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REVENUE AND FINANCE UNDER MONTANA'S 1972 CONSTITUTION

Thomas E. Towe*

The 1972 Montana Constitution brought about momentous changes in the field of revenue and finance. I submit that we still are digesting these changes. Consequently, a new constitutional convention to review and to update article VIII ("Revenue and Finance") would be premature and unnecessary, at a minimum. This paper will discuss the changes in article VIII, and explore their projected impact upon revenue and finance in Montana.

I. NINE CHANGES IN THE REVENUE AND FINANCE ARTICLE

A. Condensing and Shortening the Material

One change, a purely mechanical one, involved consolidating and condensing three of the articles, including forty-two separate sections of the 1889 Constitution, into one article containing only fourteen sections. The articles of the 1889 Constitution consolidated into article VIII of the 1972 Constitution consisted of the following:

(1) article XII, Revenue and Taxation;
(2) article XIII, Public Indebtedness; and
(3) article XXI, Montana Trust & Legacy Fund.

As Sterling Rygg, Chairman of the Revenue and Finance Committee of the 1972 Constitutional Convention, stated when introducing the majority proposal to the delegates: "We were given Articles XII, XIII and XXI, which had a total of 42 sections. You will note our proposal has only 14 sections, so we have... eliminated some sections, condensed some, and added some new ones." Perhaps the introduction to the Committee Report from the same committee best expressed the underlying philosophy:

The Revenue and Finance Committee approached its task with a different attitude. From a pure, theoretical viewpoint, the Constitution does not have to say a thing about taxation. That suggestion was made to the committee on at least two occasions. The reason is simple—the power to tax is an inherent power of the

* B.A., Earlham College, 1959; L.L.B., University of Montana, 1962; L.L.M., Georgetown University, 1965; Candidate S.J.D., University of Michigan, 1967. Mr. Towe is a partner with the Billings, Montana law firm of Towe, Ball, Enright & Mackey.

1. V MONTANA CONSTITUTIONAL CONVENTION TRANSCRIPTS 1376 (1972) [hereinafter TRANSCRIPTS].
state, a power already possessed by the state without any grant of authority. Anything in a state Constitution on the subject of taxation is either redundant (reiterating a power already possessed by the state) or restrictive.²

Because of this inherent power of a state government to tax, the drafters of article VIII of the 1972 Constitution believed they could eliminate much of the prior language. They added some provisions for emphasis, even though they were considered redundant, and they added many provisions to restrict the state's power in the field of revenue and finance.³

B. Statewide Equalization of Property Tax Values

The statewide equalization of the values used for property taxes represented the most significant change brought about by the 1972 Constitution in the area of taxation. This change resulted from a procedural change in the process of appraising property for tax purposes. The impact of this change, genuine equalization, had escaped reformers over the previous fifty years despite their great efforts.

The impact of this procedural change was calculated and intentional. The Revenue and Finance Committee reported to the convention of the large amount of testimony concerning the inadequacy of testimony concerning the inadequacy of assessment and tax equalization in the state:

Hopefully, the inequalities that presently exist within taxing districts and between taxing districts can be avoided if accountability is in some state agency. Testimony also leads the committee to believe that pressures and temptations for undervaluation and under-assessment presently exist at the local level. The current operation of the school foundation program encourages undervaluation of local property. When such undervaluation exists, the state pours in more money for educational purposes.⁴

If anything, the above words of the committee constitute a modest understatement. The 1889 Constitution charged the county assessor (an elected official) in each county with the responsibility of determining the values of all property in the county, which values were used for tax purposes. The Board of County Commissioners (elected officials) sitting as the County Board of Equalization then reviewed and adjusted those values. The State Board of Equaliza-

2. II TRANSCRIPTS, supra note 1, at 579.
3. See V TRANSCRIPTS, supra note 1, at 1376 (introductory remarks by Delegate Rygg).
4. II TRANSCRIPTS, supra note 1, at 589 (committee report).
tion, a constitutional body, ultimately decided all tax matters.

As the Committee Report indicates, it did not take long for an elected county official to realize that, by depressing the values of the property owned by the constituents in his or her county, the county would receive more state assistance under the School Foundation Program. At the same time, lower values in a county meant lower taxes paid by the residents of that county. Thus, by keeping the property values low, the county assessor (and the elected county commissioners) became local heroes—that county's residents paid less in taxes and received more money at the same time.

As a result of this local control of the property valuation, "rules of thumb" developed throughout the state. In Yellowstone County, for example, a rule of thumb dictated that all residential real estate be evaluated at forty percent of its true value. In some counties, this rule of thumb exceeded forty percent; in other counties it was even less than forty percent. In addition, another Yellowstone County rule of thumb evaluated business inventories at sixty percent of their true value. Other types of property used other percentage figures as a rule of thumb. Then, of course, variations on the same property occurred from county to county.

None of these rules of thumb were supported by statutory law; they were in addition to and applied before the enactment of the classification numbers in Revised Codes of Montana 1947, section 84-302. In fact, they appeared to conflict directly with the statutory law. The words "true and full value" used in sections 84-402 and 84-302 seemed clear and explicit. Further, section 84-401 expressly stated: "All taxable property must be assessed at its full cash value." Nevertheless, the Montana Supreme Court stated that no violation of this section occurred "as long as substantially the same proportion of the same type of property is subjected to taxation."

These rules of thumb generally were unknown and definitely not public information. In fact, because of the secret numbers, only a few local and state employees could determine what rule of thumb each county was using for each type of property. With this in mind, I introduced House Bill 398 in the 1973 Legislative Session. It simply added six words to section 84-401. The words and not at any percentage thereof at the end of "[a]ll taxable property must be assessed at its full cash value" would appear unnecessary.

and certainly nothing more than a clarification of the clear meaning of the statute. However, at the hearing on this bill, not only the State Board of Equalization, but also many civic organizations (such as the League of Women Voters), testified against the bill on the grounds that it would absolutely devastate the entire property-tax system in the state of Montana. In effect, it would have eliminated all the rules of thumb. Although House Bill 398 did not pass, the new Department of Revenue as noted below did accomplish the same result.

To the credit of the members of the Constitutional Convention's Revenue and Finance Committee, they fully recognized that specific words in the constitution would not eliminate the equalization problem. They recognized that whether the constitution used the words true and full value or full cash value, or some other equally clear and unambiguous terminology, the counties would set different standards. The only way to ensure a truly equal system of appraisal of property throughout Montana is to require state level implementation and state employees—not elected county employees—assessing all properties. Hence, sections 3 and 4 of article VIII are clear and unambiguous:

Section 3. Property Tax Administration. The state shall appraise, assess, and equalize the valuation of all property which is to be taxed in the manner provided by law.

Section 4. Equal valuation. All taxing jurisdictions shall use the assessed valuation of property established by the state.

Implementing these sections was no easy task. The local county officials did not want to give up their authority, despite the mandatory and unambiguous language of the 1972 Constitution. During the 1973 session, in which most of the legislation implementing the new constitutional provisions was acted upon, a major disagreement developed over the position of county assessors. These elected public officials with their own lobbyist carried considerable clout. They insisted that the position of county assessor be retained as an elected county official in spite of (or perhaps more correctly, in defiance of) the clear mandate of the new constitutional provisions. Further resistance hinged on the counties re-

8. The 1973 session followed the adoption of the 1972 Constitution but, since the new article VIII said nothing specific about equalization, I thought the bill might be necessary and certainly within the spirit of the 1972 Constitution.
10. MONT. CONST. art. VIII, § 3 (emphasis added).
11. MONT. CONST. art. VIII, § 4 (emphasis added).
linquishing their control of the appraisal function—a significant power. The problem was solved by compromise—the county assessor was retained as an elected official, but was placed under the direction and employment of the Department of Revenue. This solution was quite unworkable in terms of efficient operation of government, but it was the best that could be achieved under the circumstances.

The difficulties in implementing sections 3 and 4 of article VIII of the 1972 Constitution during the 1973 legislative session proved that transfer of the appraisal function from the counties to the state could not have been accomplished without a constitutional change. Such a change moreover would never have occurred without a constitutional convention.

The first reappraisal cycle implemented by the Department of Revenue abolished all rules of thumb. It was not an easy adjustment; the appellate process shouldered thousands of cases. The valuation used for property-tax purposes in one part of the state now is essentially equal to the same valuation used in other parts of the state. This change brought about by the 1972 Constitution was enormous—perhaps breathtaking in view of the political implications.

C. Unified Investment of Public Funds

The impact of mandating that “[t]he legislature shall provide for a unified investment program for public funds”12 is nearly as great as the impact of placing the appraisal and assessment of all property in the hands of one state agency.13

Before the 1972 Constitution, a number of different agencies actually made the investment decisions even though the state treasurer generally was charged with handling the state’s money. Thus, the Teacher Retirement Board invested the teacher retirement funds, and the Public Employees’ Retirement Board invested the Public Employee Retirement System (PERS) monies. The justices of the Montana Supreme Court were constitutionally appointed as the Supervisory Board for the administration of the Montana Trust and Legacy Fund. In addition, many agencies enjoyed virtually blanket authority to invest their own funds in their own manner.

Perhaps more significantly, investment income was not always

13. [For a discussion of the current status of the investment of Montana’s public funds, see Fitzgerald, Montana’s Constitutionally Established Investment Program: A State Investing Against Itself, supra this issue.] ED.
the most important factor—or even a factor—considered in making investment decisions. Large sums of money belonging to the state government simply were deposited in non-interest bearing accounts in Montana banks throughout the state. This represented something of a government plum doled out by the treasurer to “deserving” Montana banks. It was not uncommon for a bank to complain to the state treasurer that it was not receiving its share of state deposits. The state then would increase its deposits in the non-interest bearing account at that bank. At zero percent interest, investment return obviously was not a criterion for determining who was to receive these deposits.

The 1972 Constitution changed this. Now, almost fifteen percent of the General Fund budget for the state each year—more than 65 million dollars per year—comes from the unified investment system established under article VIII, section 13 of the 1972 Constitution. The Board of Investments now manages more than 3 billion dollars in assets. One of the world’s largest investors, it is managed very professionally by highly skilled and well-paid professional investors. It makes the investment decisions, and it receives top-investment dollar for all state investments, including the Teacher Retirement System funds, the PERS funds, the Coal Tax Trust funds, the Trust and Legacy funds, the Short Term Investment Pool, and all other funds managed by the state. The Short Term Investment Pool (STIP) is open to local governments and effectively has created a market in Montana for short term investment of public funds. The highest rates paid by banks and other financial institutions closely correspond to the current STIP rate.

Unlike the equalization of property-tax appraisals, the Unified Investment System might have originated without the change in the constitution. Progressive legislators such as Representative Francis Bardanouve long had been pushing for such a unified investment system designed to obtain greater revenue from the use of state funds. Nevertheless, it took a constitutional change to bring it about, and the results, again, are breathtaking.

**D. Limitations on State Indebtedness**

The 1889 Constitution limited all state debt to 100,000 dollars without a vote of the people. Borrowing money or floating a bond
issue, even when approved overwhelmingly by the people, represented a cumbersome and time consuming affair. Using the state’s good credit for short term advantage or arbitrage was impossible.

Section 8 of article VIII of the 1972 Constitution changed this. It abolished the 100,000 dollars limitation, and it added a simple requirement that the bond issue be approved by a two-third’s vote of the members of each house of the legislature. In other words, in addition to a vote by the people, state indebtedness now can be created by a two-third’s vote of each house of the legislature. In terms of modern finance, this provision brought Montana into the last half of the twentieth century. The legislature frequently approves bond issues, and arbitrage income is specifically authorized and used to great advantage by the state.19

E. Local Debt Limitations

The 1889 Constitution also limited debts of counties, cities and other local governments. It limited counties and municipalities to indebtedness that did not exceed five percent of their taxable valuation (cities and towns, however, could exceed that limit for sewer and water systems upon a vote of the people), and counties could not incur any indebtedness in excess of 10,000 dollars without a vote of the people.20

Section 10 of article VIII in the 1972 Constitution places no constitutional limits on debts of counties, cities, towns and other local governmental entities. It does, however, authorize the legislature to impose such limits. The legislature, in fact, has placed limitations on local government indebtedness similar to those that existed in the previous constitution.21 Consequently, the area of local government finance has not yet experienced the full impact of the

17. Interestingly, the Committee Report of the Revenue and Finance Committee of the constitutional convention proposed a “3/5’s” vote of “both” houses of the legislature. Both items were changed on the floor of the convention. V TRANSCRIPTS, supra note 1, at 1492, 1503-04. It appears that the change from “both” houses of the legislature to “each” house of the legislature was intended merely as a clarification amendment, even though it had a very substantive effect. V TRANSCRIPTS, supra note 1, at 1492.

18. “Arbitrage” is defined as “[t]he simultaneous purchase in one market and sale in another of a security or commodity in hope of making a profit on price differences in the different markets.” BLACK’S LAW DICTIONARY 95 (5th ed. 1979).

19. Starting in 1979, the legislature authorized the sale of Tax and Revenue Anticipation Notes (TRANS), which allows the state to borrow funds in anticipation of incoming revenue at very low rates. MONT. CODE ANN. § 17-5-805 (1989). The same money then can be invested at much higher rates for a net arbitrage income to the state.

20. MONT. CONST. of 1889, art. XIII, §§ 5, 6.

change contemplated by the framers of the 1972 Montana Constitution.

F. Highway Revenue Non-Diversion

Substantial changes resulted in the Highway Non-diversion Amendment.\(^2\) First, it limits the number of taxes placed into the Highway Fund to taxes on fuel and gross vehicle weight fees. No longer are the fees collected on the sale of new cars added to the Highway Fund.

Second, it expands the permissible use of funds earmarked for highways to include local government road and street systems, highway-safety programs, driver-education programs and tourist promotion. This substantial change helped to improve city streets, highway-safety programs, driver-education programs and tourist promotion.\(^{23}\)

Third, and most significantly, the new non-diversion amendment no longer is absolute. Upon a three-fifth’s vote of the members of each house of the legislature, the non-diversion can be broken.\(^{24}\) To date, no such vote has occurred, but the possibility does exist.

Changing from an absolute prohibition\(^{25}\) to a permissive diversion on a three-fifth’s vote of each house of the legislature represents a significant change in policy. It is an understatement to say that the impact of this change on the state of Montana has not yet been fully appreciated or realized.

G. Tax-Exempt Property

Article VIII, section 5 of the 1972 Montana Constitution made several significant changes relating to property that may be exempt from property taxation. First, exemptions for property of the

\(^{22}\) The Highway Non-diversion Amendment, adopted by the voters in 1956, is found in article XII, § 1(b) of the 1889 Constitution. It is found in article VIII, § 6 of the 1972 Constitution.

\(^{23}\) The 1889 Constitution allowed the use of highway funds for “dissemination of public information relating to the public highways, roads, streets and bridges of the State of Montana and the use thereof.” Mont. Const. of 1889, art. XII, § 1(b). Under this authority the state tourism budget was funded by highway funds before the 1972 Constitution was adopted. Now, however, express authority exists for tourist-promotion expenditures from the highway funds. Mont. Const. art. VIII, § 6(1)(c).

\(^{24}\) Mont. Const. art. VIII, § 6(2).

\(^{25}\) The voters adopted the anti-diversion amendment in a constitutional amendment placed on the ballot in 1956. Consequently, it does not date back to the original 1889 Constitution. Nevertheless, the change adopted by the constitutional framers as of 1972 is significant.

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United States, the state, counties, cities, towns, school districts, municipal corporations and public libraries, mandated by the 1889 Constitution with the word “shall,” are now permissive with the use of the word “may” in the 1972 Constitution.

Second, any private interest in any tax-exempt property now may be taxed separately. This practice developed before the adoption of the 1972 Constitution, but at that time was not clearly lawful. Perhaps the most hotly contested use of this new power is the attempt to tax the high-voltage transmission lines owned by the federal government but beneficially used by the Montana Power Company and other associated utilities.

Third, charges for capital improvements and maintenance of improvements financed by special improvement district indebtedness may be levied directly against property otherwise exempt from property taxes. This, too, was unclear under the 1889 Constitution, even though it frequently occurred.

Finally, the 1972 Constitution authorizes the legislature to exempt “any other classes of property.” In other words, under the 1972 Constitution, the legislature may create any exemption from property taxes it chooses, and the constitution does not limit the purposes for which the legislature may grant such an exemption.

A minority report signed by Delegates Mike McKeon, William H. Art and Morris Driscoll examined the wisdom of such a provision. The minority report suggested that the new provision “open[ed] the door too wide,” placed too much discretion in the hands of the legislature, and that the provision should limit the right of the legislature to grant exemptions. Indeed, shortly after the adoption of the 1972 Constitution, the legislature exempted all household furnishings, intangible property, business inventory, and a number of other items that it considered difficult to identify and to appraise. A perusal of Montana Code Annotated sections 15-6-201 to -215 reveals the rather extensive use of this exemption au-

26. Mont. Const. art. VIII, § 5(a); see also II Transcripts, supra note 1, at 590 (committee report).
27. II Transcripts, supra note 1, at 590 (committee report).
31. See II Transcripts, supra note 1, at 599-601.
authority that the legislature has taken. The far-reaching impact of this section of the constitution, however, has not yet been fully realized and we certainly will see much activity in this area in the future.

H. An Independent Appeal System

The framers of the Revenue and Finance Article of the 1972 Constitution intended to establish an independent appeal system separate from the old County Boards of Equalization and the old State Board of Equalization. As stated in the Committee Report:

Under the present tax administration program, the same governmental bodies (County Boards of Equalization and State Board of Equalization) that establish revenue policies and procedures also sit in judgment on the implementation of those procedures. Overwhelming testimony to the committee indicates that the procedure does not guarantee an independent, non-partial, objective review of tax decisions. The Montana taxpayer needs some avenue of recourse, besides the tax administrator or the courts, to evaluate his [or her] tax treatment. The proposed section accomplishes that objective by establishing an independent review procedure.\(^{32}\)

Interestingly, the lengthy detail proposed by the Revenue and Finance Committee to the convention floor was replaced with a very simple directive to the legislature to establish and to provide an independent appeal procedure.\(^{33}\)

Indeed, the legislature has established an independent system starting with the County Tax Appeal Board and ending with the State Tax Appeal Board. As the reports of the Tax Appeal Board indicate, the independent system has received extensive use. In just one issue—the so-called thirty-four percent cases—the Tax Appeal Board entertained and processed more than 6,000 appeals by persons protesting the valuation placed on their property. The County Tax Appeal Board and State Tax Appeal Board are recognized as significant parts of the total administration of the tax laws in the state of Montana.

I. Other Trust Funds

Any discussion of revenue and finance would be incomplete without referring to trust funds established by amendment to the 1972 Constitution. In particular, the Coal Tax Constitutional Trust

\(^{32}\) II TRANSCRIPTS, supra note 1, at 593-94.

\(^{33}\) See id. at 592-93 (committee report); V TRANSCRIPTS, supra note 1, at 1489-90.
Fund established in article IX, section 5 (the Environment and Natural Resources Article) has significantly contributed to the finances of the state of Montana. The Coal Tax Trust Fund, which since 1979 has received fifty percent of all severance taxes collected on coal mined in the state of Montana, currently contains more than 400 million dollars and produces over 40 million dollars in income for the General Fund each year. A constitutional referendum adopted by the voters in November 1976 established this constitutional trust fund. Its impact on the state of Montana also is enormous.

Additionally, the Resource Indemnity Trust Fund established in the Environment and Natural Resources Article merits discussion. Voters adopted it in 1974 as the very first amendment to the 1972 Constitution. The Fund now contains only about 70 million dollars, but it is scheduled to accumulate until it reaches at least 100 million dollars.

Finally, the legislature created two statutory trust funds as a result of the Coal Tax adopted in the 1975 Legislative Session: (1) the Local Impact and Educational Trust Fund; and (2) the Park Acquisition, Capitol Art, and Cultural Projects Trust Fund. Actions taken in the 1987 and 1989 Legislatures have depleted the Educational Trust Fund account. Many believe that these actions justify constitutional protection for any permanent trust fund. The impact of these coal-trust funds, even though not a part of the original 1972 Constitution, is momentous and cannot be overlooked.

II. More Time Is Needed to Digest These Enormous Changes

A new constitutional convention certainly is not necessary in the area of revenue and finance. The enormous changes of the 1972 Constitution still have not been fully implemented. For example, even though authorized by the 1972 Constitution, no real change in

34. The Permanent Trust Fund (including the Instate Investment Fund) is projected to contain $456.3 million by the end of the next biennium (June 30, 1991).
36. It is projected to contain $76.6 million by the end of the current biennium (June 30, 1991).
37. See Mont. Const. art. IX, §§ 2, 3.
40. See also the Instate Investment Fund, Mont. Code Ann. § 17-6-306 (1989), and the Bond Fund, Mont. Code Ann. § 17-5-703 (1989), both of which are an integral part of the Permanent Constitutional Trust Fund.
the state debt limitations of local governments has occurred. Similarly, the legislature has not implemented the changes in the anti-diversion amendment regarding highway funds. The legislature has merely scratched the surface of the broad authority granted it with regard to exemption of property from property taxes. The State Tax Appeal Board now is returning to normal after fully implementing a new, separate and independent appeal system for taxpayers in the state of Montana. In the area of property tax exemptions, we can expect much more from the legislature under the existing constitutional provision. The legislature has not fully addressed the sticky problems of what religious and charitable property should be entitled to an exemption from property taxes, and what type of property is entitled to such an exemption.

The 1972 Montana Constitution has engendered a much greater public awareness of the inequalities in our tax system. The thousands of appeals to the State Tax Appeal Board caused by the first major cyclical appraisal system show that Montana taxpayers are much more aware of these inequalities and are prepared to do something about them. The recent focus on the classification system, which classifies all property for property tax purposes, indicates this growing awareness of inequality. The simplicity of the Revenue and Finance Article of the 1972 Constitution, however, is broad enough to encompass this new public awareness. Because of the conscious effort to place more discretion in the legislature with fewer limitations in the constitution, the legislature has the tools to address this greater public awareness.

Even though the enormous changes in the Revenue and Finance Article of the 1972 Constitution have left much work for the legislature, no need exists, because of the simplicity and farsightedness of the section itself, to make any substantial changes in the constitutional language. The article will serve as a guide to the legislature and the people of this state through the next several decades without any substantial changes. To rewrite this article at the present time would be a giant step backward.

41. The Revenue Oversight Committee did address this question briefly in its interim study of property tax exemptions following the 1983 legislative session. However, the Revenue Oversight Committee was far too occupied with other issues to focus on the overriding public policy issues involved in this section of the constitution. See generally, Revenue & Oversight Committee, Montana's Property Tax & the 4-R Act & Other Revenue Oversight Issues: Report to the 49th Legislature (1985).

42. See, e.g., S.B. 48, 49th Leg. (1985) (attempt to reduce personal property taxes for commercial taxpayers). Similar attempts were made in both the 1987 and 1989 legislative...