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MONTANA CONSTITUTIONAL CONVENTION

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REVENUE AND FINANCE COMMITTEE

Place of Meeting: Room 215
Mitchell Building

Date Meeting Held: 1/29/72
Time Meeting Held: 10:00 a.m.

Committee Chairman: Sterling Rygg

MINUTES OF THE ELEVENTH MEETING OF THE REVENUE AND FINANCE COMMITTEE

SUBJECT OF MEETING: General Hearing on Taxation Articles

Roll Call:

Sterling Rygg, Chairman	<u>Present</u>
Maurice Driscoll, Vice Chairman	<u>Present</u>
William Artz	<u>Present</u>
E. M. Berthelson	<u>Present</u>
Dave Drum	<u>Present</u>
Noel Furlong	<u>Present</u>
Russell McDonough	<u>Present</u>
Mike McKeon	<u>Present</u>
Roger Wagner	<u>Present</u>

Time of Adjournment: 3:03 p.m.

DISCUSSION:

Chairman Sterling Rygg called to order the eleventh meeting of the Revenue and Finance Committee in Room 215 of the Mitchell Building at 10:33 a.m. Saturday, January 29. All members were present.

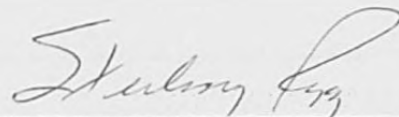
The committee heard testimony from Delegate Cedor Aronow of Shelby; Don Roberts of Billings, representing Cardinal Petroleum Co.; Lee McCartney of Havre, representing High Crest Oils, Inc.; and Clay McCartney of Chinook. All testified concerning in place taxation of minerals.

After a brief recess, the committee then heard testimony from William Hollenbaugh of the School of Forestry at the University of Montana. Mr. Hollenbaugh talked about property taxation.

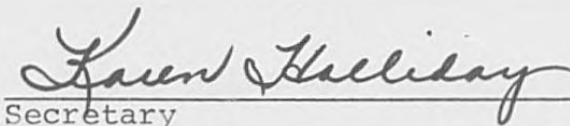
Chairman Rygg mentioned to the committee that Mr. Hollenbaugh's testimony covered Citizen Suggestions 184 and 185, as well as Delegate Proposal 35, submitted by Mae Nan Robinson of Missoula. However, he said that the committee would give Mrs. Robinson an additional hearing so that she personally might appear on her proposal concerning preferential taxation.

The meeting was adjourned.

Time of Adjournment: 3:03 p.m.



Chairman


Secretary

PROPERTY TAXATION

I am deeply concerned with the rate of environmental degradation of Montana's land base resulting from unplanned and uncontrolled development particularly in the peripheral areas adjacent to urbanizing regions. I believe part of the problems can be traced to the lack of adequate legislative tools. However, there are certain key constitutional questions also at stake. The current constitutional wording on tax equalization and its interpretation in relation to property taxation is such an issue (Article XII, Sections 1 and 11).

There is considerable evidence that property taxes contribute to forced conversion of open lands into commercial and residential uses. Taxes and the pressure of subdivision are important elements in the reduction of economic viability of many agricultural units (witness the lower Bitterroot River Valley). Although tax incentives alone will not eliminate land speculation and land conversion, they can assist in slowing the rate of subdivision or at least not contribute to its acceleration.

The present system of tax assessment is based on speculative market value rather than the existing use of land. The uniformity clauses of the present constitution reinforce, if not require, market value assessment. I believe this is detrimental to public rights and purposes and that some form of preferential taxation in recognition of public values is necessary.

The Constitutional Convention staff report on Taxation and Finance questions the usefulness of the present wording on tax uniformity (page 154). They term these statements ineffective and redundant to equal protection clause of the U. S. Constitution. I am not opposed to a tax uniformity clause in the revised constitution as long as it serves a useful purpose. However, any equalization provision should provide for or mandate future legislative consideration of a preferential taxation system in Montana.

In recent years a number of states have passed preferential taxation laws. Maryland's initial law, however, was ruled unconstitutional because it violated the uniform taxation clause. A subsequent constitutional amendment and favorable referendum vote set the stage for the preferential taxation system now used in that state. Other states have also had to deal with the uniformity clauses in their constitutions. In 1970, Washington passed an excellent preferential tax law following the adoption of a constitutional amendment. This act requires a 10 year period of dedication to specified land uses before a reduction in assessment is allowed. There is also a penalty charge in the form of back taxes for noncompliance with the terms of the dedication procedure.

In Maryland the Court of Appeals held that the legislature lacked the power to classify property for purposes of taxation thus prompting the adoption of two constitutional amendments (1960). The general taxation section now reads; "that the General Assembly shall, by uniform rules, provide for the separate assessment, classification and subclassification of land, improvements on land and personal property" (Const. of Md., D. of R., Art. 15). Another amendment specified that land in agricultural use is to be assessed on that basis and not as if subdivided (Const. of Md., D. of R. Art. 43).

In 1968, Washington amended Article VII of the State Constitution by adding a section authorizing the legislature "to provide that farms, agricultural lands, standing timber and timberlands, and other open space lands used for recreation or enjoyment of their scenic or natural beauty, shall be valued for purposes of taxation on the basis of the use to which such property currently is being applied, rather than on the highest and best use". House Bill No. 26 (Chapter No. 87) was subsequently passed on February 10, 1970, to implement this constitutional mandate.

For Montana's revised Constitution I propose the inclusion of wording similar to that used in Washington's constitutional amendment. This not only authorizes preferential taxation legislation, but it also provides a legislative mandate for its passage. I further propose that the legislature be authorized to allow tax exemptions or partial tax exemptions (percentage reductions) together with limited liability exceptions to a landowner who allows the public to use his private property for recreation purposes. This second proposal tends to shift the tax burden away from rural land owners toward the users or potential users of their lands for recreation purposes.

William C. Hollenbaugh
Associate Professor
Recreation and Land Use Planning
School of Forestry
University of Montana

TESTIMONY:

I am going to confine my remarks to oil and gas and the Constitutional provision in Article XII, Section 3, which exempts mines, mining claims, etc., from taxation. In other words, the Section in the constitution which refers to taxation of minerals in place.

The courts have held that an oil well is a mine, so things in the Constitution referring to mines, minerals, etc., refer to oil and gas as well as the more conventional types of minerals we think about. The practice has been the practice east of the Rockies that when a farmer gets ready to dispose of his land, and in the hope that there might be oil and gas on that land, to reserve the minerals. These reserves usually mean all oil, gas, hydrocarbons and minerals on the land, and the use of the surface to explore and develop and produce. This has also been used for purposes of estate planning. It is therefore impossible to levy taxes upon these reserves because it is difficult to determine what its worth. You don't know what it's worth until somebody drills, and the cost of finding out whether or not there is oil or gas may run, in the Tiger Ridge area, for example, from \$15,000, to \$250,000 in Eastern Montana. You can have engineers make appraisals, but you will get as many different appraisals as you have engineers. The only way that you can equitably tax oil and gas in place is only when it's removed. The Constitution now provides for a net proceeds tax and there is a severance tax also levied by the State of Montana. That severance tax is 2.1% of value of the first 450 barrels and 2.65% of all over that and there is no deduction on that percentage tax. This is essentially a tax on 100% of the gross production, and the Montana Supreme Court has held, under litigation coming out of Toole County years ago, that the severance tax cannot be passed on to the royalty owners.

The net proceeds tax is levied upon production and the millage on that is set by the county in which the well is located. The operator may pass a proportionate share of this tax onto the owners. The operators gets to deduct his actual lifting costs. However, he is not able to deduct his office overhead, his accounting or management expense, only the actual lifting costs, such as repairs to his equipment, labor, etc.

The only company that has large reserves of oil and gas in place in Montana is the Burlington-Northern Railroad. Most of the large oil and gas companies do not buy oil and gas rights in place. They take leases instead. Most in place rights are owned by landowners who have retired, sold the land, and kept the oil and gas rights.

If this provision is taken out and an attempt made to tax oil and gas in place, you are hurting the pioneers of Montana who homesteaded this land, retired and divided up the oil and gas rights among their children. How then can you appraise something like this, when no one knows what the value is. We need to develop a better method of administering the net proceeds tax.

TESTIMONY:

The taxation of minerals in place is evaluation of the non-productive value of minerals in place. There are states that do tax minerals in place. We favor and would like to see Montana enact a gross proceeds tax in place of all other taxes on oil production. This system is used in North Dakota, Oklahoma; the taxing authorities in those states seem to be happy with it. It is an easy tax to administer.

TESTIMONY:

The restrictions on the investment of school funds should not be in the constitution, but any investment criteria should be left to the legislature, as different investments change in quality from day to day.

The Teachers Retirement System and the PERS have always enjoyed greater returns on their money because they could invest in FHA mortgages, etc., and we could not. There should be some procedure set up so that surplus cash could be invested.

The new investment system seems to be working out all right, but there should be a definite supervisory agency other than just the Board of Investments.

It would not be a bad idea to have a board made up of one member from the Teachers Retirement System and one from the PERS.