NORTH DAKOTA LEGISLATIVE COUNCIL

Minutes of the

TAXATION COMMITTEE

Tuesday and Wednesday, September 4-5, 2007
Roughrider Room, State Capitol
Bismarck, North Dakota

Senator Bob Stenehjem, Chairman, called the meeting to order at 1:00 p.m.

Members present: Senators Bob Stenehjem, Dwight Cook, Constance Triplett, Herbert Urlacher; Representatives Larry Bellew, Wesley R. Belter, David Drovdal, Glen Froseth, Craig Headland, Gil Herbel, Jim Kasper, Scot Kelsh, Mark S. Owens, Arlo Schmidt, Benjamin A. Vig, Dave Weiler, Dwight Wrangham

Member absent: Senator Ben Tollefson

Others present: See Appendix A

It was moved by Representative Drovdal, seconded by Representative Owens, and carried on a voice vote that the minutes of the previous meeting be approved as distributed.

OIL AND GAS TAX REVENUE ALLOCATION STUDY

Chairman Stenehjem called on Mr. Lawrence Hopkins, State Treasurer's office, for presentation of information relating to oil and gas gross production tax allocations. A copy of Mr. Hopkins' prepared testimony is attached as Appendix B.

Mr. Hopkins said the State Treasurer was requested to provide information on oil and gas gross production tax allocations for the 2005-07 biennium. He said the State Treasurer's office distributed almost $227.5 million of gross production tax revenue in the 2005-07 biennium, and the state's share of that amount was almost $173.6 million. He said the state's share was allocated approximately $46 million to the state general fund, $121.8 million to the permanent oil trust fund, $5 million to the oil impact fund, and $841,000 to the oil and gas research fund.

Mr. Hopkins said the 2005-07 biennium oil and gas gross production allocations to political subdivisions totaled almost $53.9 million. The political subdivision allocations are made to producing counties and apportioned 45 percent to the county general fund, 35 percent to school districts, and 20 percent to cities. He said the State Treasurer's office distributes the county portion and the school district portion directly to counties. He said the county makes the allocations to school districts. He said the State Treasurer's office allocates the city share directly to the cities entitled to the funds. He said tables attached to his prepared testimony show the payments to individual counties and individual cities for the 2005-07 biennium.

Mr. Hopkins said oil and gas gross production gas distribution is complicated by the fact that caps are imposed at every level of distribution of gross production gas revenues. He said the oil impact grant fund was capped at $5 million for the 2005-07 biennium, which will increase to $6 million for the 2007-09 biennium. He said the general fund allocation is capped at $71 million per biennium. He said the oil and gas research fund was capped at $1.3 million, which will be increased to $3 million for the 2007-09 biennium. He said there are caps on the amount allocated for each county and for individual school districts and individual cities.

Mr. Hopkins said Bowman County allocations reached the county cap of $4.1 million in the second quarter of both fiscal years 2006 and 2007. He said McKenzie County capped at $4.1 million in the fourth quarter of fiscal year 2007. He said the cities of Marmarth and Amidon in Slope County and Medora in Billings County reached their respective city allocation caps, which are based on population. He said he is not able to report on individual school districts that reached allocation caps under the formula because the school district allocation of funds is determined at the county level. Senator Stenehjem asked what happens to excess allocations when a city or school district reaches its allocation cap under the formula, and Mr. Hopkins said the county retains funds that exceed the cap for a city or school district in the county.

Committee counsel asked why the State Treasurer's office does not make the determination of allocations to school districts. Mr. Hopkins said 35 percent of revenues allocated to the county must be apportioned by the county treasurer to school districts within the county on the average daily attendance for school districts as certified to the county treasurer by the county superintendent of schools. He said the statutory provision requires the county to make the allocation and the county has the average daily attendance information for school districts and the State Treasurer's office does not have that information.

Department of Mineral Resources

Chairman Stenehjem called on Mr. Lynn Helms, Director, Department of Mineral Resources, Industrial Commission, for testimony relating to energy development in North Dakota. Mr. Helms said he was requested to provide an overview of current and future energy demands as they relate to North Dakota. A copy of Mr. Helms's PowerPoint presentation is attached as Appendix C.

Mr. Helms said the first thing to recognize is that North Dakota has tremendous resources in all energy sectors. He said world energy consumption is expected to grow from 50 percent to 100 percent in the next 25 years. He said world consumption of energy will cause a significant percentage growth in use of renewable fuel, but the greatest demand and growth will occur in demand for oil, natural gas, and coal energy.

Mr. Helms said there are concerns about high worldwide demand for energy, but high energy use is not entirely a bad thing. He said as energy demand rises, gross domestic product rises at an even faster rate.

Mr. Helms said world economies have changed significantly and will continue to do so. He said the rate of growth of worldwide energy demand is largely dependent on the rate of demand growth in Asia. He said Asian economies have changed significantly and will continue to change. He said Asian population will continue to grow at a rapid rate, the population will become more urban, and the number of motor vehicles in Asia will increase by 485 million from 2000 to 2015. He said Asia uses 90 percent of the world's fertilizer and 20 percent of the world's pesticides and emits 30 percent of the world's carbon dioxide. To reach the United States electricity consumption levels, he said, China would have to build additional generating capacity equivalent to North Dakota’s Coal Creek Station once each week for 31 years.

Mr. Helms said world surplus oil production capacity has diminished. He said world consumption is approximately 86 million barrels of oil per day and surplus capacity is only one million to two million barrels per day. He said this would be roughly equivalent to an average North Dakotan with $32,500 annual income relying on maintaining a $2 balance in the person’s checking account.

Representative Weiler asked how reserves of oil are determined. Mr. Helms said the one million to two million barrel per day surplus capacity is the additional amount of oil that could be produced from existing wells if oil was pumped from those wells at peak capacity. He said there are plans to bring more oil production online and this could raise surplus production capacity to 15 million barrels per day, which would reduce oil prices. He said it is unlikely that this will happen because OPEC countries will not invest in expansion of production that would tend to push oil prices lower.

Mr. Helms said it is unlikely that cheap oil and gas will be available on world markets in the future. He reviewed the projected length of time available supplies of nonrenewable fuels will last.

In response to a question from Senator Urlacher, Mr. Helms said gasoline refinery development is not in step with energy demands in the United States. He said lack of refinery capacity has been exacerbated by closure of refineries, which will cause short-term price increases. He said increasing United States refinery capacity is a difficult problem and he is not sure what the states can do except perhaps try to ease Environmental Protection Agency (EPA) requirements for opening a refinery. He said refinery plans have been held up for years in EPA permitting processes and there is no end in sight for those projects.

Mr. Helms said North Dakota has tremendous resources in all energy sectors. He said North Dakota has a crude oil supply of approximately 50 to 70 years. He said North Dakota has a coal supply at current usage rates for more than 800 years. He said about two-thirds of electricity production in North Dakota is exported but lack of transmission capacity hinders expansion. He said a developing energy area is uranium production. He said uranium prices have risen dramatically and North Dakota has uranium reserves but no current production.

Representative Weiler asked whether uranium production in North Dakota would be subject to tax. Mr. Helms said North Dakota has no tax on uranium production.

In response to a question from Representative Froseth, Mr. Helms said other states tax uranium production on a price per pound or as a percentage of value.

Mr. Helms said geothermal energy use is expanding rapidly in North Dakota. He said renewable energy in ethanol or biodiesel production has a large capacity for expansion in North Dakota. He said North Dakota wind energy has the potential to generate 1.2 million megawatt-hours of electricity. He said wind power production creates high-paying jobs but wind energy generates no tax revenue for the state. He said North Dakota has production of hydroelectricity, which is not comparable to production from other sources but North Dakota is one of the top 10 states in hydroelectric production. Mr. Helms said solar energy is the only energy source North Dakota does not have in abundant supply.

Representative Belter asked whether there have been any changes in the oil drilling permit process. Mr. Helms said the drilling permit process has been simplified, including the process for drilling in national grasslands. He said some of the simplification in permitting has occurred because drilling activity has moved east and away from federal lands in the state.

Senator Urlacher asked how the actual cost of energy from various sources can be compared. Mr. Helms said it would require some calculation but it should be possible to make the comparison.

Representative Drovdal asked if it is possible to compare carbon dioxide generated by each type of energy source. Mr. Helms said that would require some calculations but it should be possible to make a comparison.

In response to a question from Representative Froseth, Mr. Helms said biodiesel production is more energy-efficient than ethanol production. He said biodiesel production uses less water and generates less carbon dioxide.

Energy Development Impact Office

Chairman Stenehjem called on Mr. Rick Larson, Director, Energy Development Impact Office, for review of the recent history of oil impact grant applications and awards. A copy of information distributed by Mr. Larson is attached as Appendix D.

Mr. Larson said 6.67 percent of oil and gas gross production tax revenue up to a maximum of $5 million per biennium is allocated for oil impact grants. He said beginning with the grant round to be awarded on June 30, 2008, the cap on grants is increased to $6 million for the biennium.

Mr. Larson reviewed the criteria for grants developed by the Energy Development Impact Office. A copy of the criteria is attached as Appendix E.

Mr. Larson said sources of information used to determine awards of funding for oil impact include financial records, past oil and gas activity, current oil and gas activity, projected oil and gas activity, tax efforts of the political subdivision, student population for school districts, onsite visits, and discussions with interested parties.

Mr. Larson reviewed the results of the 2007 grant round. He said 377 grant requests were made seeking a total of $40,598,435. He said the total amount requested was inflated by a request for $17.4 million from Williams County for a combined law enforcement and correctional center. He said the total amount awarded for all grants was $2,471,000, which was the full amount available for grants. He said almost half of the amount available for grants was awarded to townships to address township road impacts. Mr. Larson reviewed historic grant round information for comparison with the 2007 grants.

Senator Urlacher asked whether the impact grant program could be used to fund impacts caused by wind energy development or ethanol or biodiesel development. Mr. Larson said the program is dedicated by statute to address impact-only from oil and gas development.

Representative Froseth asked whether requests for impact grants usually exceed the amount available for grants. Mr. Larson said requests are received for substantially more than the funds available for allocation. He said for 2005 grants, 292 requests were received seeking $16.8 million when a total of approximately $2.5 million was available; in 2006, 337 requests were received seeking $32.1 million for which approximately $2.5 million was available; and in 2007, 337 requests were received seeking $40.6 million when approximately $2.5 million was available.

Senator Stenehjem asked how the Energy Development Impact Office can determine if the political subdivision has actually expended the funds for projects for which partial funding is awarded as an impact grant. Mr. Larson said the political subdivision that has been awarded an impact grant will not receive the funds until invoices are submitted to document the expenditure.

Committee counsel distributed to committee members a copy of a pamphlet entitled *North Dakota Oil & Gas Industry Fact & Figures,* 2007 Edition, published by the North Dakota Petroleum Council. A copy of the pamphlet is on file in the Legislative Council office.

Association of Oil and Gas Producing Counties

Chairman Stenehjem called on Ms. Vicky Steiner, North Dakota Association of Oil and Gas Producing Counties, for comments on the committee study. Ms. Steiner distributed copies of a flow chart illustrating 2007 oil tax distribution. A copy of the flow chart is attached as Appendix F. Ms. Steiner reviewed how oil tax revenues are distributed.

Ms. Steiner said recent increases in oilfield activity have created serious issues regarding funding road improvement and reconstruction in oil-impacted counties. She said this problem was brought to the attention of the Legislative Assembly in 2007 and adjustments were made to the allocation formula to provide additional allocation amounts and impact funding to address the problem. Ms. Steiner said the Association of Oil and Gas Producing Counties suggested that an escalator provision should be added to the caps on county allocations to keep pace with future increases in road costs to counties. She said an escalator provision was not included in 2007 legislation and it was suggested that that issue could be addressed during this interim. She said the association would like to have an appropriate escalator provision added to the cap on county allocations.

Ms. Steiner said the 2007 legislative increases in allocations to oil-producing counties will not be enough for some counties to adequately address road impacts for county and township roads. She said it is hard to appreciate the road impacts that are occurring unless you observe it in person. She suggested that committee members should tour the area to gain an appreciation of the road impacts.

Representative Froseth asked if there is a better method than impact funding to address road degradation. Ms. Steiner said the impact program works well in conjunction with direct allocations. She said direct allocations provide funding to areas where production is occurring but the impact program is important to address impacts to changing areas of new exploration, development, and initial production when sufficient amounts of tax revenues are not being allocated to the area being impacted.

North Dakota Association of Counties

Chairman Stenehjem called on Mr. Terry Traynor, Assistant Director, North Dakota Association of Counties, for information on county road costs. A copy of Mr. Traynor's prepared testimony is attached as Appendix G. Mr. Traynor said road costs are increasing at a rapid pace across the country. He said road costs have increased by 50 percent nationwide in the last three years while county resources have remained stable. He said this translates into less reconstruction, less maintenance, and further deterioration of roadways.

Mr. Traynor said the Federal Highway Administration and American Association of State Highway and Transportation Officials conducted a survey of road cost increases in April 2006. On a nationwide basis, he said, road construction contract costs increased by 5.8 percent in 2003, 12.7 percent in 2004, and 17.1 percent in 2005.

Mr. Traynor said North Dakota counties impacted by oil development are facing the same cost increases as the rest of the country with road maintenance but with added pressure of dramatically increased competition from the oil industry for labor, materials, equipment, and other resources and the profound effects of the development and production traffic on roadways. He said each county in the oil development area is impacted but they are impacted differently because they are in different phases and degrees of oil development.

Mr. Traynor said county road and bridge expenditures for seven sample counties in the oil development area show that road and bridge expenditures have increased from $10.5 million in 1998 to $22.9 million in 2007, an increase of almost 120 percent in 10 years. He said the costs are increasing much more rapidly in counties with the greatest current levels of production revenue and activity. He said McKenzie County costs have increased by 166 percent and Bowman County costs have increased by 344 percent in the 10-year period.

Mr. Traynor said counties with emerging and more recent growth in oil development have a somewhat different problem. He said these counties are experiencing road impacts but have not experienced the tax revenue increase that results from increased production. He said Dunn County and Mountrail County are falling behind on road maintenance largely because of the lack of revenue to adequately address the needs of development.

Mr. Traynor said Bowman County has maintained detailed historical information on road construction cost components. He said in Bowman County the cost of oil for chip seal on road surfaces has increased by 56 percent in eight years, excavation costs have increased 95 percent in eight years, gravel crushing costs have increased 112 percent in eight years, and aggregate for chip seal of road surfaces has increased 138 percent in nine years. Mr. Traynor said property taxes levied for county roads in the region have increased by about 4 percent per year but this growth has done little to keep up with road cost increases of three to eight times that annual rate.

Senator Stenehjem said it appears that Billings County has oil production but has kept road costs relatively stable. He asked why this would occur. Mr. Traynor said he is not certain but it may have something to do with established oilfields and roads.

Senator Stenehjem asked how property tax levies in oil-impacted counties for roads compare with levies for roads in other counties. Mr. Traynor said he believes property tax levies for roads in the oil-impacted counties have increased at about the same rate as for counties outside the oil-impacted area.

Mr. Cliff Ferebee, Dunn County Commissioner, distributed copies of a sheet showing Dunn County facts relating to county property taxes and the county road budget. A copy of the information sheet is attached as Appendix H. Mr. Ferebee said the oil industry traffic on Dunn County roads is something that should be seen to understand. He said Dunn County is struggling to maintain county roads. He said property tax effort exceeds 40 mills for the county and other revenues are available, including gross production tax allocations. He said despite the efforts of the county, the county is not able to meet all road needs and it appears actual road and bridge expenditures will exceed budgeted amounts. He said road material prices have doubled since 2004. He said Dunn County identified $1,250,000 in March oil impact costs for the county. He said oil impact grants funded $115,000 of those costs. He said since March an additional $250,000 in new oil impact costs for Dunn County have been identified.

Mr. Greg Boschee, Mountrail County Commissioner, said Mountrail County is trying to accommodate oil industry traffic at levels never experienced before. He said dollars expended on road costs add up so fast it is extremely difficult to try to keep up to demands. He said oil tax revenue is just getting established in Mountrail County but impacts to roads are already there.

In response to questions from Representative Drovdal, Mr. Boschee said the Mountrail County road budget has doubled from $2 million to $4 million and the county is also trying to help townships with gravel costs for roads. He said the county feels responsible for sharing township costs because the county has encouraged oil industry truck traffic to use township roads to reduce impacts to county paved roads. He said county roads were paved to a thickness to accommodate normal traffic conditions the county had experienced for many years but the pavement is not thick enough to withstand oil industry truck traffic.

Senator Triplett asked whether Mountrail County has considered upgrading the paved county roads. Mr. Boschee said Mountrail County has considered upgrading paved roads but the cost is prohibitive at this time.

Mr. Roger Hovda, Mountrail County, said in his township there will be 36 mills levied for township roads this year. He said the township spent $44,000 on roads this year, compared to normal road expenditures before oil industry impacts of $5,000 to $6,000 per year. He said there is 24-hour-a-day traffic on these township roads and the damage to the roads is constant. He said the dust raised by the traffic is another huge problem for those who live near the roads. He said the township is trying to deal with the dust problem.

Senator Stenehjem asked Mr. Hovda what he thinks is the right approach to dealing with the road problems. Mr. Hovda said he would favor having the allocation formula provide more money to counties and allowing the county to allocate funds to the areas where funds are most needed.

Representative Froseth said it appears the committee could use an estimate of the annual cost to maintain roads in the oil development area. He said it would be useful to compare these costs to costs in other counties. He said examination should be undertaken for all county and township road costs in the oil development area.

Mr. Robert Kleeman, Dunn County Commissioner, said county and township roads were not designed for carrying trucks used in the oil industry. He said the size of these trucks squashes out the roadbeds, which makes road repairs a constant and difficult problem. He invited committee members to tour the oil impact area to observe the road damage and other problems experienced by political subdivisions.

Chairman Stenehjem requested the Legislative Council staff to obtain information for committee consideration showing revenues to cities, counties, and townships from motor fuels taxes, registration fees, and other state sources.

Representative Froseth asked Mr. Traynor if the North Dakota Association of Counties could develop long-range numbers and plans for meeting road needs in oil-impacted counties. Representative Froseth said the committee needs to gain an understanding of how counties use money from various sources to address road needs. Mr. Traynor said the Association of Oil and Gas Producing Counties might be best suited to address that issue. Mr. Traynor said the Association of Counties could examine the history of road costs but that may not be useful in developing long-range cost estimates.

Senator Bill Bowman, District 39, said problems are just beginning to surface in some oil-impacted counties. He said Bowman County is already there in dealing with serious levels of road impact. He said the lifespan of a road is maybe two years with oil truck traffic. He said the constant pounding of the roads is hard to believe if you have not seen it for yourself. He said townships in Bowman County are looking for help from the county for road, culvert, and bridge repair and maintenance. He said township roads do not hold up against oil industry traffic. He said the state is the beneficiary of oil production and the state should use oil tax revenues to absorb some of the impact now falling on local governments. He said an escalator on the caps on county allocations of oil and gas gross production taxes would help to deal with future road maintenance cost increases.

Representative Drovdal agreed with Senator Bowman. He said there is a definite need for increased state assistance for road maintenance costs in oil-impacted counties. He said counties with significant oil production receive revenues from taxes on that production, but areas impacted by exploration may have little tax revenue to address impact. He said oil-impacted political subdivisions will require additional funding assistance from the state to address impact to road systems.

PROPERTY TAX REFORM AND RELIEF STUDY

Department of Public Instruction

Chairman Stenehjem called on Mr. Jerry Coleman, Department of Public Instruction, for a presentation of data on school finance and property taxes. Mr. Coleman distributed copies of *School Finance Facts*, published by the Department of Public Instruction, February 2007. Mr. Coleman also distributed copies of information compiled by the Department of Public Instruction on *Funding K-12 Schools in North Dakota*, prepared to respond to questions presented by the Taxation Committee. Copies of the information distributed are on file in the Legislative Council office.

Mr. Coleman said the *School Finance Facts* publication contains a substantial amount of statistical information about revenues, expenditures, and property tax levies for public schools. He reviewed the information in the summary of facts which shows statewide totals and averages for school districts. He said Fund Group 1 statistics show the relative shares of 2006 school district revenues from local sources (43.7 percent), county sources (1.55 percent), state sources (39.66 percent), federal sources (14 percent), and other sources (1.01 percent). He said the report shows statewide expenditure amounts for individual programs and expenditures.

Mr. Coleman said the *School Finance Facts* publication shows a rank order of high school districts by total mill levy for the 2006-07 school year. He said the publication also provides rank order by total mill levy for elementary school districts, rural districts, and nonoperating districts. He said a mill levy summary is provided for each school district in the state showing school district taxable valuation, taxable valuation per pupil, general fund levy, high school tuition levy, high school transportation levy, levies for special purposes, and total mills levied. He said the information shows the average general fund levy for school districts is approximately 193 mills and the average total mills levied for school districts is approximately 220 mills. He said the publication provides an analysis of Fund Group 1 expenditures by function on a statewide basis. He said this report contains information on average cost per pupil based on various levels of school district enrollment. He said information is provided for individual school districts to calculate total cost per pupil and average cost per pupil for each school district. He said the publication contains a comparison of rank order of high school districts by average cost per pupil for the 2005-06 school year.

Mr. Coleman said the information in separate material distributed on funding K-12 schools contains the information from the *School Finance Facts* publication on a historical basis for each year from 1987-88 through 2005-06. He said this table shows that state source funding of K-12 education declined from 58.5 percent in 1981-82 to 39.7 percent in 2005-06. During this time period, he said, school district property taxes increased from $63 million per year to $329 million per year, state funding sources increased from $207 million to $342 million, and federal source revenue increased from $23 million to $120 million.

Mr. Coleman said the information distributed shows the history of revenue sources, enrollment, and per student cost of education by school district. He said the information is presented for fiscal years 1985, 1990, 1995, 2000, and each year from 2001 through 2006.

Mr. Coleman said he was requested to find information comparing state and local shares of education funding for other states. He said a table is provided in the material distributed which shows information compiled by the United States Department of Education National Center for Education Statistics. He said the information is based on fiscal year 2005 and shows a United States average state share of education funding of 46.9 percent, an average local share of education funding of 44 percent, and an average federal share of education funding of 9.2 percent. He said the table shows these categories of funding for North Dakota at 37 percent for the state share, 46.9 percent for the local share, and 16.1 percent for the federal share. He said another table in the information distributed shows the percentage of state revenues to total revenues for elementary and secondary education for the years 1990-2002. He said during those years the United States average state share of education funding increased slightly while the state share of education funding in North Dakota declined slightly.

Senator Stenehjem said it appears there are several ways of computing the average cost per student for the state. He said one method would be to divide the total school district expenditures by the number of students. He said on that basis, it appears North Dakota is roughly spending about $9,000 per student each year. Mr. Coleman said in rough terms, cost per student could be viewed in that way.

Representative Headland asked how many property tax levies of school districts can be taken to the voters for approval. Mr. Coleman said most levies are subject to consideration by the voters in some way.

Representative Drovdal asked if it is possible to analyze revenue sources to the state general fund that have contributed to elementary and secondary education funding. He said the objective of the analysis would be to determine whether there have been changes in the share of education funding for various tax sources, perhaps considered in five-year increments for the years from 1950 to 1985. Mr. Coleman said data is probably not available for all of those years but a comparison should be possible from the data that is available.

Representative Froseth said there is a perception that costs for teachers and education have been increased by federal education requirements. He asked if it is possible to determine how many federal requirements have added to the cost of education per student. Mr. Coleman said it is hard to say how many federal requirements have impacted education costs. He said he has seen recent reports that 1 percent to 2 percent of costs result from recent emphasis by the federal government on education enhancement.

Senator Urlacher said many taxpayers are concerned about funding for extracurricular activities. He asked whether there is any way to separate the basic cost of education from other costs. Mr. Coleman said the Department of Public Instruction has considered that question and it is very difficult to define what constitutes an extracurricular activity and separate the funding for such activities.

Representative Herbel said the Legislative Assembly needs to understand the effects of shifting costs of education from local sources to state sources. He asked whether there is a way to measure the effect of additional state funding on school district budgets and budgets of other taxing districts. He said legislators hope that added state funding does not provide an incentive for increases in local spending.

Representative Vig said school districts have added security cameras and other enhancements and he asked what funding is available for these kind of expenditures. Mr. Coleman said he believes expenditures of that type would be within the general fund of the school district.

Committee Discussion

Senator Cook said he can arrange for a presentation of approximately 10 minutes to provide the committee a streamlined sales tax activity update at the next committee meeting. Chairman Stenehjem said that would be useful background information for committee members.

Bonding Issues

Chairman Stenehjem called on Mr. Mike Manstrom, Dougherty & Company LLC, and Scott Wegner, Cook, Wegner & Wike PLLP, for presentation of information on political subdivision bonding issues. A copy of testimony distributed by Mr. Manstrom is attached as Appendix I.

Mr. Manstrom said there is no legal limit on the amount of special assessment debt that can be incurred by a political subdivision. He said any market limit on special assessment bonds would be based on the issuer's credit status. He said special assessment bond issuers are required to back their bonds with general obligation credit of the political subdivision, which would be imposed through a deficiency levy. Mr. Wegner said the North Dakota Supreme Court has ruled that a pledge of general obligation backing for bonded indebtedness does not count against the political subdivision's debt limit because the general obligation credit is a contingent debt.

Representative Kasper asked if there is a listing of indebtedness of all political subdivisions in the state. Mr. Manstrom said his firm does a listing of indebtedness for bond issues by political subdivisions. He said the information could be made available to the committee.

Mr. Manstrom said bond ratings are obtained by making application to one of the nationally recognized rating agencies. He said the issuer of the proposed bonds provides financial information to the rating agency, pays the agency's fee, and the rating agency reviews the information and decides whether it will rate the bonds and what the rating will be. He said rated bonds usually have a lower interest rate because an independent third party has reviewed the financial soundness of the transaction.

Senator Cook asked whether there is any central location in state government where total indebtedness information for a political subdivision is collected. Mr. Manstrom said there is no state collection of indebtedness information.

Senator Cook asked whether bond rating agencies look at total indebtedness compared to property valuation. Mr. Manstrom said that is a significant consideration for rating agencies. Senator Cook asked what would trigger a red flag for a bond issuance. Mr. Manstrom said one factor would be if a bond rating has been downgraded but there is no specific factor that triggers the change. Senator Cook said the concern with information on indebtedness relates to the times in the 1980s when cities had problems with indebtedness levels during oil boom and bust cycles. Mr. Manstrom said he recalls those problems and Belfield was the only city that had to restructure its indebtedness as a result of the downturn in the oil industry.

Representative Kasper asked whether retirement of debt of a political subdivision for other than special assessments is entirely on property tax assessment. Committee counsel said that is correct. He said the property tax statement reflects the amount of special assessments for a taxpayer but does not reflect how much property tax goes to pay bonded indebtedness of political subdivisions for other purposes.

Mr. Wegner said a building authority is set up as a nonprofit corporation that issues bonds, uses the proceeds to build a building, and collects rental payments for use of the building from a school district or other political subdivisions. He said federal law allows a corporation established as a nonprofit corporation to issue tax-exempt bonds for the benefit of a political subdivision. He said a vote of electors is not required for bonds issued by a building authority because no debt is incurred in the constitutional sense. He said no additional tax levy is imposed and annual lease rentals are budgeted and paid from the political subdivision's general fund. He said holders of the bonds of the building authority run the risk of the political subdivision not appropriating funds to pay lease rentals. He said bondholders would have no recourse for the default against the political subdivision.

Representative Drovdal asked whether bond rating agencies examine and rate building authorities. Mr. Manstrom said building authority bonds carry a higher rate of interest because a building authority is not a political subdivision and bondholders have no recourse against the political subdivision.

Representative Kelsh asked whether there are any laws or regulations on the makeup of a building authority. Mr. Wegner said the board of directors of a building authority is generally made up of the members of the governing body of the school board or whatever political subdivision is involved.

Representative Kasper asked whether there is any way the voters of a school district could take away the power of the school board to use a building authority to finance construction. Mr. Manstrom said he is not aware of any authority for voters of a school district to eliminate the authority to use a building authority. He said use of a building authority would be limited by having available funds to make lease payments. Mr. Wegner said he is also not aware of any legal means in current law to eliminate use of a building authority by a school district.

Representative Belter asked if there is more security in a direct bond issue by a school district than in a bond issue by a building authority. Mr. Manstrom said there is more security in a direct bond issue by a school district and the lower rate of interest on direct bond issues for school districts reflects that fact.

Representative Kasper asked what difference in bond rates existed between direct bond issues and bond issues through a building authority. Mr. Manstrom said perhaps 25 basis points of difference exist between these bond issues.

In response to a question from Representative Bellew, Mr. Wegner said the Fargo School District is the only North Dakota political subdivision which has acted through a building authority for building construction.

In response to a question from Representative Schmidt, Mr. Wegner said voter approval is required for issuance of some kinds of bonds by political subdivisions and in some cases the requirement is for a 60 percent vote of approval. He said these voter approval requirements are a factor in the decision of whether to issue bonds through a building authority.

Senator Cook asked whether Mr. Manstrom is aware of any deficiency levies required in the last 25 years to cover a shortfall of funds for bonded indebtedness. Mr. Manstrom said he is not aware of any deficiency levies for payments during the past 25 years.

North Dakota League of Cities

Chairman Stenehjem called on Ms. Connie Sprynczynatyk, Executive Director, North Dakota League of Cities, for presentation of information on several topics.

Ms. Sprynczynatyk distributed copies of a pie chart depiction of 2006 general fund revenues and general fund expenditures for the cities of Bismarck, Bottineau, Devils Lake, Dickinson, Fargo, Grafton, Grand Forks, Jamestown, Mandan, Minot, Rugby, and West Fargo. She distributed copies of a report from the CITYScan publication of the League of Cities showing revenue projections from state sources through 2008 for cities. Copies of these materials are on file in the Legislative Council office.

Ms. Sprynczynatyk distributed copies of a report showing city taxable valuations and levies compared for the years 2000 and 2006. The report shows taxable valuation of property within each city for 2000 and 2006, the city levy in mills for 2000 and 2006, and the city levy in dollars for 2000 and 2006. She said the table also shows the percentage change in the levies in mills and in dollars for the years 2000 and 2006. A copy of the table is attached as Appendix J.

Ms. Sprynczynatyk distributed copies of a table showing taxable valuations and levies for North Dakota cities over 5,000 population for each year from 2000 through 2006. A copy of the table is attached as Appendix K.

Ms. Sprynczynatyk said she was requested to provide information to the committee regarding the kinds of improvements cities may fund through special assessments. She said the improvement allowed by special assessments are listed in North Dakota Century Code (NDCC) Section 40-22-01. She said special assessments may be used to fund a water supply and sewerage system; municipal street system; improvements of public places by planting trees and grass; acquiring land and easements for flood protection; and acquiring property and easements for parking lots, ramps, garages, and other facilities for motor vehicles.

Ms. Sprynczynatyk said the committee requested information on city employment and areas of growth. She said it appears the trend in growth is focused in public safety and information technology. She said the number of employees of a city will generally track with city growth but also may track with the function of a department. She said federal regulations on waste management have caused civic employment increases, and growth in information technology staff is a relatively recent development that is becoming a necessary service for city government.

Representative Drovdal said in reviewing the information on city revenues, fines and fees in the city of Devils Lake seem high compared to other cities and he asked if there is a reason. Ms. Sprynczynatyk said she will check into that question.

Senator Stenehjem asked where gas tax receipts are reflected for the city of Bismarck on the chart of revenues. Ms. Sprynczynatyk said she is not certain which category that is contained in but will check into that.

Ms. Sprynczynatyk said she was requested to provide information on use of special assessments or development fees. She said special assessment is a financing tool that can be used for many purposes associated with development of new areas. She said in each case of property development the question arises of what the developer can be required to pay. She said cities use a combination of ways to fund improvements for new property. She said special assessments are the typical method of funding in North Dakota but different approaches might be used. In Fargo, she said, developers of property are not required to prepay development costs. In Bismarck, she said, developers must prepay cost of grading, sewerlines and waterlines, curb and gutter, and 40 percent of street costs.

Representative Belter said there is concern that if a developer sets up a development area and sells lots but is unable to sell enough lots, the city may become liable for the development area. He asked whether that can occur. Ms. Sprynczynatyk said it could occur that a development would fail and the city would take possession of the lots eventually for unpaid taxes and assessments. She said that would be an extremely rare situation and cities are very cautious about approving a development if they are not certain of the demand.

Senator Cook asked if the city of Bismarck development policy is written so it can be provided to developers. Ms. Sprynczynatyk said the city of Bismarck has a written development policy. Senator Cook asked if Ms. Sprynczynatyk can find out if the larger cities in the state have written development policies and if she can obtain copies for the committee. She said she will check into that.

Mr. Jerry Hjelmstad, Assistant Director, North Dakota League of Cities, distributed copies of information comparing 2006 property tax collections and special assessments levied in the 12 largest cities. A copy of the information is attached as Appendix L.

Representative Herbel said reviewing the information on property taxes and specials indicates enormous differences in ratios of property taxes to special assessments in some cities, such as Dickinson and Mandan. Mr. Hjelmstad said levying special assessments is a local decision and it would be hard to list reasons why special assessment use is more prevalent in some cities. He said he believes Dickinson has been very reluctant to impose substantial amounts of special assessments after its experience in the 1980s, when the city got property back that was unsold when the oil industry fell flat.

Senator Cook said a certain degree of speculation could be reflected in public improvements by special assessments in some cities. Mr. Hjelmstad said that might be a factor in some cities.

NORTH DAKOTA ASSOCIATION OF COUNTIES

Chairman Stenehjem called on Mr. Mark A. Johnson, Executive Director, North Dakota Association of Counties, for a presentation of information and response to several requests from the committee. Mr. Johnson distributed written materials providing information in the areas requested by the committee. A copy of the written materials are attached as Appendix M. Mr. Johnson said Mr. Traynor would present the first portion of the information.

Mr. Traynor said information was requested to assess county budget and property tax impact of the state assumption of county functions relating to court unification and regional child support enforcement. He said legislation for court unification was passed in 1991 but was not fully implemented until 2001. He said from a county budget perspective, court unification was implemented in 1995 when the county court staff became state employees. He said counties anticipated elimination of $6.7 million per biennium in county property tax costs. However, 1995 legislation shifted an estimated $5 million per biennium in court fees and bond forfeitures from the counties to the state. He said counties derived a small net gain from unification but in the first biennium counties were required to fund over $1 million in courthouse remodeling required by court unification.

Mr. Traynor said the legislative action in 1999 shifting clerks of district courts to state funding had a more direct effect on county budgets. He said the 1999 legislation was not associated with an offsetting revenue loss. He said the transfer became effective in April 2001 and shifted an estimated $11 million per biennium in staff costs from counties to the state. He said reviewing annual audit reports indicates that after steady annual increases in county general fund expenditures of approximately 4 percent in the years prior to the employee shift, county general government expenditures decreased by 5.2 percent when the shift was made. He said a 10-year average of 4.8 percent per year increases in county general fund revenues was reduced to an annual increase of 1 percent for two years following the shift in funding for clerks of court.

Mr. Traynor said passage of 2007 Senate Bill No. 2205 shifts regional child support enforcement funding from counties to the state. He said the initial impact will not be known for several months. He said the fiscal note for the legislation as prepared by the Department of Human Services indicates that once the legislation is fully implemented counties will be relieved of $4.5 million in property tax costs per calendar year. On a statewide basis, he said, this would be an average mill reduction of 2.5 mills. He said one of the factors in passage of the 2007 legislation was the fact that regional child support enforcement costs were not evenly distributed among counties with respect to taxable valuation. He said counties will see savings of approximately one mill to three or four mills.

Mr. Traynor said the Association of Counties has surveyed county social service boards regarding budgeting after the 2007 legislation. He said counties reported that they will not be budgeting the $4.5 million in calendar year 2008 that was budgeted in calendar year 2007. He said the 2007 legislation requires counties to prefund a portion of the vacation and sick leave of the transferring employees, which has a projected cost of about $400,000 which will be included in the calendar year 2008 budget. He said the Department of Human Services informed counties that they can anticipate $1.1 million in foster care and subsidized adoption increases over budget instructions for calendar year 2007. He said health insurance premium increases for county social service agencies are expected to result in another $1 million in increased expenditures for 2008. He said approximately $2.5 million of the $4.5 million savings will result in offsetting property tax increases. He said without the savings from the regional child support enforcement transfer, these additional costs would be increased property taxes.

Mr. Traynor said information was requested on consolidation of county services. He said during the past 25 years, counties have taken the initiative to consolidate and share services in appropriate circumstances. He said examples of intercounty consolidation of services exist in the state for social service administration, correctional services, child protection investigation, software sharing and hosting, child care assistance eligibility, 911 dispatch services, public health services, respite care services, tax director services, in-home care services, county superintendent of schools, county state's attorney, and children's special health services. He said there are numerous examples of consolidations of services involving the county with cities and other political subdivisions. He said these sharing arrangements involve services for mandated drug and alcohol testing, special operations support, technology support, marriage license software, office supply purchasing, workers' compensation and safety, 911 implementation, and land record preservation. He also provided examples of counties with internal consolidations resulting in a net reduction from 1993 to 2007 of 75 full-time officials.

Mr. Traynor said a 1996 study was done at North Dakota State University entitled *Cost Savings From Consolidated North Dakota Counties* (Ag. Econ. Rept. No. 361). He said the conclusion of the researcher in the study was that consolidating counties is not the answer for reducing costs for county government services in North Dakota. He said the researcher stated that substantial cost-savings could be achieved for some services in some regions of North Dakota, but not for other services and regions. Mr. Traynor said counties have learned this lesson, as each county has worked within its borders and with neighboring counties to identify services that can be effectively consolidated in the county's circumstances.

Mr. Johnson said obstacles that must be overcome to promote consolidation of services include fears of loss of control and being forced to provide more services than county citizens would have wanted. He said another aspect limiting consolidation is in provisions of law that limit flexibility, such as in statutory provisions governing the possibility of sharing services of a state's attorney.

Mr. Traynor said the Association of Counties was requested to provide information on county budget and staffing trends. He said the association has compiled county audit data since 1991 and county staffing data since the early 1980s. He said information was drawn from these sources to provide responses. He said examination of county general fund expenditures over 20 years or more shows county expenditures adjusted for inflation have not significantly increased. He said this is despite dramatic construction inflation on highway costs. He said the production price index for road and street construction has been running at more than 300 percent of consumer price indexes for the last several years. He said county employment levels in most sectors have seen no growth or decline. He said in the area of public safety, local needs and federal grant funding have encouraged addition of law enforcement officers. He said examining welfare expenditures over the past 10 years shows growth in all counties, but the growth in the four largest population counties is at a rate almost three times that of the other counties. He said county staffing trends follow changes in demands on counties.

Representative Kasper asked if it would be possible to prepare a county-by-county comparison of taxable valuation and property tax levies over a period of years, similar to the information presented earlier by the League of Cities. Mr. Traynor said it should be possible to prepare information on a similar basis.

Mr. Traynor said information was requested to illustrate where in the state property tax capacity is exceeded by demands for services. He said property tax revenues are generally considered the appropriate source to support services that directly benefit property. He said road maintenance and construction, public safety, emergency management, fire protection, land records, and tax assessment functions have a link to property. He said with that link, the change in the value of property generally tracks with the level of services. He said property taxes used to support services not linked to property can create inequities and higher tax burdens for property owners. He said the most obvious example of this is county funding for social services. He said the easiest means of identifying counties with tax capacity problems is to look at the mill levy rate. He said counties with below average tax capacity include reservation counties and those with many miles of roads to maintain and counties faced with recent and repeated flooding and inundated land which raises costs and lowers property values.

Mr. Johnson said the Association of Counties was requested to attempt to identify mandates on county government. He said the Office of Management and Budget requested the association to prepare a report on state mandates on county government prior to the 2007 legislative session. He said the information from that report has been updated. He said the report identifies approximately $14 million in biennial impacts to county governments. He said these are recurring impacts that must be funded each biennium. He said a comparison with total county property taxes shows that these mandates have directly resulted in almost 4 percent of county property taxes levied.

Representative Bellew said district court facilities must be provided and funded by counties and this does not appear as one of the mandate costs in the report. Mr. Johnson said that is correct, and the information could have been included but was not included in the report.

Representative Froseth said he has heard complaints from residents of rural areas about the cost of transporting defendants to larger counties because judges do not want to hear cases in smaller courthouses. Mr. Johnson said those kind of concerns were expressed at the time the state took over funding district courts but protections for rural areas were later removed from the law.

Mr. Johnson said the Association of Counties was asked to provide information on the reports that North Dakota has a relatively high number of government employees compared to other states. He said government employment data is tracked by the United States Census Bureau. He said from available data it appears that county employment is approximately 7 percent of government employment in North Dakota. He said this compares to 33 percent for the state; 24 percent for schools; 12 percent for the federal government; 10 percent for cities; and 14 percent for townships, parks, and other political subdivisions. He said comparing government employment in North Dakota with other states indicates that state government employee positions per capita are substantially higher than the nationwide average while local government and county government employees per capita are below average nationwide.

Representative Bellew asked whether higher education employees are included in the state government employment data. Mr. Johnson said he believes classified higher education employees are included.

Representative Headland said some county employment has been taken over by the state and that is not reflected in the data. Mr. Johnson said that is correct and the association can try to analyze that for the next meeting.

Residency

Chairman Stenehjem called on committee counsel for a presentation of a memorandum entitled

Residency Issues Under North Dakota Law. Committee counsel said a portion of a study directed by 2007 Senate Bill No. 2032 calls for examination of improved collection and reporting of property tax information to identify residency of property owners with minimized administrative difficulty. He said the committee requested information on how residency is determined under North Dakota law and the feasibility of establishing a single definition of residency for all purposes. He said North Dakota law provides a general definition for determining residency which follows the general rule applied in the United States. He said in some instances, North Dakota law provides a more restrictive definition of residency within a limited subject matter area.

Committee counsel said residence, legal residence, and domicile are terms sometimes used interchangeably but which may have significantly different meanings in law. He said the general law in the United States is that domicile consists of two elements, which are residence and the intent to remain. He said North Dakota law and the North Dakota Supreme Court have recognized the same principles in determining residence. He said it is provided by statute that residence can be changed only by the union of act and intent, there can be only one residence, and a residence cannot be lost until another is gained.

Committee counsel said there are hundreds of North Dakota statutory and constitutional references to residence and domicile. He reviewed the statutory occurrences of various references and statutory provisions including specific residency requirements. He said determination of residence requires making a finding of fact regarding a person's intent. He reviewed the kinds of evidence that may be used to determine a person's intent regarding residence.

Committee counsel said an attempt to redefine residence or domicile for all purposes under North Dakota law would be extremely difficult and require consideration of hundreds of sections of law to avoid unintended consequences. He said because the committee's study directive requires only that the committee determine a means of identifying residency of property owners, focusing on that issue would probably be a more productive use of committee time.

Committee counsel said determination of residency requires a determination of a person's intent. He said determination of the fact question regarding intent is common for courts but not for county officials. He said information to be gathered regarding residency of property owners is for informational purposes only and the study directive calls for minimized administrative difficulty. He said under election laws, when questions arise about a person's residence for voting purposes, election officials may require the individual to sign an affidavit of residency. He said applicants for game and fish licenses may be required to submit an affidavit of residency. He said an affidavit must be executed under oath and witnessed by a notary public or other person authorized to administer oaths. He said a simpler method than requiring an affidavit might be to require property owners to return a written statement provided with property tax statements stating whether the property owner is or is not a resident of North Dakota. He said it appears that once this information is obtained for all property, it would only have to be requested when ownership changes.

Representative Wrangham said he would like to know whether other states collect this information and how they do it.

Senator Triplett said property ownership and a required statement of residency may cause special problems for members of the military. She said consideration should be given to whether there are any possible unintended effects for military personnel resulting from requiring a statement of residency from property owners.

Special Assessment Protests or Property Tax Referrals

Chairman Stenehjem called on committee counsel for a presentation of a memorandum entitled *Special Assessment Protests or Property Tax Levy Referrals*. Committee counsel reviewed the statutes allowing a protest of city improvements by special assessments and the incorporation of those provisions to govern county special assessments. He reviewed the requirements for approval of township special assessments.

Committee counsel said there is no statutory provision providing authority for referral of a budget or property tax levy by a taxing district. He said ordinances are subject to referral but it appears from court decisions that a tax levy is not considered an ordinance.

Committee counsel said if statutory provisions were to be created to allow referendum of property tax levies and budgets, the provisions of current law regarding budget deadlines would probably need to be adjusted.

Senator Cook said he recalls a law requiring an audit if a special assessment project final costs are more than the engineer's estimate by a certain percentage. He said the State Auditor should be requested to describe any audits performed because of this requirement.

Tax Department

Chairman Stenehjem called on Ms. Marcy Dickerson, State Supervisor of Assessments, Tax Department, for presentation of information in response to several committee requests. A copy of Ms. Dickerson's prepared testimony is attached as Appendix N.

Ms. Dickerson said it was requested that information be provided for residential, commercial, and agricultural property in each county to show the percentage of true and full value paid in annual property taxes. She said this information is also called the effective tax rate and that information is provided on Appendix A attached to her testimony. She said for 2006 the effective tax rate for residential property statewide is 1.95 percent. She said the effective tax rate for commercial property is 2.21 percent. She said the effective tax rate for agricultural property based on its valuation for property tax purposes is 1.6 percent but if market value is used, the effective tax rate for agricultural land is .83 percent.

Ms. Dickerson said she was requested to provide information on when agricultural property classification changes to another property classification because of a change of use of the property. She said the question directed attention to recreational or hunting use of agricultural land and asked for information on whether other states have developed a workable method of changing assessment status of property used primarily for recreational or hunting purposes.

Ms. Dickerson reviewed the statutory provision defining agricultural property under NDCC Section 57-02-01. Ms. Dickerson said the definition of agricultural property is not subject to interpretation. She said property used to raise agricultural crops or graze farm animals is agricultural property and the property continues to be assessed as agricultural property until put to a use other than raising agricultural crops or grazing farm animals. She said the statutory provision lists seven factors for consideration and when any four or more of the conditions exist the property ceases to be agricultural property. She said the statutory provision does not include any language about primary use of property or measurement of use. She said as long as the parcel is being used to raise agricultural crops or graze farm animals and four of the specified conditions do not exist the parcel is assessed as agricultural land. She said it does not matter if the parcel is being used largely or primarily for some other purpose. She said if a parcel is being used exclusively for some purpose other than raising crops or grazing farm animals, that parcel does not qualify as agricultural land.

Ms. Dickerson said in considering laws in other states, the most common criterion for classification as agricultural land appears to be the primary use of the land. She said primary use of land is measured in other states by consideration of revenue produced. She said it may be assumed if the primary use of CRP land is recreational and the recreational use generates more revenue than CRP payments, that land will lose agricultural status in some states.

Ms. Dickerson said she gathered information from nine states regarding treatment of agricultural land for assessment purposes. She said all of the states assess CRP land as agricultural land. She said all of the states have various size, use, or income requirements that land must meet to remain classified as agricultural. She said none of the nine states indicate any special provisions regarding land used for hunting except South Dakota, and the South Dakota law relates to a state-owned public shooting area or a state-owned game production area.

Ms. Dickerson said Arizona law requires primary use as agricultural land and that the land must have been in active production for at least 7 of the prior 10 years to qualify as agricultural property. She said Arizona also requires a reasonable expectation of the agricultural operation generating an operating profit. She said Idaho requires land to be actively devoted to agriculture and CRP status is defined as actively devoted to agriculture. She said Minnesota defines agricultural land as used for raising or cultivation of agricultural products or enrollment in a state or federal program. She said if a parcel in Minnesota is used for both agricultural and commercial purposes, the assessor classifies part of the property in each of those classifications. She said Montana law provides that property is agricultural if the owner or operator markets not less than $1,500 in agricultural products from the land and CRP payments are considered marketing agricultural products. She said Nebraska law provides that land zoned predominately for other than agricultural or horticultural use is not to be assessed as agricultural or horticultural land. She said New Mexico law provides a presumption that land is not used for agricultural purposes if income from nonagricultural use of the land exceeds the income from agricultural use of the land. She said South Dakota requires agricultural land to meet two of three criteria, which are that at least one-third of the total family gross income of the owner must come from pursuit of agriculture, principal use of the land must be devoted to agricultural purposes, and the parcel must consist of at least 20 acres of unplatted land or contiguous ownership of not less than 80 acres of unplatted land. She said the same acreage requirements apply to platted land but the board of county commissioners may increase the minimum acreage requirement to 160 acres. She said Wyoming law requires use of property to be for the primary purpose of obtaining a monetary profit as agricultural or horticultural land. She said Wyoming provides that CRP land remains classified as agricultural property throughout the duration of the CRP contract.

Ms. Dickerson said she was requested to provide information showing the property tax capacity of counties and tax revenue from other sources for counties. She said property tax capacity is determined by dividing 2006 taxable value for the county by the estimated 2006 population. She said the property tax capacity as calculated is shown on Attachment B of her prepared testimony. She said taxable valuation per capita ranges from $7,274 in Slope County to $480 in Sioux County and the median taxable valuation is $3,416 in Nelson County. She reviewed the information in her testimony relating to county revenue receipts from coal severance taxes, coal conversion facilities privilege taxes, transmission line taxes, rural electric cooperative taxes, telecommunications carriers taxes, and oil and gas gross production taxes. She said counties also receive allocations of sales taxes through the state aid distribution fund and other state appropriations and allocations.

Ms. Dickerson said she was requested to provide information on how property is assessed, how the equalization and abatement processes function, and how the sales ratio study is used in property assessments. She said assessments are made by the appropriate assessment official and assessments are approved or modified by township and city boards of equalization. She said county boards of equalization are responsible for equalization among townships and cities. She said the State Board of Equalization is responsible for equalization among all counties.

Ms. Dickerson said a taxpayer dissatisfied with a property assessment may choose between an informal or formal appeal process to challenge the assessment. In the informal process the taxpayer first contacts the local assessor and then appeals to the township or city board of equalization and may subsequently carry the appeal to the county board of equalization and the State Board of Equalization. She said in the formal appeal process a taxpayer may file an application for abatement with the county auditor. The county auditor forwards the application to the township or city, which forwards it to the county board of equalization. If the taxpayer is not satisfied with the decision of the county board of equalization, the taxpayer may appeal to the district court.

In response to a question from Representative Kasper, Ms. Dickerson said under the informal appeal process, once the decision has been made by the State Board of Equalization it is not subject to appeal to a court. She said under the formal procedure, the decision at the county level may be appealed to the district court and subsequently to the Supreme Court.

Ms. Dickerson said the sales ratio study is conducted through the Property Tax Division of the Tax Department. She said the study examines annual sales of property in all 53 counties and the 13 major cities. The study collects data to determine prices at which properties have sold in the prior year and those sales prices are compared to the true and full value as placed on property by assessors for that year. She said each county or major city is required to submit 30 usable sales for each class of property or 10 percent of the total number of properties of a class within the county or city. She said if an insufficient number of sales took place in the prior year, the county or city must submit sales from up to three earlier years. She said if there are still an insufficient number of sales, the county or city must submit current year appraisals. She said the Property Tax Division periodically provides updated information to assessment officials for use in valuing properties. When counties have submitted annual abstracts of assessment, the Property Tax Division calculates the ratio of true and full value of current year assessments to prior year sales prices. This ratio is used by the State Board of Equalization in determining whether county assessments are properly tracking market value and agricultural land value. She said the State Board of Equalization has adopted a policy to allow plus or minus 5 percent tolerance for agricultural, residential, and commercial assessments.

Senator Cook asked where the information is obtained on the prices of sale of property for the prior year. Ms. Dickerson said state law requires that the consideration paid for a property transfer must be included on the deed filed with the county recorder or on a separate statement filed with the State Board of Equalization. Senator Cook asked how reliable the statements on deeds or filed with the board are for valuation purposes. Ms. Dickerson said for the most part, the information provided is accurate and she said the information provided is subject to review. In response to a question from Senator Cook, Ms. Dickerson said a 2005 bill would have required sharing of sales ratio study information with appraisers and realtors, but the bill failed.

Representative Herbel asked if there is a penalty that applies for lying about the consideration on a deed or a statement filed with the State Board of Equalization. Ms. Dickerson said there is a penalty for a person who falsifies consideration received or falsely certifies that a report has been filed with the State Board of Equalization. She said the penalty imposed is a Class B misdemeanor.

Committee counsel said use of sales ratio study comparisons was raised because committee members have heard reports that a single sale of property in a small community can result in an increase in the market value of all property in the community. He asked whether this is a correct understanding of how the sales ratio study works. Ms. Dickerson said one sale of property would not be a sufficient basis for changing the market value of all property in a community.

Ms. Dickerson said she was requested to provide information on property taxes levied on various classes of property to illustrate any shift of tax burden among property classes. She said Attachment K to her prepared testimony shows property taxes levied for various classes of property from 1983 through 2006.

Senator Cook said the most significant change shown on the schedule appears to be a shift of tax burden from agricultural property to residential property. He asked what factors contribute to this shift. Ms. Dickerson said the increase in taxes on residential property is primarily attributable to two factors, which include a greater amount of new residential property and increased market value of existing residential property. She said there has been no increase in the amount of agricultural land and the valuation of agricultural property for assessment purposes is not based on market value but on productivity. Senator Cook said the information on Attachment A indicates that the market value of agricultural land is significantly more than the productivity value used for assessment purposes. He said the data provided indicates that market value is closer to the productivity formula value for agricultural land in some counties. He asked why there is an apparent difference. Ms. Dickerson said many factors may be involved and part of the difference may be related to the makeup of property in the county. She said city growth may affect market value of agricultural property upwards in some counties. She said in some counties poor agricultural land may be in demand for hunting, which would increase market value. She said demand for agricultural property in certain areas would affect market value but not agricultural value under the formula.

Ms. Dickerson said she was requested to provide information on use of detailed soil surveys for valuing agricultural property. She said since the Taxation Committee meeting on July 18, the Association of Counties has conducted a survey regarding use of soil surveys and has received 32 responses from the 53 counties. She said of the counties responding, 15 reported they are in compliance with use of soil surveys, 8 counties reported they are working on becoming compliant, and 9 counties reported they are not in compliance.

Ms. Dickerson said at the beginning of August, the Tax Department sent requests to all counties to provide documents for review to determine what each county needs to do to become compliant with the requirements of 2007 House Bill No. 1303. She said the Tax Department requested counties to provide initial responses and valuation schedules by October 1, 2007. She said the Tax Department is working with the Association of Counties, assessment officials, and state geographic information system personnel to assist counties in implementing 2007 House Bill No. 1303. She said some counties are experiencing problems.

Senator Urlacher said the prepared testimony shows Stark County as reporting being in compliance with soil surveys, but Stark County is also listed as one of the counties not in compliance. Ms. Dickerson said there is an obvious error and she will check to determine which category Stark County should be under.

Senator Cook said 2007 House Bill No. 1303 contains provisions for reports to the interim Taxation Committee by noncomplying counties of the reasons for noncompliance. He said it will be necessary to determine the counties that are not in compliance. He said at the July committee meeting it was reported that 18 counties are not in compliance. He asked whether the number of noncomplying counties is growing. Ms. Dickerson said the actual number has not been determined and the Tax Department and Association of Counties are working to determine which counties are in compliance.

Committee counsel said it would be useful to receive a report from a county that is in compliance with use of soil surveys regarding how that county achieved compliance and what approximate costs were involved. Ms. Dickerson said she does not know at this point which counties are the most recent in implementing use of detailed soil surveys. She said when the review of status of counties is completed, it would be possible to receive information from complying counties.

Senator Urlacher said he understands that software is available from vendors for implementing detailed soil surveys. Ms. Dickerson said she believes several vendors have software available at different prices for implementing use of detailed soil surveys in assessments.

Senator Stenehjem said the data provided indicates there may be a shift in property tax burden from agricultural to residential property. He asked whether there is a true shift in property tax burden for those properties. Ms. Dickerson said the property tax per acre for agricultural land has not changed much since 1981. She said there has been a substantial increase in taxes on residential property during that time.

Senator Urlacher said the agricultural property valuation formula has been adjusted since 1981 by including use of production expenses. Ms. Dickerson said that is correct and the formula is based on agricultural market conditions so it should not be expected that agricultural valuations under the formula would keep pace with residential property market valuations.

Representative Herbel said part of the difference in taxload for agricultural and residential property is the addition of new residential property. He asked whether it is possible to identify how much of the residential property tax burden increase is attributable to new property. Ms. Dickerson said it might be possible to obtain information on the value of new residential and commercial property by county.

Senator Cook asked whether, if agricultural land was assessed at 75 percent of market value, agricultural property would bear a greater share of the taxload. Ms. Dickerson said that would shift a greater share of the taxload to agricultural property but perhaps not as much as one might think because other factors are involved in determining the tax bill for a parcel of property. Senator Cook said the committee needs to develop a better understanding of why agricultural property market value is so much less in some counties than in other counties.

Representative Shirley Meyer, District 36, asked whether there is any CRP land that has lost agricultural status because of use for other purposes. Ms. Dickerson said she is not aware of any property in CRP that has lost agricultural status.

Ms. Dickerson distributed copies of materials developed by the Tax Department to provide for review of agricultural land valuation procedures and use of detailed soil surveys. She described how the use of soil surveys by counties will be reported and evaluated. A copy of the information is attached as Appendix O.

INCOME TAX STUDY

Chairman Stenehjem called on Ms. Kathryn Strombeck, Research Analyst, Tax Department, for presentation of testimony on individual income tax statistics. A copy of Ms. Strombeck's prepared testimony is attached as Appendix P.

Ms. Strombeck said she was requested to provide information comparing Form ND-1 and Form ND-2 income tax liability under the study of the feasibility of eliminating Form ND-2.

Ms. Strombeck said until 1980 there was only one individual income tax filing method in North Dakota. The income tax return had many of the same deductions and credits currently available on Form ND-2. The rates ranged from 1 percent to 7.5 percent on taxable income over $30,000. Those rates placed North Dakota in the middle of the pack among states with broad-based income taxes.

Ms. Strombeck said in 1980 an initiated measure created an energy cost relief credit of $100 for all individual income tax filers. She said 1981 legislation provided additional income tax relief by creating the optional "short form" tax return. The preexisting return then became known as the "long form." She said since that time North Dakota has had optional filing under either of the two income tax return methods. The tax computed on the "short form" was significantly less than the tax computed on the "long form" and for the great majority of taxpayers it continues to be more advantageous to file Form ND-1 than to file on the higher rate return Form ND-2.

Ms. Strombeck said North Dakota currently has two income tax systems but both are essentially "long forms." She said both forms start with federal taxable income and have several deductions and credits in common. She said there are differences in deductions and credits available on the two forms and they have vastly different tax rates. She said the tax rates on Form ND-1 continue to be among the lowest in the nation. She said the rates on Form ND-2 are at the high end when compared to tax rates around the country. She said another significant difference is that Form ND-1 may be e-filed and is supported by electronic filing vendors but Form ND-2 is not.

Ms. Strombeck said two tables attached to her testimony show all individual income tax deductions and credits available in 2005. She said the column shows those available on Form ND-1 and Form ND-2 and under the column for Form ND-2 appears a number in parenthesis that is the number of returns on which the deduction or credit was claimed. She said for tax year 2005, 2 percent of income tax returns were filed on Form ND-2 and those returns paid only four-tenths of 1 percent of total income tax liabilities for the tax year. She said the deductions and credits available on Form ND-2 are the only things that made Form ND-2 a viable option for the few taxpayers who file that return. She said the most significant deductions and credits for Form ND-2 are the deductions for medical expenses not allowed on the federal income tax return, the federal income tax deduction, and the long-term care credit. She said generally it takes at least two deductions or credits available on Form ND-2 to make filing on that form work for a taxpayer.

Ms. Strombeck said sampling of returns indicates that the average savings for the typical Form ND-2 filer over what the filer's liability would be on Form ND-1 is approximately $25. She said it appears there is generally a tax preparation cost involved in filing Form ND-2. She said of approximately 6,500 Form ND-2 returns processed this year, only 233 of them were prepared by the taxpayers themselves. She said the rest of those returns were filed with preparation by tax practitioners. She said costs associated with dual-return preparation by tax practitioners offset some of the savings to the taxpayer.

Ms. Strombeck said the committee requested information on the fiscal impact of moving all Form ND-2 deductions and credits to Form ND-1. She said the table attached to her testimony shows estimated biennial fiscal impact for each deduction and credit if it was allowed on Form ND-1 and the total estimated biennial fiscal impact of moving all deductions and credits from Form ND-2 to Form ND-1 would be approximately $99 million to $117 million.

Ms. Strombeck said the committee also requested estimated rate deductions needed on Form ND-1 so that if Form ND-2 were eliminated no taxpayer would pay more taxes. She said there are approximately 1,000 Form ND-2 filers with zero net tax liability. She said this means to avoid increasing taxes for any taxpayer would require reducing the tax rate for the lowest income bracket on Form ND-1 to zero. She said it does not appear practical to reduce the Form ND-1 rate to zero and an alternative may be to repeal the optional Form ND-2 and provide a tax credit to filers on Form ND-1 who had filed Form ND-2 in the previous year. She said it could probably not be structured to be revenue-neutral for every taxpayer but could offer some benefit to previous Form ND-2 filers and provide a predetermined and limited overall fiscal effect.

Representative Belter asked if the proposed initiated measure approved for circulation would affect only the rates on Form ND-1. Ms. Strombeck said that is correct. Representative Belter said if the initiated measure were approved, it would probably eliminate use of Form ND-2. Ms. Strombeck said that is correct.

In response to a question from Representative Drovdal, Ms. Strombeck said approximately two-thirds of Form ND-2 filings are by nonresidents.

Senator Stenehjem asked whether cost-savings would result for the Tax Department by eliminating use of Form ND-2. Mr. Cory Fong, Tax Commissioner, said when consideration was given to eliminating Form ND-2 in 2005, it was estimated that savings to the Tax Department would be about $25,000. He said the Tax Department will have to reconsider the estimate.

Representative Drovdal said for most taxpayers, he would think use of professional tax preparers is generally for federal return purposes and not specifically for state returns. Ms. Strombeck said that is correct.

Representative Kasper asked if there is a profile of a typical Form ND-2 filer. Ms. Strombeck said the most common factors would be that the person would be a nonresident with a large federal income tax liability and unused medical deductions carried over from the federal return.

Senator Stenehjem asked how much revenue gain would result for the state if Form ND-2 were eliminated. Ms. Strombeck said revenue gain to the state would be approximately $153,000, which is an average of about $25 per filer.

COMMITTEE DISCUSSION

Senator Urlacher said one aspect of tax fairness is to examine the total tax burden for an individual under the three major tax types. He said tax fairness might be provided by equalizing burdens among tax types. He asked whether information is available that would allow consideration of tax burdens per individual under different circumstances. Committee counsel said information on tax burden comparisons is provided by several sources on a national basis. He said one of the most useful and credible comparisons is provided by a study done by the city of Washington, D.C. He said that study and others that provide useful comparisons could be reviewed for the next committee meeting.

Representative Kasper said the League of Cities provided good information on taxes in cities. He said the Association of Counties will try to put similar information together for counties. He said it would also be useful if the same information was provided for school districts and perhaps park districts. Representative Kasper said it would also be useful if an attempt is made to determine the characteristics of an average North Dakota resident for purposes of tax burden comparisons.

Representative Herbel said the committee will have to consider the cap on oil and gas gross production tax allocation to counties. He said the question is how to approach consideration of that issue for the next meeting. Senator Urlacher said consideration should be given to adding an escalator to the caps. He said the committee should look at whether there is an appropriate escalator based on changes in road maintenance costs.

Senator Stenehjem said there are unmet needs for roads all across the state. He said the question is how fair funding assistance can be provided for all political subdivisions. He said the League of Cities and Association of Counties should consider this issue. Senator Stenehjem said for the next committee meeting, information should be presented to illustrate allocation of funds for political subdivision road purposes from federal sources, fuels taxes, registration fees, and other sources.

Representative Belter said it might be appropriate at this time to ask the Association of Oil and Gas Producing Counties to bring forward a plan for changes in the gross production tax allocation formula.

Representative Meyer said she does not think the committee can understand the impact being felt in the oil exploration area without seeing it firsthand. She said some counties are experiencing serious negative impact with little or no production revenue.

Senator Urlacher said it must be remembered that the oil impact fund allocations are an important component of addressing needs of oil exploration and production impacts. He said impact grants fill the gaps that exist in allocations if impact grants are adequately funded.

Representative Froseth said he would also like the Association of Oil and Gas Producing Counties to bring forward a plan for how the Legislative Assembly should address allocation of gross production tax revenues. He said consideration should also be given to impact of ethanol production and other energy industries on roads for future funding assistance. He said the committee should move forward with the elimination of income tax Form ND-2.

Senator Stenehjem said there can be significant road impacts where ethanol and biodiesel production facilities are located depending on factors, such as capacity of a facility, truck traffic, and hauling routes.

Representative Headland said he would like to obtain an estimate of what income tax rates on Form ND-2 would be revenue-neutral, in consideration of the revenue gain by eliminating Form ND-2.

Senator Stenehjem said information should be provided on a per county basis showing the production of oil and gas subject to tax, how much tax is collected, and where the tax revenue goes.

Representative Drovdal said another aspect for consideration under the oil and gas tax allocation is that 35 percent of the county share goes to school districts. He said school districts in the area say they will get no benefit because that allocation is imputed in the education funding formula. He said information should be provided on how allocations to school districts are treated for education funding purposes.

Senator Cook said he recently participated in a National Conference of State Legislatures session on property taxes. He said it became apparent during the discussion that other states struggle with similar issues to those being considered by this committee. He said there were areas mentioned by counties in which provisions of law limit flexibility and consolidation opportunities. He said more detailed information should be provided on each of the topics mentioned regarding the restrictions of statutory provisions for the tax director, state's attorney, and other officers.

Senator Cook said consideration might be given to whether assessments should remain under local control or whether the state should provide for statewide assessments of property. He said other states provide statewide assessment services for uniformity. He said another issue he thinks should be considered is whether political subdivisions should report their indebtedness levels to some state office to serve as a central information source. He said he continues to be concerned with the shifting of property tax burdens from agricultural property to residential property.

Representative Froseth asked whether the Legislative Assembly ever provided funding to counties for implementation of soil survey use in assessments. Senator Urlacher said he does not recall a specific appropriation being provided. Chairman Stenehjem asked committee counsel to look into whether a legislative appropriation was provided to implement use of soil surveys.

In response to a question from Senator Urlacher, Mr. Fong said the Tax Department could provide a mockup of a redesigned income tax return if Form ND-2 is eliminated.

Representative Headland said he would like an estimate of the resulting Form ND-1 tax rates and the fiscal effect if the rates are cut by 10 percent.

Representative Drovdal said the committee should retain consideration of simply eliminating Form ND-2 and retaining Form ND-1 in its current status.

Committee members discussed the possibility of an analysis of the proposed initiated measure being circulated. Senator Cook said it might be best if the committee holds off on discussion of the issue until the petition is filed so the discussion does not interfere with the signature process.

Representative Bellew said the property tax burden is still the No. 1 issue he hears complaints from constituents about. He said the committee should not forget the importance of this issue to taxpayers.

It was moved by Senator Cook, seconded by Representative Belter, and carried on a voice vote that the meeting be adjourned subject to the call of the chairman. Chairman Stenehjem adjourned the meeting at 4:40 p.m.

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John Walstad
Code Revisor

ATTACH:16