

NORTH DAKOTA LEGISLATIVE COUNCIL

Minutes of the

TAXATION COMMITTEE

Tuesday, September 30, 1997
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, William E. Gorder, Mick Grosz, Ralph L. Kilzer, Kenneth Kroeplin, Ronald Nichols, Alice Olson, Dennis J. Renner, Earl Rennerfeldt, Arlo E. Schmidt, Ben Tollefson; Senators Randel Christmann, Layton Freborg, Ed Kringstad, Vern Thompson, Herb Urlacher

Members absent: Representative Edward H. Lloyd; Senators Meyer Kinnoin, Randy A. Schobinger

Others present: See Appendix A

Chairman Belter reported that Senator Herb Urlacher will serve as vice chairman of the Taxation Committee.

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

FARM BUILDINGS EXEMPTION STUDY

Chairman Belter called on Mr. Larry Osborn, Richland County Director of Tax Equalization, for comments on application of the farm buildings exemption in Richland County. A copy of Mr. Osborn's prepared testimony is attached as Appendix B. Mr. Osborn said that Richland County was hopeful it could develop a way to resolve its farm buildings exemption application dilemma through the nine criteria listed in Appendix B-1 of his presentation. He said efforts in developing these criteria came to an end after a March 1997 Attorney General's opinion concluded that a home rule county could not use home rule powers to establish a method to determine what property is taxable as commercial property. He said he was hopeful that the criteria could be refined through discussions with agricultural groups and would result in a fair method of segregating farm operations to distinguish taxable commercial operations from tax-exempt agricultural operations. He said he would recommend that the Taxation Committee examine the possibility of establishing a number of criteria for consideration in

determining what is a commercial agricultural operation for purposes of the farm buildings exemption.

Representative Brown asked for estimated costs to the township and county for services directly attributable to the Burkel turkey farm, especially road costs. Mr. Osborn said he does not have cost figures with him, but he could get the information for the committee.

Representative Belter said that in the nine criteria proposed by the county for distinguishing farm operations from commercial enterprises, there is specific mention of livestock but no mention of hogs, poultry, or other animals. He said whatever criteria would be developed should not be specific to certain kinds of animals. Mr. Osborn said he agrees that any criteria should apply uniformly to the raising of all kinds of animals.

Mr. Osborn said a somewhat related issue has come to the attention of Richland County officials during the most recent meeting of the county board of equalization. He said the problem encountered is that North Dakota Century Code (NDCC) Section 57-12-01 requires the county board of equalization to conduct a continuous day-to-day meeting until it has completed all equalization duties. He said this statutory requirement does not provide for any time between initial presentation of a complaint and the recommendation to the board of equalization for the tax director to investigate and review the value of the property subject to the complaint. He said the Richland County Board of County Commissioners will recommend to the North Dakota County Commissioners Association annual meeting a resolution recommending amendment of NDCC Section 57-12-01 to allow the county board of equalization to meet within the first 10 days of June and to complete its prescribed duties before the end of June. He said this change would allow time to give adequate consideration to complaints presented and still allow the county board of equalization to submit its abstract of equalized values to the State Tax Department by the scheduled July 1 date.

Chairman Belter called on Mr. Wade Moser, North Dakota Stockmen's Association, for comments on the

farm buildings property tax exemption study. Mr. Moser said he was requested by the chairman at the previous committee meeting to investigate the feasibility of developing a consensus recommendation from agricultural groups on application of the farm buildings property tax exemption. He said he discussed this issue with representatives in attendance at a meeting of the Ag Coalition. He said there was a consensus of opinion that the North Dakota Supreme Court decision in the *Butts Feed Lots* decision is not an appropriate approach to determining application of the exemption. He said agricultural group representatives are eager to work on this problem but have no recommendation at this point. He said the North Dakota Stockmen's Association will take the lead in getting agricultural group representatives together to see if a consensus recommendation can be developed.

Chairman Belter called on Mr. Dave Paulson, Richland County Commissioner, for comments on the farm buildings property tax exemption study. Mr. Paulson said in regard to the question asked earlier by Representative Brown about costs attributable to the Burkel turkey farm, the county spent almost \$30,000 for road maintenance last year directly attributable to truck traffic to and from the farm.

Mr. Paulson said there are many inequities under the farm buildings exemption law as it stands with interpretation by the Supreme Court and change is needed. He said he would recommend an approach similar to the nine criteria that were under consideration in Richland County. He said this would be a reasonable starting point of discussion.

Senator Christmann asked whether the nine criteria that were under consideration in Richland County would have made Mr. Burkel's turkey farm buildings subject to taxation while exempting the buildings of other turkey growers in the county. Mr. Paulson said it was not necessarily the objective to tax Mr. Burkel's buildings, but the effort was undertaken to develop a means to separate large, commercial-type operators from smaller, traditional family farm operations. He said the Richland County Commission recognized that there is no single criteria that would make this distinction and it was necessary to develop a list of considerations and provide that if a certain number of those conditions exist, the operation would be deemed commercial.

Representative Brown asked whether road damage is caused by other agricultural producers' trucks. Mr. Paulson said obviously any agricultural producer trucking commodities on county and township roads causes road maintenance problems. He said a certain level of traffic is anticipated, but intense road usage causes a greater level of road deterioration and it is for this reason that commercial operations

should be subject to a greater property tax burden to offset the damage.

Senator Christmann asked whether the property tax bill that would be payable on Mr. Burkel's buildings if they were taxable would cover the road maintenance costs of the county. Mr. Paulson said he is not certain how much would be payable in property taxes on Mr. Burkel's buildings if they were taxable.

Chairman Belter called on Ms. Clarice Liechty for comments on the farm buildings exemptions study. Ms. Liechty said her husband and she have farmed for 37 years and are concerned about the farm buildings exemption application. She said in reviewing the nine criteria that were considered in Richland County, she is concerned by the requirement regarding employment of full-time employees who are not immediate relatives of the farm family. She said this could result in unfair treatment because her husband and she have no immediate family available to assist in running the farm and would be more likely to hire employees than a farm family with a large number of children available. She said her husband and she live off the farm and that would be another problem under the Richland County criteria. She said another of the criteria in Richland County is the existence of commercial property within one mile of the farm, which could be the result of development that is no fault of the farmer. She said another criteria is a sale of property for more than four times the county average agricultural value and this could be a disqualifying factor. She suggested caution in using the nine criteria developed in Richland County because it appears there are several areas in which unfairness could result.

Senator Thompson said it is apparent that change is needed in existing law and the committee requires a recommendation from groups representing agricultural producers.

PROPERTY TAX RELIEF STUDY

Chairman Belter called on Mr. Barry Hasti, State Supervisor of Assessments, for information on assessment of flooded property. A copy of Mr. Hasti's prepared testimony is attached as Appendix C.

Senator Thompson asked whether Mr. Hasti has a suggestion on how to fix the agricultural property valuation model to address the problem with flooded agricultural land assessment. Mr. Hasti said he cannot think of an easy fix for the problem. He said some agricultural property that is inundated in wet cycles is some of the most productive agricultural property during dry cycles. He said some people believe temporary inundation should not be a basis for eliminating assessment of the property because the property has long-term value due to its high productivity in dry cycles. He said others believe

flooded agricultural property should carry no assessed value. He said the situation with inundation by rising waters of Devils Lake is different from cyclical inundation because water from Devils Lake is likely to remain for an extended time. He said different inundation situations make it difficult to determine how to approach assessment problems. He said use of soil surveys might be a solution to the dilemma, but it would be quite expensive to complete soil surveys for the state. He said the fact that land in a county is inundated and is not producing crops will be reflected in the valuation formula because it will decrease countywide production figures. He said there is some question of how inundated lands affect county average valuations per acre as determined under the valuation formula.

Senator Christmann asked what effect flooded agricultural property had in the counties around Devils Lake last year. Mr. Hasti said he is not certain what effect inundated lands have had in those counties. He said the valuations of agricultural land for Ramsey County have had somewhat smaller increases than the statewide average but it is difficult to determine the cause of the decrease, which is not large.

Senator Thompson said Ramsey and Nelson Counties are going to consider individual abatements for inundated agricultural lands. He said this will be a difficult process and he thinks the counties need further assistance in determining what to do.

Representative Schmidt said there is a serious problem in the counties in which agricultural land is being lost to the rising waters of Devils Lake. He said political subdivisions are faced with increased costs and diminished tax bases and property owners are faced with the loss of farms they have operated for years. He said the state needs to carefully examine this situation.

Chairman Belter called on Mr. Hasti for information on current equalized valuations and comparison of valuation changes in recent years among various classes of property. A copy of Mr. Hasti's prepared testimony is attached as Appendix D. He said as a result of passage of 1997 House Bill No. 1069, the net effect for agricultural valuations statewide is a decrease of almost 3.5 percent in 1997 average agricultural values per acre statewide. He said the 1997 bill added one additional year of production data to the computations for 1997 valuations.

Chairman Belter called on Mr. Dwight Aakre, North Dakota State University Department of Agricultural Economics, for review of agricultural property valuations under the valuation formula for the 1997 tax year. A copy of statistical data distributed by Mr. Aakre is attached as Appendix E.

Mr. Aakre said the biggest change for the most recent agricultural property valuations was the addition of another year of data to the computation. He

said under this change, five of the most recent seven years of data are now used for computation and in the next round of computations, to be done in December, six of eight years of data will be used. He said the reason for excluding two years of data is that the highest and lowest production years are discarded and the remaining years are averaged. He said the data in Table 1 of the material he distributed shows computations of valuations of agricultural land by county based on using six, seven, eight, nine, or 10 years of data. He said the column headed by "5 for 7 years" is the valuation determined for 1997. He said the column headed "4 for 6 years" illustrates valuations that would have been in place without the 1997 legislation. He said the column headed "6 for 8 years" indicates what would happen with addition of 1989 data. He said the substantial change is because of the drought year that was dropped out of the formula and the Legislative Assembly wisely chose not to bring that year of data back into computations by making the phasing-in of data prospective from the year 1989.

Mr. Aakre said the data in Table 2 illustrates that the fluctuations of valuations for noncropland are not as substantial as the variations for cropland. He said as additional years of data are added to the base, cropland valuations will become more stable. He said one problem with adding additional years of data is that for noncropland, the additional years added are poor years, which will tend to hold down noncropland valuations.

Mr. Aakre said the third and fourth sheets of data are computations for illustration purposes for Cass County and Morton County. He said these tables illustrate the good production year in 1996 statewide and the substantial increase in cropland production in Cass County for 1996. He said the 1996 data is not yet complete and in some cases he used 1995 data for 1996 assumptions. He said when the data is received, the calculations on these sheets will change somewhat. He said the substantial drop in production for noncropland is directly attributable to a drop in cattle prices for 1996. Mr. Aakre said a falling capitalization rate yields a higher average valuation per acre for agricultural land. He said the fifth sheet of the materials he distributed shows the capitalization rates determined for the years 1989 through 1997.

Representative Schmidt said he has heard suggestions in his area that the capitalization rate fluctuations are causing too much variation in assessed valuations for agricultural land from year to year.

Representative Gorder said costs of farming are increasing more rapidly than income from farming. He asked whether the valuation formula reflects net or gross income. Mr. Aakre said net farm income has been decreasing because the variable costs of

farming have been increasing faster than gross income. He said the model does not measure variable costs of farming and is based only on gross income. Representative Gorder said consideration should be given to using net farming income in the valuation formula.

Representative Belter asked whether Mr. Aakre sees needs for change in the formula. Mr. Aakre said he visited several counties last year and the concern he heard most often is what to do with values of nonproducing acres, especially areas inundated. He said the question is whether the calculation should divide dollars of production for the county by all agricultural property acres in the county or by only the acres that are actually in production. In response to another question from Representative Belter, Mr. Aakre said the formula currently uses only producing acres in determining county valuations.

Chairman Belter called on Mr. Rick Clayburgh, State Tax Commissioner, for presentation of a memorandum prepared by Ms. Kathryn Strombeck of the Tax Department. A copy of the memorandum is attached as Appendix F. Mr. Clayburgh said Ms. Strombeck is unable to be present and was requested to prepare information on tax burden impacts across various income categories. He said the information presented is the most recent available and it is expected that more current data will become available in the near future and can be shared with the committee.

Mr. Clayburgh said recent newspaper reports indicated that state tax revenues are down. He said these reports were based on Tax Department cash flow reports, which may not reflect receipts of major retailers who send in sales tax reports at the end of each month. He said he thinks data for the second quarter of 1997 will show positive growth in the economy and tax revenues in spite of the worst disaster in state history. He said it is still too early to tell where revenue receipts will be for the third quarter and it is too early to tell how this season's harvest will affect revenues. He said he expects a less than good harvest from reports he has heard. He said the Tax Department is closely monitoring sales tax receipts in the Red River Valley in an attempt to determine the impact on retail sales of rebuilding efforts in Grand Forks and other flood-damaged areas.

COMMITTEE DISCUSSION

Chairman Belter said he anticipates that the Tax Committee will meet jointly with the Electric Utilities Committee to review matters of common concern with regard to the electric industry. He said this joint meeting is tentatively scheduled for November 13, 1997.

Representative Belter asked Mr. Moser whether there is a timetable for agricultural groups to meet regarding a recommendation on the farm buildings property tax exemption. Mr. Moser said a timetable has not been established but he will try to get the group together prior to the next Taxation Committee meeting.

Representative Brown said the committee should explore the possibility of counties or townships imposing special assessments for road damage caused by traffic attributable to certain agricultural producers. He said he believes some consideration was given to this approach during the 1995-96 interim. Committee counsel said the special assessments approach was considered during the previous interim and the committee could be briefed on the discussion that took place at that time.

CHARITABLE ORGANIZATION PROPERTY TAX EXEMPTION

Chairman Belter called on Mr. Ben Hushka, Fargo City Assessor, for comments on charitable organization property tax exemptions in Fargo. A copy of Mr. Hushka's prepared testimony is attached as Appendix G.

Representative Tollefson said Mr. Hushka's testimony points out the confusion that arises over terminology and application of the exemption for "charitable," "nonprofit," and 501(c)(3) organizations exempt under federal income tax laws. He asked whether a good definition of the term "charitable" would help assessors in application. Mr. Hushka said it would help assessors to have a workable definition of "charitable" that can be applied. He said Pennsylvania officials have attempted to do this, as indicated in his testimony.

Representative Kilzer said he questions whether charitable care is provided by hospitals as it once was. He said he believes the care that was once provided as charity is now provided by cost shifting. He asked how deep assessment officials dig on the issue of charitable use of property by hospitals. Mr. Hushka said hospitals and nursing homes are specifically exempt in the statutory provision so there is no "charitable use" issue to examine. He said if this were an issue there is little guidance on what "charitable use" would mean for hospitals.

In response to a question from Senator Thompson, Mr. Hushka said a clinic that was merged with a nonprofit hospital would remain taxable after the merger if it was taxable before the merger.

In response to a question from Representative Brown, Mr. Hushka said a clinic located in a hospital or located in a separate facility and owned by a nonprofit organization would be a different issue than

a for-profit clinic merged with a hospital. He said a clinic located within a hospital would be taxable.

Representative Kilzer said he knows there is a clinic in a Bismarck hospital that is tax-exempt.

Senator Kringstad asked whether a pharmacy located within a nonprofit hospital would be exempt from property taxes. Mr. Hushka said a pharmacy owned by and located in a nonprofit hospital would not be subject to the property tax if its sales are limited to hospital patients.

In response to a question from Representative Schmidt, Mr. Hushka said the claimant of a property tax exemption can be asked to provide proof of nonprofit status. He said in the case of hospitals, financial statements could be extremely complex and beyond the ability of assessment officials to analyze.

IMPACT OF TAX-EXEMPT PROPERTY ON SCHOOL DISTRICTS STUDY

Chairman Belter called on Ms. Connie Sprynczynatyk, Executive Director, North Dakota League of Cities, for comments on the effect of property tax exemptions on school districts. Ms. Sprynczynatyk said state law has numerous provisions relating to property tax exemptions. She said most property tax exemptions give no discretion to political subdivisions. She said some exemptions under state law are within the discretion of the city, for property within city limits, or the county, for property outside city limits. She distributed copies of a report prepared in 1993 relating to exemptions granted at the discretion of political subdivisions.

Ms. Sprynczynatyk said the granting of discretionary property tax exemptions has a ripple effect on all political subdivisions. She said although only the governing bodies of cities and counties have authority to approve these exemptions, an exemption may impact tax revenues of school districts, park districts, water districts, fire districts, and other political subdivisions. She reviewed data on the impact of discretionary exemptions in Burleigh and Morton Counties in 1992. She said it is important to understand that granting of an exemption generally does not result in a loss of tax revenue but often results in shifting of tax burden to other taxable property within the taxing district.

Representative Tollefson asked whether Bismarck has completed assessment valuation of hospitals in the city. Mr. Scott Stromme, Bismarck City Assessor, said the assessment of hospital property is being conducted but has not been completed.

In response to a question from Senator Freborg, Ms. Sprynczynatyk said the effect of a property tax exemption is different for different political subdivisions, depending on whether a political subdivision is below or at its mill levy limitation and whether the

political subdivision is subject to a limitation in mills or dollars levied in a previous year.

Representative Brown asked whether there is evidence of an increase in the amount of charitable property tax exemptions. Ms. Sprynczynatyk said she is unable to provide information on that issue but believes that if there has been an increase in the amount of exempt charitable property, it would probably have occurred in the larger cities.

Representative Belter asked whether cities will eliminate granting of the two-year exemption for new residential property. Ms. Sprynczynatyk said she cannot say whether cities will eliminate the exemption. She said the city of Bismarck eliminated use of the exemption but it was not eliminated without disagreement. She said builders and realtors in some communities are very strong in support of the exemption for new residential property.

Senator Urlacher asked Mr. Hushka for an estimate of costs to the city of Fargo of valuing exempt property. Mr. Hushka said he cannot provide an estimate of cost for assessing exempt property because it is done as an ongoing effort in the city of Fargo and is combined with assessment of taxable property. He said he can give the example that it took four commercial appraisers most of the summer to establish valuations for hospitals in Fargo.

Committee counsel distributed copies of materials from various sources on property tax exemptions for charitable organizations. He said review of these materials indicates that all 50 states have provisions exempting property of charitable organizations from taxation. He said it appears all states have problems in application of exemptions for charitable properties. He said the materials distributed include information on events in the state of Pennsylvania referred to by Mr. Hushka relating to refining the definition of "charitable organization."

Chairman Belter called on Mr. Richard Ott, Executive Director, North Dakota School Boards Association, for comments on the effect of property tax exemptions on school districts. Mr. Ott said that at its previous meeting the committee requested information from school districts on the impact of exemptions granted by cities and counties on school districts. Mr. Ott said the association has sent surveys to 235 school districts and has received responses from 167. He said the association is getting a lot of calls and this is generating lots of interest. He said survey results are not complete but 76 of the 167 responses received show some degree of property tax exemptions within the district and there has been an apparent recent increase in exempt property. He said the association will share the results of the survey when completed.

Mr. Ott said the association wants to make clear that it does not seek authority to veto city and county

exemption decisions. He said the association believes school districts should have the right to determine whether an exemption applies to the school district portion of the levy on subject property but the school districts do not want to interfere with the right of counties and cities to waive their own portions of taxes on subject property.

COAL INDUSTRY TAXATION STUDY

Committee counsel distributed copies of a letter from Dr. David Ramsett relating to the possibility of updating a study completed in 1986 on tax policy impact on the lignite industry. A copy of Dr. Ramsett's letter is attached as Appendix H. Committee counsel said Mr. John Dwyer, President, North Dakota Lignite Council, is out of state but had indicated that if the Legislative Council pays for half of the cost of updating the lignite industry study, funding for the other half of costs could be obtained from another source.

It was moved by Senator Freborg, seconded by Senator Christmann, and carried that the Taxation Committee request approval by the chairman of the Legislative Council for expenditure of Legislative Council funds for 50 percent of the cost, not exceeding \$5,000, for updating a study on the impact of taxes on the North Dakota lignite industry and their effect on the industry in the competitive market. Voting in favor of the motion were Representatives Belter, Brown, Christopherson, Gorder, Kilzer, Kroeplin, Nichols, Olson, Renner, Rennerfeldt, Schmidt, and Tollefson and Senators Christmann, Freborg, Kringstad, Thompson, and Urlacher. There were no negative votes.

PROPERTY TAX BURDEN STUDY

Committee counsel distributed copies of a letter from Dr. Jay A. Leitch, North Dakota State University Department of Agricultural Economics, regarding estimated costs of updating portions of a 1994 study of the state tax system to allow assessment of changes in property tax burden relative to other tax types. A copy of Dr. Leitch's letter is attached as Appendix I.

Representative Gorder asked whether the Tax Department could complete the update of the previous study. Committee counsel said a difficulty with updating the study is that the amounts used in the previous study were converted to 1994 dollars for comparison. Committee counsel asked Mr. Hasti whether the Tax Department research analysts would be able to update the study. Mr. Hasti said he is not certain whether the Tax Department could update the study but the question could be presented to the Research Division of the Tax Department. Chairman Belter said the committee would await word from the Tax Department on whether the department can

update the study before taking any action on the question of hiring a consultant.

COMMITTEE DISCUSSION

Chairman Belter asked whether committee members have suggestions for information to be presented at future meetings.

Representative Gorder said he would appreciate obtaining an opinion from Mr. Aakre on whether the agricultural property valuation formula could be adjusted to use net farm income rather than gross farm income as a measure in the formula.

Senator Kringstad said it is useful to have information presented to the committee on study topics, but it may be more useful to schedule an extended time for committee members to discuss where these studies are going and any possible conclusions.

Representative Brown asked whether the committee should wait for recommendations from agricultural groups or draft legislation relating to the farm buildings exemption. Chairman Belter said he thinks committee members who have ideas should proceed with getting bill drafts prepared. He said the agricultural groups may not be able to conclude a specific recommendation and it would be best for the committee to proceed while waiting for any recommendations.

Representative Tollefson said he would like further information on how other states define charitable activities for purposes of the property tax exemption for charitable organizations. Committee counsel said other states have probably developed interpretations in the same way as North Dakota, through court decisions, administrative rulings, and practice. He said it would be difficult to assemble information on this topic and, in discussing this issue with staff at the National Conference of State Legislatures, this is the reason a national survey has not been completed. Committee counsel said the approach that has developed in Pennsylvania might be of particular interest and a report on the details of Pennsylvania developments might be useful. Representative Tollefson said that would probably be helpful.

Representative Brown said it would be helpful if a report could contrast North Dakota law with Pennsylvania law. He said it would also be useful to provide information on how charitable organizations are treated under other tax types such as sales and income taxes.

Ms. Sprynczynatyk said an area that may not relate to committee studies directly but would be of significant interest is the number and impact of sales tax exemptions.

Chairman Belter said it might be useful for the committee to review the bills that were considered in the 1997 legislative session relating to the property

tax exemption for charitable organizations. Representative Brown said it would be useful to review those bills and the testimony received.

Representative Gorder said he questions whether information is available on the income and expenses and net profit for hospitals. He asked whether information would be available to enlighten the committee on these issues. Representative Kilzer said he knows the two hospitals in Bismarck prepare annual financial reports that would show much of this information.

Senator Christmann said constitutional issues should be examined if the farm building exemption

application is left to local option rather than applied uniformly statewide.

The meeting was adjourned at 2:45 p.m.

John Walstad
Committee Counsel

ATTACH:9