

## PROPERTY TAX RESTRUCTURING IN 1981 - BACKGROUND MEMORANDUM

In 1979 the North Dakota Supreme Court heard and decided *Soo Line Railroad Co. v. State*, 286 N.W.2d 459. In the case, three railroads, including the Soo Line Railroad, challenged the assessments made by the State Board of Equalization for the years 1974, 1975, and 1976. The court held the board must redetermine the Soo Line's assessments for the years 1974, 1975, and 1976. The court went on to say the use of a higher percentage of assessed value for centrally assessed property is impermissible under state law and the court would "no longer countenance de facto classification of property in North Dakota for purposes of taxation."

### 1979-80 INTERIM STUDY

Very soon after the release of the Soo Line Railroad decision, the 1979-80 Legislative Council's interim Finance and Taxation Committee requested and received authority from the Legislative Council to study property taxation restructuring. The committee obtained information based on the sales ratio study showing that in 1976 assessments as a percentage of market value were for agricultural land--10.5 percent, residential property--15.1 percent, commercial property--16.8 percent, and property assessed by the State Board of Equalization--24 percent. The committee report states the assessment to market value percentages information received during the 1979 legislative session were agricultural land--6.8 percent, residential property--10.4 percent, commercial property--12.2 percent, and property assessed by the State Board of Equalization--18.4 percent. Updated information provided by the Tax Department during the interim study showed assessment to market value percentages were agricultural land--5.6 percent, residential property--9 percent, commercial property--10 percent, and property assessed by the State Board of Equalization--15.5 percent. The committee recognized it would be necessary to establish classifications for these property types and recommended three alternative bill drafts. None of the bill drafts recommended by the interim committee were enacted.

### 1981 PROPERTY TAX REFORM

In 1981 the Legislative Assembly implemented property tax reform through the passage of Senate Bill No. 2323 to remedy the unconstitutionality of the state's prior method of taxation. Senate Bill No. 2323 had the following primary objectives in restructuring the property tax system:

1. Establish four classifications of property for assessment purposes.
2. Improve and equalize assessments across the state.
3. Provide for more complete information for the sales ratio study to provide a measure for the State Board of Equalization to judge the uniformity of assessments against market values in all areas of the state.
4. Transition agricultural property assessment from market value to a productivity value basis, to eliminate reliance on the rapid and erratic changes in market value and establish a more stable and generally lower valuation for agricultural property.
5. Provide a method to preserve levy authority based on the taxing authority level of political subdivisions which existed prior to the potentially dramatic changes that could be caused by the bill.
6. Gradually bring the taxable value of centrally assessed property into a state of relative equality with other commercial property and do so immediately for railroad property to comply with a mandate of federal law.

The bill provided that starting in 1981 all property must be valued at its true and full value except as otherwise provided by law. The bill provided for valuation and assessment of agricultural lands based on a productivity formula determining a capitalized average annual gross return for agricultural land. The bill provided for protection of taxpayers and taxing districts for 1981 and 1982 based on an option for a taxing district experiencing a substantial decline in valuation to levy the same amount in dollars as the district levied the prior year plus 7 percent. The bill required statements of full consideration to be filed with the State Board of Equalization or the Register of Deeds upon the transfer by deed of any property in the state. The bill created definitions for agricultural property, residential property, commercial property, and centrally assessed property. The bill provided residential property must be assessed at 9 percent of true and full value; agricultural property must be assessed at 10 percent of true and full value as determined under the valuation formula; commercial and railroad property was to be assessed at 10 percent of true and full value; and all centrally assessed property, excluding railroad property, was to be assessed at 14 percent of true and full value for 1981, 13 percent for 1982, 12 percent for 1983, 11 percent for 1984, and 10 percent after 1984. The amount determined for each property classification was to be known as the assessed value. This proved to be an error that required correction during the 1981 special session. The reason railroad property was grouped with commercial property was federal law--the

Railroad Revitalization and Regulatory Reform Act of 1976--prohibited states from assessing railroad property at a higher percentage of value than other commercial property.

Establishing assessed value as 9 or 10 percent of true and full value substantially reduced the debt limit of 5 percent of assessed value imposed on political subdivisions by Article X, Section 15, of the Constitution of North Dakota. This was corrected by legislation approved in the November 1981 special legislative session providing that assessed value is 50 percent of true and full value, which restored the debt limits for political subdivisions to approximately previous levels. The 1981 special session legislation introduced taxable valuation as the amount against which mill levies are applied to determine property tax liability and provided that residential property taxable value is 9 percent of assessed value; agricultural property taxable value is 10 percent of assessed value as determined under the productivity formula; commercial and railroad property taxable value is 10 percent of assessed value; and centrally assessed property, excluding railroad property, taxable value is 14 percent of assessed value for 1981, 13 percent for 1982, 12 percent for 1983, 11 percent for 1984, and 10 percent after 1984.

### **Protection of Taxpayers and Taxing Districts**

Senate Bill No. 2323 contained a "temporary" provision allowing each taxing district to levy in 1981 and 1982 the same amount in dollars as that taxing district levied the prior year plus 7 percent. This provision was included because it was known that assessments among taxing districts in the state were extremely variable. In many districts, the new law would have substantially reduced the property tax base, and in others, it would have substantially increased the property tax base. This provision was viewed as a transitional provision that would be effective only for two years while the property tax restructuring was occurring. It was known that assessed values would increase in 38 counties, with 25 counties showing an increase of 10 percent or more. It was also known that assessed values would decrease in 15 counties, with 4 counties having a decrease of 10 percent or more. Assessed valuations in smaller political subdivisions were sometimes subject to even more radical fluctuations.

The erratic pattern of increase or decrease in assessments among political subdivisions was caused by several factors. One factor was the mix of the types of property within the assessment district because assessments of some property types increased and some decreased. Generally, higher-quality agricultural land was undervalued in the market and tended to increase in value more rapidly under the productivity valuation approach than lower-quality agricultural land. The state average assessment ratio for agricultural land was 5.9 percent in 1979, but there were significant differences among counties in applied assessment ratios. Another factor in assessment disparity was local considerations influencing assessment of certain property types at a higher or lower rate than other property types. The net result was great variations in total assessed value among political subdivisions made it impossible to assure that political subdivisions would retain the same, or even nearly the same, tax base as before the passage of the 1981 legislation, and very significant tax increases or decreases could have occurred in some political subdivisions by application of existing mill levy limitations to the new assessed or taxable values of property within the taxing district.

The 1981-82 interim Finance and Taxation Committee studied the issue of eliminating the "temporary" optional method of determining levy limitations but found no solution and that the disparities would still exist. The "temporary" optional method of determining was reenacted by each legislative session from 1983 until 1995 with allowable percentage increases of 4 percent per year for 1983 and 1984, 3 percent per year for 1985 and 1986, 5 percent per year for 1987 and 1988, 5 percent per year for 1989 and 1990, 4 percent per year for 1991 and 1992, 3 percent in 1993, 2 percent in 1994, 2 percent in 1995, and 2 percent in 1996. The 1995 legislation provided for no increase in 1997 and 1998. If a taxing district had taken the maximum allowable percentage increase each year from 1981 through 1996, it would have increased its levy authority limit in dollars by more than 88 percent plus the amount of allowable increase for new property in the taxing district. The longer the "temporary" optional method of determining levy limits remained in effect, the more dramatic the potential effect of its elimination became. In 1997 a temporary provision was added because of flood disasters to allow a county, city, township, or school district eligible for federal funds on a matching basis as a result of a disaster to levy an amount necessary to match the federal funds. The additional levy was limited to a 2 percent increase over the base year, and the amount levied for this special purpose was to be excluded from future calculations of base year levies. Since 1997, the provision (North Dakota Century Code Section 57-15-01.1) has remained in law and allows a taxing district the option of levying the same amount in dollars as in the highest of the three previous years.