

BEFORE THE STATE TAX APPEAL BOARD
OF THE STATE OF MONTANA

DOUGLAS E. & DEBRA L. BOWMAN,)
Appellants-Respondents,) DOCKET NOS.: PT-2002-1
) and CROSS APPEAL PT-2002-2
)
 -vs-)
)
 THE DEPARTMENT OF REVENUE) FACTUAL BACKGROUND,
 OF THE STATE OF MONTANA,) CONCLUSIONS OF LAW,
) ORDER and OPPORTUNITY
 Respondent-Appellant.) FOR JUDICIAL REVIEW

The above-entitled appeals were heard on December 6, 2002, in Conrad, Montana, in accordance with an order of the State Tax Appeal Board of the State of Montana (Board). The notice of the hearing was duly given as required by law. The taxpayers, represented by Douglas E. Bowman, presented testimony in favor of their appeal and in opposition to the Department of Revenue's appeal. The Department of Revenue (DOR), represented by Charles Pankratz, region 2 manager, and Wanda Bandow, appraiser, presented testimony in opposition to the taxpayers' appeal and in favor of its appeal.

The duty of this Board is to determine the appropriate property classification and market value for the property based on a preponderance of the evidence. Testimony was presented and exhibits were received.

The Board denies the taxpayers' request for residential classification but does modify the determination of market value.

This decision modifies the decision of the Pondera County Tax Appeal Board.

STATEMENT OF ISSUE

The issue before this Board is to determine whether the subject improvements should be classified and valued as commercial or residential property. Another area of dispute is whether the improvements should be measured internally or externally for valuation purposes. The Department of Revenue land value is not in contention.

FACTUAL BACKGROUND

1. Due, proper, and sufficient notice was given of this matter, the hearing hereon, and of the time and place of the hearing. All parties were afforded opportunity to present evidence, oral and documentary.

2. The subject property is described as follows:

The improvements located upon a tract of land, 210 X 150, Block 95, Valier First Addition, County of Pondera, State of Montana. (Geocode 26-4097-04-1-21-02).

3. For tax year 2002, the DOR established a market value of \$361,500 for the improvements and \$6,771 for the land.

4. Douglas Bowman timely filed an appeal with the Pondera County Tax Appeal Board on June 21, 2002, requesting an improvement value of \$274,372, stating:

Same as AB-26 1) We should be classed as residential not commercial 2) Sq. footage of floor space of floor area is 1622' more than we have. 3) Sect. #4 Tower should be attic not support area. 4) Boiler room should be support.

5. In its decision dated August 15, 2002, the Pondera County Tax Appeal Board adjusted the subject valuation, stating:

Due to the reclassification from commercial to residential, square footage to remain the same in accordance with currently accepted practice; Bell tower issue resolved prior to hearing; boiler mechanism area assessed type 012 in the basement.

6. Mr. Bowman timely appealed the county decision to this Board on September 13, 2002 stating:

Square footage is not right due to wall thickness. Realty transfer used by Revenue is NOT for this property. Request that tax paid under protest be refunded.

7. The Department of Revenue timely appealed the county decision to this Board on September 16, 2002, stating:

The nature of the proof adduced at the hearing was insufficient from a factual and legal standpoint to support the board's decision.

TAXPAYER'S CONTENTIONS

The subject property is currently being operated as a bed and breakfast known as the "Stone School Inn" in Valier. The taxpayers live on the top floor.

Mr. Bowman's argument is that the property should be classified as residential rather than commercial and that the DOR's appraised value is too high because the subject improvements are over four feet thick at the footing level. The DOR has a generally accepted practice of measuring improvements from the exterior walls. In the case of the subject improvements, with 33 to 34 inch thick walls at ground level, this practice overstates the living area by 1,449.5 square feet. Mr. Bowman's requested value is the amount of money he has put into remodeling the building, approximately \$43.00 per square foot.

His father bought the building in the late 1950's from the school district. In 1988-89, he sold the building for \$22,500 on a contract for deed with no down payment. The buyer died two and a half years into the contract and his family turned the property back to the taxpayers. The buyer also bought the balance of the city block that the building sat upon from the school district.

Taxpayer's Exhibit 1 contains a definition of "floor area" from the 1997 Uniform Building Codes: *"Floor area is the area included within the surrounding exterior walls of a building or portion thereof, exclusive of vent shafts and courts. The floor area of a building, or portion thereof, not provided with surrounding exterior walls shall be the usable area under the horizontal projection of the roof or floor above."*

Mr. Bowman took the interior measurements of the building, wall to wall, and arrived at a total usable area of 6,326.5 square feet. The DOR arrived at a measurement of 7,776 square feet of living space. The difference is 1,449.5 square feet. The typical wall thickness for modern homes is six inches, with masonry walls being anywhere from eight to twelve inches thick.

Mr. Bowman's contention is that he is being assessed for a substantial amount of usable area that doesn't exist. The subject improvements are an exception to the DOR's generally accepted practice of exterior measurement because there is too much area in those walls to be ignored.

The second issue is that of classification. The county board changed the classification of the improvements from

commercial to residential. Mr. Bowman stated that it is essential that this classification be upheld. He testified that he learned of over 30 bed and breakfast properties in Montana with similar operations as the subject property and discovered his property to be one of three in the entire state with a commercial classification. Commercial property is granted a 13 percent reduction in market value, per statute, while residential property is given a 31 percent reduction. This 18 percent difference is the primary reason the taxpayers are seeking the residential classification, in addition to the equity issue.

Mr. Bowman applied for tax relief under form AB-56A. This form references Section 15-24-1502, MCA, which provides for tax exemption and abatement for remodeling, reconstruction or expansion of certain commercial properties. This statute provides an exemption during the construction period, not to exceed 12 months, and for up to 5 years following completion of construction that increases a commercial property's taxable value by at least 5%. In addition, a provision exists for a property tax reduction for 4 years following the increase in taxable value caused

by remodeling. The tax exemption and relief discussed above was granted by the Pondera County Commissioners.

Mr. Bowman stated that the property is currently listed for sale at \$300,000.

DOR'S CONTENTIONS

Wanda Bandow, an appraiser with the Pondera County Appraisal Office, conducted the inspection and appraisal of the subject property.

DOR Exhibit B, a copy of the property record card for the subject property, shows that the property has been classified as commercial. The land is considered residential because of the residential zoning in the area in which it is located. The DOR land value is not in contention.

The DOR's primary issue on appeal is that of classification. The DOR's position is that the commercial remodeling exemption and phase-in benefits could not apply to a residential property. (The county board provided residential classification to the improvements.) This property has been allowed a five year tax exemption on any of the remodeling benefits based upon the submission of an application for **commercial** remodeling. Mr. Bowman's

application referenced a remodeling project totaling \$150,000. In its assessment process, the DOR took its full value of \$361,500, and exempted \$150,000 of value for the first five years, pursuant to Section 15-24-1502, MCA.

Therefore, the assessment that was mailed to the taxpayers, and the subsequent tax bill, is based on a value of \$211,500. The assessment has also been given the 13 percent reduction afforded commercial properties.

A superior benefit accrues from having a commercial designation, according to the DOR, with a 13 percent reduction in addition to the \$150,000 exemption for five years. The DOR looked at the primary use of the building in determining whether the commercial or residential percentage deduction should be applied.

Ms. Bandow inspected the subject property approximately one year ago in response to a request for property review filed by the taxpayer through an AB26 form. As a result of this inspection, Ms. Bandow changed the use type designation of the structure's bell tower from living area to support area.

Ms. Bandow testified that she did not re-measure the exterior of the building because she had measured it in

1997. The 1997 measurements were exterior, as were the measurements of "every building I've ever valued", according to Ms. Bandow. The basement area measures 2,752 square feet based on an exterior measurement. The DOR measurements for the first and second floors are 2,512 square feet. The basement measurement is larger due to the presence of additional area housing the boiler.

The exterior wall was constructed of sandstone in 1911. The DOR assumed "brick" to be the construction material since its appraisal forms don't include sandstone as one of its construction material choices. The property was remodeled in 2000 by the taxpayers, giving the property a DOR effective year of 1982. The effective year assignment is a reflection of the maintenance and care a property has received. The effective year helps to determine the amount of physical depreciation a property will receive.

The DOR used the cost approach to value the subject building. Ms. Bandow attempted a regional market investigation and discovered one property: a "much newer school with a large gymnasium." Ms. Bandow's testimony was that this property is not comparable to the subject.

Section 15-1-101 (d) (i), MCA, defines commercial property as ". . . property used or owned by a business, a trade, or a corporation, as defined in 35-2-114 or used for the production of income, except property described in subsection (1) (d) (ii) . . . The following types of property are not commercial: agricultural land, timber lands and forest lands, single-family residences and auxiliary improvements and improvements necessary to the function of a bona fide farm, ranch or stock operation, mobiles homes, manufactured homes used exclusively as a residence except when held by distributor or a dealer as stock in trade."

Ms. Badow testified that the portion of the above statute referencing income production carried the most weight in her determination that the subject improvements are commercial. The subject improvements do produce income as a bed and breakfast operation. The upper floor, where the taxpayers live, has been identified as having residential usage with a lower overall value (\$128,490 versus \$182,060 for the lower floor from DOR Exhibit B) in reflection of the different use type.

Mr. Bowman questioned why other bed and breakfast operations were not given commercial classification due to income production. Ms. Bandow replied that "this [the subject] is a unique property" but agreed that, if a property is income producing, it is a commercial property.

The DOR's appraisal does not reflect any adjustment for the presence of the 31 to 33 inch thick walls. The DOR's opinion is that a typical commercial brick building would have a wall thickness of 6 to 8 inches: "From the Department of Revenue's standpoint, I'd say, we would agree that a six to eight inch wall, somewhere in that range, is normal for brick or for concrete block." (Charles Pankratz testimony, State Tax Appeal Board hearing, December 6, 2002).

Upon questioning by the Board, Ms. Bandow discussed the other bed and breakfast property of which she is aware in Pondera County. This property was built as a residential structure (a homesteader's shack) according to Ms. Bandow, and "one look at it would tell you it's just a home. You'd never know it was a bed and breakfast if it didn't have the sign in front." The Bowman bed and breakfast has its own separate living area upstairs with a commercial kitchen and

a purveyor's license while the other bed and breakfast has a common kitchen and less distinct living quarters for the owners. In Ms. Bandow's view, these distinctions cause the Bowman property to be commercial and the other bed and breakfast to be residential. Ms. Bandow acknowledges that the other bed and breakfast does produce income.

BOARD'S DISCUSSION

The DOR's common appraisal practice is to use exterior measurements for all properties it is charged to appraise. To do otherwise for the subject property would create an inequity among other taxpayers in Montana.

However, the Board finds merit in the argument that the subject construction is atypical in today's market. Walls constructed of 31 to 33 inches of construction material are not the norm and do impact the property's marketability. The DOR testimony was that "a six to eight inch wall, somewhere in that range, is normal for brick or for concrete block."

Therefore, the Board will order the DOR to adopt the taxpayer's interior measurements with the addition of eight inches on each wall to recognize the presence of insulation, wiring, etc., and to recognize the decrease in functional

utility experienced by the presence of the "superadequate" exterior walls.

Taxpayer's Exhibit 1 contains a reference to his interior measurements of the basement (32' X 60'), the first floor (32' X 60') and the second floor (32' X 60'). The DOR is ordered to add eight inches to each those measurements, i.e., the basement, first and second floor records would each reflect measurements of 32' 8" X 60' 8".

Regarding the classification issue, the subject property is clearly in commercial usage, as defined in Section 15-1-101 (d) (i), MCA, for the "production of income."

CONCLUSIONS OF LAW

1. The State Tax Appeal Board has jurisdiction over this matter. §15-2-301 MCA.
2. **§15-8-111, MCA. Assessment - market value standard - exceptions.** (1) All taxable property must be assessed at 100% of its market value except as otherwise provided.
3. **§15-2-301, MCA. Appeal of county tax appeal board decisions.** (4) In connection with any appeal under this section, the state board is not bound by common law and

statutory rules of evidence or rules of discovery and may affirm, reverse, or modify any decision.

4. **§15-1-101 (d) (i), MCA. Definitions.** The term "commercial", when used to describe property, means property used or owned by a business, trade, or a corporation as defined in 35-2-114 or used for the production of income, except property described in subsection (1) (d) (ii). (Emphasis supplied.)

5. **§15-24-1502, MCA. Tax exemption and abatement for remodeling, reconstruction, or expansion of certain commercial property - approval.** (1) (a) Subject to the conditions of this section, remodeling, reconstruction, or expansion of an existing commercial building or structure that increases its taxable value by at least 5%, as determined by the department, may receive a property tax exemption during the construction period, not to exceed 12 months, and for up to 5 years following completion of construction. The property tax exemption is limited to 100% of the increase in taxable value caused by remodeling, reconstruction, or expansion.

6. It is true, as a general rule, that the appraisal of the Department of Revenue is presumed to be correct and that the taxpayer must overcome this presumption. The Department of Revenue should, however, bear a certain burden of providing documented evidence to support its assessed values. (Western Airlines, Inc., v. Catherine Michunovich et al., 149 Mont. 347, 428 P.2d 3, (1967)).

7. The appeals of the taxpayer and the DOR are hereby granted in part and denied in part and the decision of the Pondera County Tax Appeal Board is modified.

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ORDER

IT IS THEREFORE ORDERED by the State Tax Appeal Board of the State of Montana that the subject improvements shall be entered on the tax rolls of Pondera County by the local Department of Revenue office at the value reflective of commercial designation and in accordance with the exterior measurement approach discussed in the Board's Discussion section above. The appeals of both the taxpayer and the Department of Revenue are therefore granted in part and denied in part, and the decision of the Pondera County Tax Appeal Board is modified.

Dated this 9th day of January, 2003.

(S E A L)

BY ORDER OF THE
STATE TAX APPEAL BOARD

GREGORY A. THORNQUIST, Chairman

JEREANN NELSON, Member

MICHAEL J. MULRONEY, Member

NOTICE: You are entitled to judicial review of this Order in accordance with Section 15-2-303(2), MCA. Judicial review may be obtained by filing a petition in district court within 60 days following the service of this Order.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 9th day of January, 2003, the foregoing Order of the Board was served on the parties hereto by depositing a copy thereof in the U.S. Mails, postage prepaid, addressed to the parties as follows:

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