%	1.5%	-21%
Commercial (non-preferred)	1.89%	2.1%	11%
Agricultural	2.16%	TBD	TBD

Note: Taxes are paid a year behind, so this reform would be implemented in 2025 for 2024 taxes.
Source: Property Task Force Report.

- **Residential (preferred)**: Applies to primary residents and long-term rentals valued at less than four times the median residential market value.
- **Residential (non-preferred)**: Applies to out-of-state residents, short-term rentals, and the portion of property value exceeding four times the median residential market value.
- **Commercial (preferred)**: Applies to commercial properties valued at less than six times the median commercial market value.
- **Commercial (non-preferred)**: Applies to the portion of commercial property value exceeding six times the median commercial market value.

Subcommittee's Comments:

1. Minimal change to tax revenue.
2. 15% to 20% decrease in taxes for preferred taxpayers.
3. 25% to 45% increase in taxes for non-preferred taxpayers.

The subcommittee members did not unanimously support the proposal. Dr. Horpendahl, the sole economist on the task force, expressed a dissenting opinion.

Key Insights into Homestead/Comstead/Agstead Exemptions Tax Policy:

- NOT a tax cut
    - Tax increase based on the 2022 assessment cycle.
    - Revenue-neutral based on the 2023 assessment cycle.
- Shifting tax burden
    - Between taxing jurisdictions and property classes: Depending on the composition of preferred and non-preferred properties within counties, taxes may rise or fall for all property classes, including those not covered by the proposal.
    - Within property classes: Shifts tax burden to higher-valued, non-preferred residential/commercial/agricultural properties. Considered a progressive tax reform.
    - Onto smaller base of payers: Shifts tax burden from everyone to a small group of taxpayers. For every $1 decrease in taxes for a preferred residential taxpayer, there is a corresponding $4 increase for non-preferred taxpayers (a 1:4 ratio). Similar shifts are expected in the agricultural and commercial classes.
- Not means tested
    - Tax relief for businesses is often means-tested: it is proposed that all small-scale businesses are eligible regardless of profitability.
- Complexity and Administration
    - While the proposal is transparent and relatively easy for the public to understand, determining "preferred" status requires additional government workers and resources for administration and compliance. Taxpayers would also need to apply for preferred status.
- Impact on Renters
    - The proposal provides no guaranteed relief for long-term renters. Whether rent decreases will depend on local housing market conditions, including the supply and demand elasticities.

What It Isn't

- Not a Tax Cut: redistributes the existing tax burden.
- Not a Permanent Fix: does not address the underlying flaws in Montana's property tax system.
- Not a Reset: It does not return tax burdens or tax revenue to pre-2023 values.

Policy 1 is preferred over Policy 2 because it generates the same tax revenue without causing shifts in the tax burden between property classes. The caveat is that all taxable rates would need to be slightly higher, as Policy 2 is a permanent tax increase.

A Middle-Ground Policy Proposal

Policy 1 stands out as the most equitable and efficient tax policy reform. It maintains revenue neutrality without the adverse side effects of tax burden shifts or administrative complexity. While **Policy 2 offers progressive relief for residents and increases taxes for non-residents, its implementation could increase tax burdens for non-preferred commercial and agricultural groups, potentially making it less appealing regarding fairness**.

There is a middle ground between Policy 1 and Policy 2 by taking the best of both proposals. **This would use Policy 1 as a baseline and then add a Homestead exemption (and no Comstead or Agstead Exemptions)**. This would maintain tax shifts between property classes and within property classes, except residential, which would shift the tax burden from residents to non-residents. This policy proposal was enacted in Montana in 2008 and repealed in 2015. Ultimately, the goal of reforming Montana's property tax system should be to balance revenue stability, taxpayer fairness, and simplicity.

Policy 3: Reduction to the Mills of the 95-Mills Levy

The 2023 property reassessment significantly increased market values, resulting in an additional $99 million in property tax revenue for the state through the 95-Mills Levy. In response, 49 counties filed suit against the State, arguing that due to higher property values, only 77.9 mills would be needed to generate the required school revenue. The counties essentially **advocated changing the 95-Mills Levy from a fixed mills levy to a floating mills levy**.

The court ruled that state agencies, such as the DOR, interpret legislative intent. In this case, the DOR determined that counties should continue collecting 95 mills, resulting in supplemental tax bills for 2023 in the affected counties.

Key Insights into Reducing the Mills in the 95-Mills Levy Tax Policy:

- **Revenue Stability:** Tax revenue remains consistent between the 2022 and 2023 tax years.
- **Proportional Reductions:** Provides proportional tax reductions across all properties.
- **Inter-Class Burden Consistency:** The tax burden *between property classes* remains balanced, preventing one class from shouldering more taxes while another pays less.
- **Intra-Class Burden Consistency:** The tax burden *within a property class* is proportional, ensuring that properties in the same class are taxed consistently.
- **Tax Burden Shifts:** Tax burdens are not prevented from shifting within and between property classes due to changes in property values.
- **Alignment with Local Tax Policy:** Aligns with local governments' use of floating mills levies.
- **Complexity and Transparency:** Although more complex and complicated for the public to understand, it is low-cost.

While Policies 1 and 3 generate the same tax revenue and maintain consistent tax burdens within and between classes, Policy 1 is preferred because it is simpler and corrects the tax shifts that would otherwise occur between property classes due to changes in property values.

Policy 4: Enacted Property Tax Rebate Program

The [Montana Property Tax Rebate] program was introduced as part of a broader initiative to provide financial relief to homeowners. Governor Gianforte signed the program into law to **reduce the property tax burden on Montanans who owned and resided in their homes during 2022 and 2023**. In 2023, approximately 226,600 property owners applied, representing 77.6% of those eligible. $152 million was rebated to taxpayers- about $53 million more than the additional taxes collected through the 95-Mills Levy.

Key Insights into Property Tax Rebate Program Tax Policy:

- **Revenue Impacts:** Reduces tax revenue for the State.
- **Mitigates Inter-Class Burden Shift:** Reduces the tax burden shift between property classes due to rising residential property values.
- **Intra-Class Burden Shift:** This program intentionally shifts the tax burden within residential properties. It functions as a progressive subsidy, with lower-valued properties receiving a proportionally larger rebate than higher-valued ones.
- **Transparency and Participation:** The policy is simple and transparent for the public to understand, but the complicated application form led to low participation—nearly a quarter of eligible homeowners did not apply. It is low-cost to implement but provides no relief for long-term renters, making it a regressive policy for non-homeowners.
- **Complexity:** Adds unnecessary complexity to the tax system. The state could have adjusted property tax rates or mills levied before collection, eliminating the need for the rebate.

Policy 1 is preferred over Policy 4 because it generates the same tax revenue without causing tax burden shifts between and within property classes.

Summarizing Tax Policies 1- 4

The four tax policies analyzed here represent distinct approaches to addressing Montana's evolving property tax landscape, with varying implications for taxpayers, government revenues, and fairness across property classes.

- **Policy 1: Proposed Reductions in Taxable Rates** focuses on maintaining consistency in the tax burden across property classes through value-neutral rate reductions. This policy avoids shifting tax burdens while preserving revenue stability, making it the most balanced and straightforward approach. It ensures fairness while avoiding complexity by preventing disproportionate tax hikes within or between property classes.

- **Policy 2: Homestead, Comstead, and Agstead Exemptions** introduces a tiered, progressive system that shifts the tax burden toward higher-valued and non-preferred properties. While this progressive approach relieves primary residences and small businesses, it creates significant tax shifts within and between counties and property classes. Its complexity requires substantial administrative oversight and creates uncertainty regarding the long-term impact on renters and Montana's macroeconomy.

- **Policy 3: Proposed Reduction to the 95-Fixed Mill Levy** aligns tax collections more closely with property values through a floating levy mechanism. While this approach maintains revenue stability, it introduces complexity and allows for tax shifts between and within property classes. The benefit is a proportional tax reduction across all taxpayers, but it falls short of fully addressing disparities created by rising property values.

- **Policy 4: Property Tax Rebate Program** directly relieves homeowners but is inherently regressive, excluding renters and other property classes. While it offers a simple and transparent solution, it complicates tax administration and does not address the root cause of rising property values. Moreover, the rebate's disproportionate effect on lower-value properties and exclusion of other classes contribute to tax burden shifts and inequities.

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