

NORTH DAKOTA LEGISLATIVE MANAGEMENT

Minutes of the

TAXATION COMMITTEE

Wednesday and Thursday, March 11-12, 1998
Brynhild Haugland Room and Roughrider Room, State Capitol
Bismarck, North Dakota

Representative Wesley R. Belter, Chairman, called the meeting to order at 9:00 a.m.

Members present: Representatives Wesley R. Belter, Grant C. Brown, Chris Christopherson, Mick Grosz, Ralph L. Kilzer, Kenneth Kroeplin, Edward H. Lloyd, Ronald Nichols, Alice Olson, Dennis J. Renner, Earl Rennerfeldt, Arlo E. Schmidt, Ben Tollefson; Senators Randel Christmann, Ed Kringstad, Randy A. Schobinger, Vern Thompson, Herb Urlacher

Members absent: Representative William E. Gorder; Senators Layton Freborg, Meyer Kinnoin

Others present: See Appendix A

It was moved by Representative Rennerfeldt, seconded by Senator Urlacher, and carried that the minutes of the previous meeting be approved as mailed.

COAL INDUSTRY STUDY

Chairman Belter called on committee counsel to review the terms of a contract entered with Dr. David Ramsett for a study of the impact of state tax and regulatory policy on the North Dakota lignite industry. Committee counsel said a contract has been entered among the Legislative Council, North Dakota Lignite Energy Council, and Dr. David Ramsett. He said the cost of the study would not exceed \$10,000 and the costs are to be equally divided between the Legislative Council and the North Dakota Lignite Energy Council. He said the contract provides for delivery of two copies of the final report to the Legislative Council and if further publication of the report is desired, it will be the responsibility of the Legislative Council or Lignite Energy Council.

Committee counsel said the timetable under the contract requires presentation of a preliminary report by July 1, 1998, and a final report on or before August 1, 1998. He said the final report will be presented to the Taxation Committee. He said the contract requires that the study would include, at a minimum, an analysis of:

1. Trends in output and capacity utilization of regional power-producing facilities.
2. Trends in lignite and subbituminous coal production.
3. Trends in open market (MAPP) sales by regional power producers.
4. State coal industry tax impact for North Dakota, Wyoming, and Montana.

5. Competition between subbituminous and lignite coal.

6. Recent trends in public utility regulation and possible impacts on North Dakota lignite.

Chairman Belter said he intends that the committee will complete its interim study activities in September. He said receiving the report from Dr. Ramsett on approximately August 1 means it will be necessary to have proposed legislation ready for committee consideration when Dr. Ramsett delivers his report. He said this means it will be necessary for the Lignite Energy Council to advise the Taxation Committee of its suggestions for legislative change at the next meeting of the Taxation Committee, which he anticipates will be in June.

Mr. Clifford Porter, North Dakota Lignite Energy Council, said the council has provided information to Dr. Ramsett for his study and will continue to work with him to be sure he has the information he requires for his study. Chairman Belter advised Mr. Porter that it would be appropriate for the Lignite Energy Council to make recommendations to the Taxation Committee at its June meeting of its proposed areas of consideration for legislation. Chairman Belter said it would not be necessary to have specific recommendations, but it would be important to recommend at least areas of statutory authority that would ultimately be included in legislation so that a preliminary bill draft could be prepared and ready for committee consideration when Dr. Ramsett delivers his report.

Chairman Belter called on Tax Commissioner Rick Clayburgh for a briefing on a lawsuit filed against the state by out-of-state coal producers. Mr. Clayburgh said two coal producers from other states have filed suit in federal district court seeking to strike down 1997 North Dakota legislation that imposed sales taxes on coal that has not been subjected to the severance tax in North Dakota. He said the basis of the challenge is under the commerce clause of the United States Constitution and the plaintiffs allege that the North Dakota law unconstitutionally discriminates against out-of-state producers. Mr. Clayburgh said attorneys representing the state think the law will withstand the challenge. He said it is anticipated that it will be one year to 18 months before a district court decision is reached and after that the issue may be appealed to the United States Supreme Court.

Chairman Belter asked whether any coal is entering North Dakota which would be subject to

taxation under the law being challenged. Mr. Dean Peterson, North American Coal Company, said there have been recent imports of small amounts of subbituminous coal for blending purposes but not for test burns. He said the imports would amount to only approximately 3,000 tons.

Mr. Clayburgh said participation of representatives from coal-producing counties has been offered in the lawsuit. He said it has not yet been decided what form the participation of counties will take. He said meetings will be held in the near future to decide how counties will participate in the defense of the law.

PROPERTY TAX RELIEF STUDY

Chairman Belter called on Mr. Tony Clark, Tax Department, for a review of information prepared by the Tax Department for its upcoming *Red Book* publication regarding property tax and other tax burdens. A copy of the information distributed by Mr. Clark is attached as Appendix B.

Mr. Clark said state tax collections have been very stable since 1984 with the exception of the years 1986 to 1988, when significant declines in oil tax collections negatively impacted state revenues.

Mr. Clark said the share of state and local tax collections of total revenues has been remarkably constant since 1978. He said state tax collections have accounted for approximately 60 percent of total taxes and local tax collections have accounted for approximately 40 percent of total tax collections since 1978 with the exception of a brief period during the oil boom when the state's share of collections was higher.

Mr. Clark said comparison of major state and local tax types over the most recent 20 years of data does not indicate any recent substantial shifting of reliance from one tax type to another. He said reliance on property taxes as a percentage of total tax collections has declined slightly from 1992 through 1997. He said the most significant variation from the norm in this comparison is the heavy reliance on oil tax revenues in the early to mid-1980s. He said the most significant recent development among tax types is the growing significance of local sales taxes.

Mr. Clark reviewed a comparison of statewide average mill rates, property tax valuations, and general property taxes levied for years 1984 through 1997. He said property taxes levied have shown a steady rate of growth since 1984. He said property valuations declined slightly from 1985 through 1994 but have increased in the most recent three years for which data is available. He said statewide average mill rates were on the increase until the most recent year when a decline occurred which is attributable to the increase in valuations. He said since 1993, North Dakotans have paid more property taxes because their property is worth more.

Mr. Clark reviewed data on the share of total property taxes levied against each class of property--residential, commercial, agricultural, and centrally assessed property. He said the share representing

commercial and centrally assessed property has been relatively constant from 1984 to 1997. He said the most significant shift in the tax burden among classifications has been from agricultural to residential property. He said in 1984 agricultural property bore 37 percent of the tax burden and residential property bore 32 percent. He said the share of total tax burden that was removed from the agricultural sector has been picked up by residential property, where the share of the tax burden has increased from 32 percent of the total in 1984 to 37 percent of the total in 1997.

Mr. Clark reviewed data on comparisons of total property taxes levied by schools, counties, cities, and other taxing districts. He said school district taxes are responsible for most of the increase in property taxes from 1983 through 1997. In 1983, schools levied 43 percent of all property taxes and in 1997 they levied 51 percent of all property taxes. He said the second greatest increase in property taxes levied during the years 1983 through 1997 has occurred for county levies.

Mr. Clark reviewed data comparing tax statistics for North Dakota and other states. He said North Dakotans pay less in total state and local taxes than regional and national averages. He said caution must be used in reviewing statistics on taxes per capita because the base for comparison uses all taxes collected by a state and its local governments and this can be misleading because "exported" taxes like energy taxes are attributed to taxpayers in the state. He said it is not true that Wyoming taxpayers are paying a heavy per capita tax burden, but statistics may lead observers to that conclusion because energy taxes are included in the figures used.

Mr. Clark said another method of comparison of tax burdens is comparing the percentage of personal income devoted to state and local taxes. He said this can be useful to determine the effect of taxes in states with different average income levels or with sparse populations. He said in states with sparse populations and lower average incomes, a greater percentage of income must be devoted to supporting governmental services than in larger population or wealthier states. He said using this type of measurement, North Dakotans pay about the regional average in total state and local taxes.

Mr. Clark reviewed information comparing state and local revenue composition by tax type for regional states. He said states in the region have different degrees of reliance on various tax types. He said South Dakota has a very heavy reliance on sales and property taxes. He said Montana has a very heavy reliance on income and property taxes and has no general sales tax. He said Minnesota has a heavier reliance than North Dakota on property, sales, and income tax revenues.

Mr. Clark said all states in this region have shown an increased reliance on state revenue collections and a decreasing reliance on local collections.

Mr. Clark reviewed data intended to measure the regressivity of local and state taxes in regional states.

He said North Dakota taxes are less regressive than the regional and national averages. He said measures of regressivity can be useful, but it is also important to consider the total effect of taxes. He said Minnesota's tax system is considered to be relatively progressive compared to other states. He said it should be observed that taxpayers in every income group in Minnesota still pay a greater percentage of income in state and local taxes than comparable taxpayers in North Dakota.

Committee counsel asked Mr. Clark whether his review of statistical information leads him to believe that property tax increases have been more dramatic than other components of the tax structure of the state. Mr. Clark said property taxes have risen, but the increase is not necessarily out of proportion with increases in other tax types. He said more analysis would be required to determine whether increases on agricultural property in certain areas of the state have been more severe than for other areas.

Senator Thompson said neighboring states have recently provided property tax relief to taxpayers. He asked whether the statistics used in the comparisons incorporate the effect of these tax relief efforts. Mr. Clark said property tax relief in Minnesota, South Dakota, and Montana is not reflected in these statistics. He said one of the problems with comparisons is that data is somewhat dated before it becomes generally available for comparison purposes.

In response to a question from Representative Tollefson, Mr. Clark said an interesting study might be to look within a school district at taxes on agricultural property versus residential and commercial property to see if shifting has occurred in tax burdens.

Representative Schmidt said the reason for the property tax relief study is that agricultural property has continued to have higher tax bills while production has been very poor due to excess moisture and disease. He said many farmers are frustrated with increasing property tax bills and dramatic declines in income.

Chairman Belter called on Mr. Barry Hasti, State Supervisor of Assessments, for presentation of comparisons of effective tax rates for various property classifications. A copy of Mr. Hasti's prepared testimony is attached as Appendix C.

In response to a question from Representative Belter, Mr. Hasti said these statistics indicate that rates of property taxes and market value are quite stable for recent years, but property taxes have increased slightly as a percentage of market value. He said this indicates that property taxes are rising slightly faster than property valuation or inflation.

Representative Belter asked Tax Commissioner Clayburgh for information on the number of cities imposing city sales taxes. Mr. Clayburgh said approximately 60 cities are currently imposing city sales taxes and additional cities will soon be imposing taxes that have been approved by their voters and five more cities will vote in June on whether to impose city

sales taxes. Representative Belter asked whether information could be provided showing populations of cities imposing city sales taxes. Mr. Clayburgh said he would provide the information later in the meeting.

Senator Thompson said the committee has received a substantial amount of information that indicates that property taxes have increased slightly in recent years. He said this does not appear to be a great problem, but it is difficult to evaluate the information and there may be areas in which the effect is more severe. He said it appears the committee should consider the rate of property increase as compared to the rate of increase in state aid to political subdivisions through foundation aid and the state aid distribution fund.

Senator Christmann said increases in agricultural property valuations are a source of concern and if all things in the valuation formula are considered, it appears that low interest rates are largely responsible for recent increases in valuations. He asked Mr. Hasti whether he is correct in assuming that the capitalization rate has a major impact on agricultural property valuations. Mr. Hasti said it is correct to assume that the interest rate is very influential in determining agricultural property valuations. He said if the interest rate was cut in half, agricultural property valuations would double.

Senator Christmann asked whether Mr. Hasti believes that the agricultural property valuation formula overemphasizes the importance of current interest rates. Mr. Hasti said when the formula was initially instituted it provided a fixed interest rate for capitalization. He said a floating rate was established in 1983 because the fixed rate was much lower than market rates. He said the floating rate was established at a time of high interest rates and has been declining for several years. He said the declining rate has caused a gradually increasing value for agricultural property. He said the Legislative Assembly could certainly change the amount being used as a capitalization rate.

Representative Schmidt asked what would happen if a fixed capitalization rate were included in the valuation formula. Mr. Hasti said the effect would vary because political subdivisions are limited in levy amounts either by the amount levied in dollars or by the amount levied in mills applied to valuation. He said creating a fixed rate that is higher than the current floating rate would cause some shifting of tax burdens away from agricultural property and onto other types of property. He said a fixed rate would not reflect market conditions and in the future would probably be artificially low, producing higher valuations than conditions would produce.

Chairman Belter asked whether committee members have any requests for legislation regarding the property tax relief study. He said since no requests have been received, he would assume that this study is nearing conclusion. He said it appears the reason for property tax increases is an increased amount of spending by political subdivisions. He said

it appears two things that can relieve property tax burdens are restraint in local government expenditures and increased aid to political subdivisions from the state. He said he will try to develop a concluding recommendation for this study topic for consideration by the committee at its next meeting.

Senator Thompson said the committee will be considering bill drafts relating to agricultural property valuation that might be of assistance in some instances in relieving property tax burdens that have substantially increased.

After the luncheon recess, Tax Commissioner Clayburgh distributed copies of tables showing North Dakota city populations in alphabetical order and ranked according to population and a table showing North Dakota cities imposing city sales taxes with the date of origin of the city sales tax, the rate of the tax, exemptions allowed by the city, and other information.

PROPERTY TAX EXEMPTION IMPACT ON SCHOOL DISTRICTS STUDY

Chairman Belter called on committee counsel to review a bill draft [prepared at the committee's request based on 1997 House Bill No. 1318](#). Committee counsel said 1997 House Bill No. 1318 was introduced at the request of the North Dakota School Boards Association and would have allowed a school district to "opt out" of exemptions granted by cities and counties to new businesses under North Dakota Century Code Chapter 40-57.1. He said the 1997 legislation failed in the House on a vote of 31 to 65.

Committee counsel said the bill draft contains the same provision as the 1997 legislation, allowing a school district to approve a motion to disallow an exemption or payments in lieu of taxes granted by a city or county to the extent of the school district's tax levy. He said the bill draft does not give a school district "veto" authority over exemption decisions and applies only to property taxes levied by the school district. He said it is important to note that the authority does not extend to all exemptions granted by cities or counties. He said the authority would not apply to exemptions granted by a city or county for new residential property, improvements to commercial and residential property, pollution abatement improvements, and property used to provide early childhood services.

Senator Christmann said he recalls that school districts had authority to have ex officio representation on city or county governing bodies considering property tax exemption decisions. He asked for a review of the history of the provision. Committee counsel said 1995 legislation established the right of school districts to have a representative participate in city or county governing body decisions regarding property tax exemptions. He said the legislation gave the school district no voting authority and the legislation was temporary. He said the legislation expired on June 30, 1997, and that no legislation was

introduced or considered in 1997 to extend the expiration date of the law.

Chairman Belter called on Mr. Kevin Cooper, North Dakota Industrial Development Association, for comments on the bill draft. Mr. K. Cooper said the Industrial Development Association would oppose allowing schools to opt out of exemptions for new businesses. He said North Dakota has a great need for economic development and existing authority for exemptions has served the state well. He said the concept in providing tax incentives is that the community invests now to receive benefits later.

Mr. K. Cooper said economic development brings many benefits, including benefits to school districts. He said economic development professionals need tools to compete with other states to bring new businesses into a community and to assist beginning businesses in becoming established. He said granting of exemptions is a commitment to economic development. He said economic development is in the best interests of the state, including education.

Senator Christmann asked whether the Industrial Development Association would have a problem with the law adopted in 1995 allowing school districts to have a member as a nonvoting member of a city or county governing body considering property tax exemption decisions. Mr. K. Cooper said the association has no problem with that approach.

Representative Schmidt asked whether there are projects now on the tax rolls which started out with an exemption for economic development purposes. Mr. K. Cooper said there are several projects now paying property taxes that became established with the assistance of property tax exemptions. He said the association has done studies that demonstrate significant benefits to all of the community from economic development efforts.

Senator Urlacher asked whether there are any statistics on how many exemptions granted for new businesses have now expired and the businesses have continued on the tax rolls. Mr. K. Cooper said the association did a 1995 study on 29 projects. He said he does not recall the specific numbers but would guess that several of those projects are now taxable. He said he could check if the committee would desire definite information. Mr. K. Cooper said there was talk in the earlier stages of economic development efforts that businesses would take advantage of exemptions and, after the exemption expired, would leave the state or the community. He said it has not proven to be true that businesses have taken advantage of exemptions in that fashion. He said businesses that have been granted exemptions were carefully evaluated by local officials and have proven to be solid corporate citizens of the community.

Senator Thompson asked whether economic development officials have had discussions with schools about replacing revenue losses from economic development efforts. Mr. K. Cooper said economic development professionals do not consider it a loss when a new project is established because if

the project did not exist there would be no additional tax base anyway. He said eventually property will be taxable so he views it as a net gain when a new business is established. He said he hopes schools understand the need for economic development and that it is not intended that economic development will be a detriment to schools. He said perhaps it is necessary for economic development professionals to consult with school district representatives.

Representative Belter said it should be an objective of economic development efforts to better measure the benefit of and need for tax exemptions. He said it is important for economic development professionals to become more skilled at providing incentives tailored to the needs of new businesses. He said this may also alleviate some concerns of school districts.

Chairman Belter called on Mr. Jess Cooper, Greater North Dakota Association, for comments on the effect of property tax exemptions on school districts. A copy of Mr. Cooper's prepared testimony is attached as Appendix D.

Representative Belter asked whether the Greater North Dakota Association opposes having a school district representative as a nonvoting member of a city or county governing body considering exemptions. Mr. J. Cooper said the association would not oppose that approach.

Senator Christmann asked whether the Greater North Dakota Association opposes schools having authority to opt out of property tax exemptions granted by cities or counties. Mr. J. Cooper said the association opposed that approach in the 1997 legislative session and still opposes that approach.

Chairman Belter called on Mr. Jerry Hjelmstad, North Dakota League of Cities, for comments on the study of the impact of property tax exemptions on school districts. Mr. Hjelmstad distributed copies of statistical information on 1997 taxable valuations and tax levies in North Dakota cities.

Mr. Hjelmstad said the Legislative Assembly gave authority to grant property tax exemptions in recognition of the importance of economic development to the state. He said the Legislative Assembly chose to have cities and counties make the decisions about granting exemptions for a good reason, because cities and counties are in the best positions to weigh the benefits and assess the costs of a project and the needs of the community.

Chairman Belter called on Ms. Doreen Mehlhoff, Executive Officer, North Dakota Association of Builders, for testimony relating to the study of property tax exemptions and their impact on school districts. A copy of Ms. Mehlhoff's prepared testimony is attached as Appendix E. Ms. Mehlhoff said the bill draft being considered by the committee does not relate directly to exemption for new residential property which may be granted by cities and counties, but the study topic includes that issue. She said that issue is of critical importance to the Association of Builders and is the reason for her testimony.

Senator Urlacher said several cities have dropped the exemption for new residential property and asked whether the Association of Builders has information on which subdivisions have or do not have the exemption. Ms. Mehlhoff said she is not certain and has been trying to find out, but it is difficult without contacting each political subdivision.

Representative Brown asked whether there is evidence that the exemptions for new residential property helps young families to obtain housing. Ms. Mehlhoff said that is an important aspect of these programs and it is clear that these programs assist young families.

Chairman Belter called on Mr. Richard Ott, Executive Director, North Dakota School Boards Association, for comments on the study of the impact of property tax exemptions on school districts. Mr. Ott said there cannot be any argument that there are important benefits to economic development. He said it has been mentioned in testimony that these exemption decisions do not create reductions in property tax revenues when they apply to property that did not previously exist. He said it is important to remember that if a new project results in new students for a school district, that is an immediate cost to the school district and may be substantial if many new students come in. He said a school district cannot wait 5 to 10 years for property tax revenue to meet needs because the impact of new students is immediate.

Mr. Ott said perhaps what is needed is something similar to the asbestos abatement levy to give schools authority to increase levies to meet needs of increased student enrollments when there is not an additional property tax base. He said this is just a thought that has occurred to him which might be worth exploring.

Mr. Ott said there is an element of self-determination involved in these exemption decisions. He said if schools were making exemption decisions, other political subdivisions would certainly be justifiably concerned. He said the objective of school districts is to achieve the right to make their own decisions regarding exemptions from taxes they levy. He asked why it would be assumed that school boards would opt out of these exemptions. He said his guess is that school districts would recognize the benefits of worthwhile economic development projects and agree to exempt the property from school district levies. He said the objective should be to allow school districts the right to make their own decisions. He said it should also be remembered that good schools are an economic development tool because good schools are a selling point for a community.

Representative Grosz asked whether Mr. Ott knows the dollar amount of impact on a school district from a new home in the community. Mr. Ott said the association has not done a study on this topic, but he would observe that the average cost per student for education is more than twice what state aid contributes.

Chairman Belter called on Mr. Dave Johnson, North Dakota Home Builders Association, for comments on the study of the impact of property tax exemptions on school districts. Mr. Johnson said he wants the committee to be aware that the state of Minnesota has recognized the importance of economic development tools in competitive situations along the North Dakota border. He said Minnesota has provided sales tax exemptions that apply only in certain cities along the North Dakota border. He said the state of Minnesota has also allowed granting of up to two-year property tax exemptions for new residential property in five cities along the North Dakota border and allows those cities to grant a credit for commercial property. He said this indicates that economic development tools are working.

Chairman Belter called on Ms. Mary Van Sickle, Bismarck-Mandan Development Association, for comments on the study of impact of property tax exemptions on school districts. A copy of Ms. Van Sickle's prepared testimony is attached as Appendix F.

Representative Brown asked whether the Bismarck-Mandan Development Association would oppose allowing school district nonvoting representation on city or county governing bodies considering property tax exemptions. Ms. Van Sickle said the Bismarck-Mandan Development Association supports schools and would not oppose school representation on these decisions.

Chairman Belter asked whether committee members have any comments regarding the study of the impact of property tax exemptions on school districts.

Senator Christmann said he could support something like the 1995 temporary legislation that would allow schools a voice in exemption decisions although they would not have a voting right.

Representative Kroeplin said he agrees with the opinions expressed by those testifying today. He said he thinks consideration could be given to having different rules for different areas. He said growing population areas do not seem to have as much problem attracting development as rural areas and areas with declining population and business bases.

Senator Urlacher said under open enrollment, many school districts in his area are taking in students. He said he believes there is a positive or minimal effect of a new student coming into a district. He said he would support something like the 1995 legislation allowing school districts to participate but not vote on exemption decisions.

Representative Grosz said the Legislative Assembly does not grant the exemptions for new businesses. He said those decisions are a matter of local discretion, and he believes local government officials have done a good job assessing these requests and that they will weigh concerns of schools in their decisions. He said he does not think the effect of a new student to a school district is that serious unless a very large number of students are added.

Senator Urlacher said he appreciates that cities and counties have done a good job in decisions on exemptions. He said it is important to remember that the 1995 law that expired was put in place because there was a lack of contact to school districts on these exemption decisions.

Representative Tollefson said he agrees with Representative Grosz that city and county officials have done a good job evaluating exemption applications. He said to change the process that has worked well would be an error.

Representative Schmidt said small towns present different situations. He said school board and economic development officials may be the same people in a small town. He said current law gives schools no input, and he would like to see a change to allow schools to have participation in decisions.

Senator Urlacher said he believes it is important for schools to have input but not necessarily a veto or opt out authority. He said he would like to consider a bill draft that would reinstate the law that was enacted temporarily in 1995.

Representative Olson said she cannot imagine local government officials ignoring concerns of school district representatives. She asked whether there have been any problems since the expiration of the 1995 law.

Representative Grosz said he thinks the 1995 law was a compromise. He said North Dakota's economy seems to be growing, and he questioned whether it would be wise to make changes in a program that is working.

Senator Thompson said he would support a request for a bill draft to reinstate the expired 1995 law.

Senator Urlacher said in many cases there has been dialogue with local school officials on exemption decisions but sometimes that has been forgotten. He said that must be the reason for creation of the 1995 law. Senator Urlacher said he would like to have a bill draft based on the 1995 law for consideration. Chairman Belter requested committee counsel to prepare a bill draft for committee consideration based on the 1995 legislation that expired in 1997 to allow school district representatives to participate with no voting right in city and county decisions on property tax exemptions.

AGRICULTURAL PROPERTY VALUATION STUDY

Chairman Belter said the chairman of the Legislative Council has assigned to the committee the study of valuation and assessment of agricultural property and inundated lands. He called on committee counsel to review a bill draft [prepared at the request of the committee to incorporate an unproductive agricultural land category in the valuation formula.](#)

Committee counsel said Mr. Hasti suggested at the December 16, 1997, meeting of the Taxation Committee that problems with assessing inundated

lands might be alleviated with creation of an unproductive agricultural land classification. He said the bill draft attempts to accomplish this by amending North Dakota Century Code Section 57-02-27.2, relating to valuation and assessment of agricultural lands. He said this section establishes the formula for valuation of agricultural property. He said the formula presently recognizes only cropland and grazing land or noncropland categories. He said the bill draft establishes a category of unproductive agricultural land that is permanently or temporarily unsuitable for growing crops or grazing farm animals. He said the value for unproductive agricultural land would be determined by the Agricultural Economics Department of North Dakota State University (NDSU) at an unspecified percentage of the value determined for noncropland for the county. He said this would relieve the Agricultural Economics Department the duty of establishing countywide values for unproductive land and would peg the value to the value of noncropland. He said the percentage is left blank in the bill draft to be filled in at an appropriate rate. He said the bill draft states that valuation of unproductive agricultural land may recognize the probability that the property will be suitable for agricultural production as cropland or for grazing in the future.

Representative Olson asked Mr. Dwight Aakre, NDSU Department of Agricultural Economics, how conservation reserve program (CRP) property would have been categorized under the formula. Mr. Aakre said CRP land would be categorized as cropland in the valuation formula.

Representative Grosz asked Mr. Hasti whether this approach of unproductive agricultural land would allow a landowner to remove all of his sloughs from the tax rolls. Mr. Hasti said assessors will look at sloughs as part of the value of an entire parcel and reflect that in valuation. He said this approach would probably have no effect on sloughs and their effect on agricultural property values. Representative Grosz said he is concerned that the bill draft as written will require assessors to examine every parcel of agricultural property every year.

Representative Belter asked whether assessors have authority under current law to adjust valuations for unproductive lands. Mr. Hasti said that authority exists, but it is necessary for all property values to generate an average value for the county equal to the amount determined by NDSU. He said lowering value on one property requires increasing valuations on other properties to make the average meet its necessary level. He said the problem that arises is that if there is a substantial amount of unproductive property in the county, it is not possible to lower the valuation without either making it impossible to meet the county average or shifting a huge tax burden to other agricultural property. This is the reason he suggested establishing a category of unproductive property, to allow temporary problems to be put into this category so it would not affect the values of other properties.

In response to a question from Senator Thompson, Mr. Hasti said a category for unproductive agricultural land would be a tool for use of local assessment officials to keep valuations more accurate for the county as a whole.

In response to a question from Representative Rennerfeldt, Mr. Hasti said unproductive property would still be subject to property taxes but at a lower rate than would otherwise be assigned to the property.

In response to a question from Representative Kroeplin, Mr. Hasti said the overall effect of creating a nonproductive agricultural land category would be to shift property tax burden to nonagricultural property and to agricultural property that is suitable for production.

In response to a question from committee counsel concerning the time lag from the reporting of property being unsuitable for production to the time when the assessment is reduced, Mr. Hasti said that report would show up in the assessment for the following year so the time lag would be minimal.

Representative Brown asked whether under the bill draft a drought disaster would mean a parcel of property is temporarily unsuitable for grazing farm animals. Committee counsel said he is not certain and that raises a significant consideration.

Senator Christmann asked whether farmland that has been inundated is currently selling for much less than it was worth before flooding. Senator Thompson said property in the Devils Lake Basin that has been inundated is probably worth 10 percent of its former value, but farmers are seeking to hold onto the property in the hope that the water will recede. He said there have been instances of sales and one instance where a farmer seeking to sell inundated land to the United States Fish and Wildlife Service was denied permission by the county commission.

Senator Kringstad asked whether federal assistance has been available to farmers whose lands have been flooded. Senator Thompson said assistance has been made available to some farmers but not to all farmers in this situation.

Senator Christmann said it appears the alternatives that exist for assisting with the flooded farmland problem is to force shifting of property tax burdens to other taxpayers in the district or for state financial assistance to be provided. Chairman Belter said entertaining the possibility of funding from the state is outside the study authority of the Taxation Committee under the specific directives of the chairman of the Legislative Council. He said the study is to focus only on valuation of agricultural property.

Representative Belter said it appears more work is needed on the language in the bill draft. He said it appears the language should focus on inundated property only. Representative Renner said it might be useful to provide for approval by the county of designation of property as unproductive agricultural land. Committee counsel said it would also be necessary to consider changes in the use of the term "temporarily" with regard to unproductive property. He

said the term is vague and perhaps it would be more useful to describe the unproductive nature of the approach in annual terms.

Chairman Belter called on committee counsel to review a bill draft [to establish a production cost component in the formula for valuation and assessment of agricultural property](#). Committee counsel said the bill draft was prepared in response to a request from the previous committee meeting. He said consultation with the Agricultural Statistics Service and the Agricultural Economics Department at NDSU yielded a recommendation that the statistics that could be used for this approach were contained in the National Agricultural Statistics Service Annual Index of Prices Paid by Farmers. He said this index is used in the bill draft. He said the bill draft provides that a base year index of prices paid by farmers is to be established for the 10 years ending in 1998. He said the high and low years are to be discarded and the remaining years are to be averaged. He said after the base year, each year a calculation would be made using the most recent 10 years available, averaging the eight years remaining after discarding the high and low years, and dividing this amount by the base year index to arrive at a production cost increase factor that would be divided into gross returns to arrive at average annual gross returns. He said a five percent increase in production costs will result in a five percent decrease in property valuations. He said the committee may wish to consider whether a direct reduction of land values for production cost increases should be used.

Representative Renner asked whether declines in the index of prices paid by farmers could result in property valuation increases. Mr. Aakre said decreasing prices paid by farmers would increase property valuations under the approach in the bill draft.

Representative Renner asked whether it would be simpler to raise the capitalization rate to obtain property tax relief for agricultural property. Representative Belter said there would need to be a good reason to simply lower valuations of agricultural property because it would shift taxes to other properties. He said a legitimate reason would have to exist to decrease agricultural property valuations.

In response to a question from Representative Belter, Mr. Aakre said the use of a prices paid by farmers index would tend to hold agricultural property valuations down in the long term.

Representative Belter asked Mr. Aakre whether a statistical run could be completed to determine the likely effect of the change in the bill draft. Mr. Aakre said a sample run could be performed based on some assumptions.

Chairman Belter called on Mr. Terry Traynor, North Dakota Association of Counties, for comments related to the agricultural property valuation study. Mr. Traynor said he was asked to assist in gathering information on valuation problems with property in the

Devils Lake Basin. A copy of the information distributed by Mr. Traynor is attached as Appendix G.

Mr. Traynor said the information distributed was prepared as of March 10, 1998, and is still changing on almost a daily basis. He said tax abatement requests are still being reviewed.

Chairman Belter said an issue has arisen in the news on valuation of exempt property. He said he was of the impression that 1997 legislation had alleviated the requirement for assessment officials to value farm buildings. He asked Mr. Hasti to provide the committee with a briefing on the recent developments. Mr. Hasti said a news article has arisen from comments of the Towner County director of tax equalization that valuations would need to be established for all farm buildings in the county.

Mr. Hasti said a 1995 law required assessment of all exempt property for establishment of a tax base for political subdivisions. He said complaints of assessors led to a 1997 amendment requiring only that certain property, composed basically of discretionary and charitable exemptions, have valuations established for tax-based purposes. He said although the Legislative Assembly amended the 1995 law, no change was made in a preexisting provision of law requiring assessment of all exempt property. He said because of the preexisting law, he is not able to advise assessment officials that they do not have an obligation to assess exempt property. He said he could recommend that counties concentrate resources on establishing values of property for which they must report valuations.

In response to a question from Representative Belter, Mr. Hasti said counties are going about valuation as contemplated under the 1997 law with the exception of Towner County, which is the only county in which an effort has been made to establish values for farm buildings.

The meeting was recessed and Chairman Belter reconvened the meeting in the Roughrider Room on Thursday, March 12, 1998.

CHARITABLE ORGANIZATION PROPERTY TAX EXEMPTION STUDY

Chairman Belter called on committee counsel to review three bills considered during the 1997 Legislative Assembly relating to the property tax exemptions of charitable organizations.

Committee counsel said 1997 House Bill No. 1289 was passed in the House and then reconsidered and failed to pass on a vote of 38 to 58. He said the bill would have amended the property tax exemption statutory provisions of the state and charitable organizations to provide that after June 30, 1997, any property acquired, improved, or constructed would not be exempt unless the exemption is specifically approved by the governing body of the city, for property within city limits, or the governing body of the county, for property outside city limits.

Committee counsel said 1997 House Bill No. 1460 failed to pass in the House on a vote of 11 to 82. He said the bill would have amended the exemption for institutions of public charity to apply only to an organization organized and operated exclusively for charitable purposes. He said the bill would have further provided that an organization is not operated exclusively for charitable purposes if it or an organization affiliated with it pays wages exceeding \$75,000 to any person employed in the state during a taxable year.

Committee counsel said Senate Bill No. 2385 was approved by the House and Senate but was vetoed by the Governor and the veto was sustained. Committee counsel said the bill would have prohibited any nonprofit corporation from acquiring more than 16,000 acres of land in North Dakota.

Representative Belter said acquisition of property by nonprofit corporations is a matter of concern. He said there is another acquisition currently underway. He said these organizations have deep pockets and outbid farmers for property. He said once property is acquired by a nonprofit corporation, it is permanently removed from production.

Representative Brown said he has discussed the situation with Senator Wanzek, who introduced 1997 Senate Bill No. 2385, and he remains interested in this topic. He said the Nature Conservancy has announced another acquisition of property, after members of the Legislative Assembly were given the impression that they had received an assurance that the Davis Ranch was the final large acquisition by the Nature Conservancy. He said he thinks this topic should be further explored.

Senator Christmann said another aspect of competition for agricultural property between charitable organizations and farmers which concerns him is income tax treatment. He said income tax law favors charities to acquire property because they receive donations that are encouraged by tax laws while the farm owner who wants to acquire property must do it with after-tax dollars. He said he believes there is inequity in encouraging this competition with agricultural producers.

Representative Lloyd said he lived in the Jackson Hole, Wyoming, area and has experience with public ownership and acquisition of property. He said most of the Jackson Hole area is in public ownership and use restrictions and loss of tax base should be a real concern to North Dakotans.

Representative Schmidt asked whether there are any court cases relevant to limitations on sale or acquisition of property. Committee counsel said research on this topic could be done for the next committee meeting.

Chairman Belter called on committee counsel to review tax treatment for charitable organizations under North Dakota taxes. Committee counsel said the treatment of charitable organizations under income, sales, and property taxes in North Dakota was the subject of the request. He said a

memorandum was reviewed at the initial committee meeting regarding property tax treatment of charitable organizations which covered that topic in depth. He said income tax treatment of charitable organizations for state income tax purposes is generally dictated by federal law because North Dakota's income tax is heavily federalized. He said a corporation that is exempt from income taxes for federal purposes is exempt from income taxes at the state level. He said it is important to remember that the 501(c)(3) description that is used for charitable organizations is an income tax consideration under the federal Internal Revenue Code and has nothing to do with application of the property tax exemption under state law. He said sales tax treatment of charitable organizations has some unique aspects. He said nursing homes, hospitals, intermediate and basic care facilities, and voluntary health associations are exempt from sales taxes on purchases they make which are for the benefit of their patients or residents. He said the limitation that the purchase must be for the benefit of a patient or resident was incorporated to deal with situations in which a hospital was doing laundry for another hospital and competing with private laundry businesses. He said in that instance soap purchased for laundry for the other hospital would not be exempt from sales taxes. He said the sales tax law provides that exemptions for charitable organizations do not apply to regular retail sales that are in direct competition with retailers. He said there may be problems in administration of this provision to determine what is in direct competition.

Committee counsel said the sales tax exemption for charitable organizations does not exempt all purchases made by nonprofit organizations. He said the law details organizations that are exempt from sales and use taxes. He said hospitals, nursing homes, state and local fairs, nonprofit meal delivery groups, and public and private schools are exempt. He said an exemption is not provided for churches and church groups, service clubs, social clubs, veterans' groups, trusts, recreation groups, youth groups, labor organizations, fraternities and sororities, professional associations, and private for-profit schools.

Chairman Belter called on Mr. Arnold Thomas, President, North Dakota Healthcare Association, for testimony on the study of property tax exemptions for charitable organizations. A copy of Mr. Thomas' prepared testimony is attached as Appendix H.

Representative Tollefson said it appears to him the central issue in application of exemptions is the appropriate definition of charitable activity. In response to several questions from Representative Tollefson, Mr. Thomas said not all services of hospitals are considered charitable; and measuring charitable status by contributions to the community would be an approach involving arbitrary standards of measurement. In response to further questions from Representative Tollefson, Mr. Thomas said charitable activity cannot be measured by simple accounting

exercises, and other states have developed more restrictive definitions of charitable organizations for property tax purposes which might be advisable to consider.

Representative Belter asked whether the Healthcare Association has for-profit hospitals as members. Mr. Thomas said organizations referred to as investor-owned hospitals are members of the association. He said there are three categories of hospitals in North Dakota, including church-based hospitals, community hospitals, and investor-owned hospitals.

Mr. Thomas said each of the three categories of hospitals meets the same licensing requirements so there is no difference in the care provided. He said the differences are that investor-owned hospitals have an obligation to shareholders to provide a return. He said it is a recent development and business management practices are being applied to health care operations. He said the return in a not-for-profit operation remains in the health care industry rather than going to investors.

Representative Kilzer said hospital activities have changed substantially in recent years. He said federal government actions that were designed to contain medical costs have not contained costs but have shifted them to other payers. He said hospitals in Bismarck have budgets larger than the public school system. He said health care customers are now paying for services that did not exist several years ago like sports medicine, women's health centers, screening services, and other efforts. He said these activities are claimed as charitable activities by hospitals and are funded by the services paid for by other patients. He said these efforts are largely to expand operations and the client base for the hospital.

Representative Grosz asked whether hospitals pay special assessments. Mr. Thomas said hospitals are subject to full payment of special assessments as are any other taxpayers.

Representative Lloyd said a consideration in the Pennsylvania law is that a hospital does not pay compensation based on financial performance. He said community hospitals he is familiar with do use this type of incentive to provide a bigger bonus for successful operation and similar incentives. He asked whether this is common practice of nonprofit hospitals. Mr. Thomas said financial performance of a facility is one measurement tool for administrative effectiveness.

Senator Thompson asked whether pharmacies and clinics on the premises of a hospital are eligible for tax-free treatment. Mr. Thomas said an Attorney General's opinion addressed these situations and a for-profit clinic in a nonprofit hospital would be subject to property taxes and that part of the facility is carved out for assessment purposes and is subjected to property taxes. He said there are some difficulties under the sales tax law with this kind of situation because a tongue depressor used in the clinic is taxable while the same tongue depressor used across

the hall in the hospital is exempt. He said some issues involved with this situation are being explored. He said recent administrative decisions regarding pharmacy issues creates some questions that he is uncertain about and he will have to do some research to provide accurate responses.

In response to a question from Representative Belter, Mr. Thomas said the legislation recently enacted in Pennsylvania is broad in application and applies to all charitable organizations. He said the association is reviewing this legislation and is comfortable working with the committee on this study topic.

Representative Grosz said the hospital environment has changed substantially in the last 30 years or so. He said other businesses contribute to police and fire protection and costs of education. He asked whether hospitals feel compelled to help pay for these services. Mr. Thomas said there is a moral obligation to assist in these public services, but how to meet that obligation is the issue. He said satellite health care facilities get assistance from hospitals in larger cities and several other issues complicate the matter of determining who would be subject to taxes and how much those taxes would be. He said hospitals provide community services in many respects and that must be considered in these decisions as well.

Representative Nichols said links of small community facilities to facilities in larger cities is a two-way street and the large facility has access to more patients. He asked whether that should be a consideration. Mr. Thomas said that is a consideration but also is a complicating factor.

In response to a question from Representative Tollefson, Mr. Thomas said charitable organizations come in varying degrees. He said the difficulty faced by the Taxation Committee is trying to determine how to delineate charitable activities that would be entitled to property tax exemptions from those that would not be entitled to exemptions.

Chairman Belter called on Mr. Hjelmstad for comments on the property tax exemption for charitable organizations study. Mr. Hjelmstad said what is needed is fair application of property tax exemptions. He said constitutional and statutory provisions are vague. Representative Belter asked whether cities would like to have authority to decide what is a charitable activity and who would be entitled to exemption. Mr. Hjelmstad said it is hard to argue against local control, but he believes the constitutional requirements of North Dakota law would necessitate uniformity of application statewide.

Chairman Belter asked for committee comments and directives regarding the charitable property tax exemption study.

Representative Brown said he would like to have a bill draft prepared similar to 1997 Senate Bill No. 2385, regarding limitation on the acreage that may be owned by a nonprofit corporation in the state.

Representative Kilzer said he would like to have a bill draft prepared to provide that hospital property is exempt from property taxes only to the extent it is used for inpatient services.

Representative Tollefson said he believes the key issue is to define charitable activities for purposes of property tax exemption and he would like a bill draft that narrows the definition of charitable activities. Chairman Belter asked Representative Tollefson to work with committee counsel to accomplish his objective.

Senator Thompson said the League of Cities expressed concerns about fair administration of the exemption for charitable organizations. He suggested that the league contact committee counsel with any suggestions in this regard.

FARM BUILDINGS EXEMPTION STUDY

Chairman Belter called on committee counsel to review a bill draft [prepared at the chairman's request to eliminate the considerations announced by the North Dakota Supreme Court](#) in the *Butts Feed Lots* decision. Committee counsel said the Supreme Court decision provided that the farm buildings exemption would not apply and a farming operation would be deemed an industrial operation if the farmer purchased the majority of feed for animals raised on the farm, the animals raised on the farm were not owned by the farmer, replacement animals for the farm were not produced on the farm, and if the farmer engaged in contract feeding of animals on the farm. He said the bill draft states that these factors may not be considered in applying the exemption. He said the bill draft does not state what should be considered but eliminates the factors deemed important by the Supreme Court.

Chairman Belter called on Mr. Wade Moser, North Dakota Stockmen's Association, for comments on the farm buildings exemption study. Mr. Moser said members of the Ag Coalition have discussed this issue and a subcommittee was appointed for this purpose. He said extensive consideration has been given to this issue and the subcommittee believes a simple approach is the best. He said the suggestion of the group is that the statutory provision be amended by adding language to provide that the exemption is for farm buildings and improvements only on farms that raise or grow an unprocessed agricultural product, regardless of feed source. He said subcommittee members believe this approach is closer than the interpretation of the Supreme Court to what was originally intended under the law.

Senator Urlacher said the suggestion is an interesting one, but he questions what is meant by unprocessed with regard to an agricultural product and he asked whether mixing grain and similar activities would constitute processing. Mr. Moser said determining what constitutes processing would be an important decision and the subcommittee was discussing a limitation that anything involved with final

preparation of the product for human consumption would be considered processing.

Representative Belter asked committee counsel whether the suggestion from the Ag Coalition members would be compatible with the approach in the bill draft considered by the committee. Committee counsel said the bill draft listed factors that should not be considered in applying the exemption. He said the suggestion of the Ag Coalition would be compatible with this approach because it attempts to delineate what should be considered and what is not farming activity. Chairman Belter asked committee counsel to combine the suggestion of the Ag Coalition in the bill draft considered by the committee.

Chairman Belter called on Mr. Dave Mueller, North Dakota Turkey Growers Association, for comments on the farm buildings exemption study. Mr. Mueller said the Supreme Court requirement of considering the source of feed as a determining factor for the exemption creates a problem. He said in his operation he purchases feed although he could raise and grind his own feed. He said he chooses not to grind his own feed as an economic management decision. He said it would be an inefficient use of resources to process his own feed. He said another issue from the Supreme Court decision that creates a problem is the requirement that the farm produce replacement animals. He said in turkey growing operations replacement birds must be purchased because it is not practical to raise replacement birds.

Senator Christmann said exempting all farming operations could be easily done. He said he recalls there was a desire during the last interim to find a way to tax large turkey growing operations while retaining the exemption for smaller operators. He asked whether Richland County would be content to exempt all turkey growing operations regardless of size. Mr. Mueller said it is impossible to satisfy everyone's concerns. He said the Turkey Growers Association believes the large operation in question has an economic benefit to the community and is entitled to be treated as an exempt farming operation.

Chairman Belter called on committee counsel to review a bill draft [to allow beginning farmers to qualify for the farm buildings exemption](#). Committee counsel said the bill draft was prepared when it was pointed out at the previous meeting by Ward County officials that a beginning farmer cannot qualify for the farm buildings exemption because the statutory provision requires a history of farm income, which would not apply for a beginning farmer. He said the bill draft revises the statutory provision in several respects, but the most significant change is the provision that a beginning farmer would qualify and that a beginning farmer is defined as one who has acquired ownership and occupancy of a farm within the three preceding calendar years, who normally devotes the major portion of time to farming activities, and who does not have a history of farm income for each of the three preceding calendar years. He said it appears necessary to use a three-year period for the

exemption for beginning farmer income because a three-year timeframe is used in the existing law. He said an oversight in the bill draft should be corrected by changing the word "each" to the word "any" on page 2, line 4 and line 11.

Representative Renner said it might be useful to include depreciation as an add back to net income under the income limitations of the exemption. Committee counsel said he would have to do research and report to the committee on whether depreciation is included or excluded from net farm income under the exemption.

Representative Grosz said it seems unusual that legislation would be needed to allow beginning farmers to qualify for the farm buildings exemption because the situation must have arisen many times in the past. He asked whether an abatement could be given for beginning farmers to allow the benefit of the exemption. Mr. Chuck Krueger, Tax Department, said he does not believe an abatement could appropriately be granted for a beginning farmer who would not qualify under the farm buildings exemption.

After some discussion among committee members, Chairman Belter said it appears that either the week of June 8 or the week of June 22 looks like the time for the next committee meeting.

Chairman Belter asked whether action should be taken regarding efforts in Towner County to assess farm buildings. Representative Schmidt asked Mr. Leon Samuel, Morton County Director of Tax Equalization, whether this is a problem. Mr. Samuel said he thinks the situation is limited to this county and perhaps because the tax director is relatively new, the instructions were taken too literally. Chairman Belter requested a bill draft to be prepared that would repeal the 1897 provision contained in North Dakota Century Code Section 57-02-14.

It was moved by Representative Renner, seconded by Representative Brown, and carried that the meeting be adjourned subject to the call of the chairman. The meeting was adjourned at 1:05 p.m.

John Walstad
Code Revisor

[ATTACH:8](#)