

NORTH DAKOTA LEGISLATIVE MANAGEMENT

Minutes of the

TAXATION COMMITTEE

Tuesday, August 2, 2011
Harvest Room, State Capitol
Bismarck, North Dakota

Senator David Hogue, Chairman, called the meeting to order at 9:00 a.m.

Members present: Senators David Hogue, Randy Burckhard, Dwight Cook, Jim Dotzenrod, Dave Oehlke, Ronald Sorvaag; Representatives Craig Headland, Larry Bellew, Wesley R. Belter, David Drovdal, Glen Froseth, Lyle Hanson, Patrick Hatlestad, Richard Holman, Jim Kasper, Shirley Meyer, Marvin E. Nelson, Mark S. Owens, Roscoe Streyle

Members absent: Senator Lonnie J. Laffen; Representative Mike Nathe

Others present: See [Appendix A](#)

Committee counsel reviewed the [Supplementary Rules of Operation and Procedure of the North Dakota Legislative Management](#) for the 2011-12 interim.

PROPERTY TAX STUDY

Chairman Hogue called on committee counsel for presentation of a memorandum entitled [Property Tax Reform and Relief - Background Memorandum](#).

Committee counsel said a 2009 amendment will reduce the minimum capitalization rate to 7.4 percent for 2011, and there will be no minimum capitalization rate after 2011. He said the capitalization rate is expected to decline in the near term, and a declining capitalization rate tends to increase true and full value of agricultural property.

Committee counsel said in taxable year 2010, political subdivisions levied almost \$814 million in property taxes and special taxes. He said the constitutional one-mill levy for the State Medical Center was levied in the amount of \$2.3 million, bringing total property taxes and special taxes in the state to more than \$816 million in 2010.

Committee counsel said state funding to political subdivisions has increased relative to property taxes after the 2009 and 2011 legislative sessions. The memorandum contains an appendix showing major state appropriations and revenue allocations for direct assistance to political subdivisions from the 2001-03 through 2011-13 bienniums.

Committee counsel reviewed the provisions of 2007 property tax relief legislation provided through an income tax credit. He said the income tax credit approach had administrative difficulties. He said 2009 and 2011 property tax relief legislation was based on funding from the state to reduce up to 75 mills in

school district property tax levies and replacement of the revenue to school districts through mill levy reduction grants from the state.

Committee counsel said the study directive requires examination of whether property is subject to property taxes exceeding 1.5 percent of the true and full value of the property. He said during the proceeding interim, it was determined that agricultural and residential property are below that benchmark, but it will be necessary to reexamine the effective tax rate for the four classifications of property. He said studies involving property tax issues are being conducted by the Education Funding and Taxation Committee and the Property Tax Measure Review Committee.

Chairman Hogue said the property tax study will be one of the committee's biggest tasks. He said it will be necessary to examine the level of relief provided and determine whether the state will be able to sustain property tax relief levels going forward.

Representative Kasper said residential property is at more than 1.5 percent of true and full value in Fargo. Committee counsel said the information obtained during the previous interim was based on statewide statistics, and there are areas in the state where taxes against property exceed 1.5 percent of true and full value.

Representative Froseth said information should be obtained for all four property classifications to determine property taxes as a percentage of true and full value.

Senator Cook said the \$814 million in property taxes and special taxes may include special assessments. He said information should be obtained to show total property taxes, special assessments, in lieu taxes, and special taxes that apply to property.

Representative Bellew said it would be useful to obtain information on the percentage of property taxes compared to true and full value for each county. He said it would be useful to obtain the information requested by Senator Cook for each county.

Representative Headland said consideration should be given to the effect on property taxes of home rule for cities and counties. He said the question would be whether property tax increases at a faster rate under home rule.

Representative Kasper said the homestead tax credit should be monitored. He said information should be obtained on usage and cost by county for the homestead tax credit.

Representative Streyle said an important part of the committee study will be to consider where the state will be in future years for property tax relief funding. Committee counsel said information can be requested on the estimated cost of providing property tax relief for the 2013-15 biennium on the same basis as the 2011 legislation.

Representative Kasper said a lingering issue in property tax relief that is mentioned in the study is determining residency of property owners. He said information should be provided on ways to determine residency of owners.

Representative Bellew said the state provides funding for the veterans' homestead credit, and the same information should be provided for that credit as was requested for the homestead credit.

Senator Cook said another component of the study directive is examining variability of funding resources among taxing districts. He said information should be obtained to examine the sales tax base of home rule cities and counties on a per capita basis.

Representative Kasper said legislation has been considered that would eliminate property tax exemptions for nonprofit entities. He said information should be obtained on valuations and loss of property tax revenue for nonprofit entities' property. Senator Cook said information should be reviewed for all exempt property.

Representative Meyer said information should be obtained to determine nonresident mineral royalty owners.

SPECIAL ASSESSMENTS STUDIES

Chairman Hogue called on committee counsel for presentation of a memorandum entitled [Special Assessments - Background Memorandum](#). Committee counsel said two study directives were assigned to the Taxation Committee relating to the study of special assessments. He said a single background memorandum was prepared because the study directives are very similar, except for a portion of each study directive which focuses on aspects within the study. He said 2011 Senate Bill No. 2356 includes language directing examination of possible processes and procedures to transition to alternative funding mechanisms. He said 2011 House Bill No. 1322 places emphasis on imposition and relative rate of special assessments against agricultural property and agricultural property tax issues within and near city boundaries.

Committee counsel reviewed statutory provisions governing imposition of special assessments. He said property owners are allowed the option of protesting a special assessment project. He said a successful protest requires filing of written protests against the resolution of necessity containing names of owners of a majority of the area of property within the improvement district. He said 2001 legislation was considered but not enacted which would have excluded political subdivision property from consideration in the property from which protests must

come. He said 2011 legislation would have changed the protest requirement from a majority of the property in the district to a requirement of protest by owners of property that will be subject to a majority of the proposed costs of the project.

Committee counsel said assessment of benefits of a special assessment project to property owners usually is done by appointment of a special assessment commission, which determines parcels of property that will be especially benefited by the improvement and the amount in which each parcel will be benefited. He said an alternative method of assessment is assessing benefits of a per square-foot basis with consideration of the distance of the property from the marginal line of the public way or area improved. He said property owners are allowed an opportunity to protest assessments against their parcels of property.

Committee counsel said Supreme Court decisions have concluded that it is not the province of the court to substitute its judgment for that of the commission making special assessments. He said enactment of 2011 House Bill No. 1322 provided that if an action challenges the determination of benefits and special assessments for agricultural property, the decision of the special assessment commission regarding agricultural property is not entitled to deference by the court and the court shall consider determination of benefits and special assessments for agricultural property de novo.

Committee counsel said with respect to agricultural property tax issues for agricultural property within and near city boundaries, there is no statutory effect on agricultural property assessment from being located within or near city boundaries. He said there are several factors listed in statute for consideration of the status of property as agricultural. He said some of these factors may be affected by location of property in or near a city. He said for assessment purposes, none of the valuation factors in the formula or modifiers that may be used to adjust assessments has any relation to proximity to a city.

Representative Bellew asked whether special assessments are imposed by ordinance or resolution. Committee counsel said he will examine statutory provisions and provide information. In response to a question from Representative Bellew, committee counsel said an ordinance is generally subject to referral, while a resolution is not.

Representative Owens said he believes there are key issues on which the committee must obtain information for the study of special assessments. He said the issues are determination of how many states use special assessments and how many states require or allow alternative funding methods. He said information should be obtained on alternative funding methods to allow determination of whether transition to alternative funding methods requires special provisions.

Senator Cook said information should be provided on optional ways of assessing benefits and why there

are two methods. He said information should also be provided on options other than special assessments for improvement projects.

Senator Cook said major flood disasters in North Dakota raise several questions regarding the use of special assessments. He said consideration should be given to whether it is possible to special assess costs of dikes to protect property and if those assessments would be subject to challenge. He said there may be problems with establishing a special assessment district after the costs have been incurred.

Senator Cook said another flood-related issue is the extent of property tax abatements to be considered for flooded properties and how those abatements might impact revenues of affected political subdivisions or impact other taxpayers.

Representative Kasper said consideration should be given to home rule authority versus special assessment laws. He said consideration should be given to what can be done under home rule authority that differs from state laws on property taxes and special assessments. He said he also is concerned with the use of a building authority to construct public buildings and avoid voter approval of a bond issue. He said property taxes or special assessments might be used to pay the bill to a building authority for lease of a facility. He said information should be provided to the committee on the use of building authorities.

Senator Sorvaag said a comparison should be provided to the committee on the cost of residential property constructed with the use of special assessments for improvements versus the cost if paid by the developer.

Representative Meyer said agricultural land has been subjected to special assessments in some areas. She said information should be obtained on whether this is happening in all parts of the state.

INCOME TAX STUDIES

Chairman Hogue called on committee counsel for presentation of a memorandum entitled [Income Tax Credit Study - Background Memorandum](#) and a memorandum entitled [Corporate Income Tax Study - Background Memorandum](#).

Committee counsel said the Legislative Management assigned two income tax studies to the Taxation Committee. He said 2011 Senate Bill No. 2006 directs the study of income tax credits under individual and corporate income taxes. He said 2011 House Bill No. 1047 directs the study of financial institutions taxes and corporate income taxes. He said the Legislative Management approved this study but amended it to eliminate consideration of financial institutions taxes. He said separate memorandums were prepared to address individual income taxes and corporate income taxes. He said the individual income tax credit study is limited to tax credits, and the corporate income tax study covers all aspects of corporate income taxes.

Chairman Hogue called on Mr. Joe Becker, Tax Department, for background information on income tax credits. Mr. Becker distributed to the committee copies of charts providing information on individual and corporate income tax credits ([Appendix B](#)). He said the charts also provide information on financial institution tax credits and a summary of each credit. He said the credits are listed in the chronological order of enactment. He said the first three charts show the fiscal effect of income tax credits for the 2006 through 2009 tax years. He said for each tax year the number of claimants and amount or value of the credits is listed. He said in some cases the number of claimants is too few to report the information, to protect confidentiality of taxpayer information. He said Chart 4 of the material distributed is a summary of tax credit provisions, and these credits are shown in alphabetical order.

Chairman Hogue said angel fund income tax credits were made transferable by 2011 legislation, and the responsibility to receive a report from the Tax Commissioner on the transfer of those credits was assigned to the Taxation Committee. He asked when that information would be available for delivery to the committee. Mr. Becker said he is not certain at this time but the transfer provisions were limited to 2011 or 2012 tax years, so it may be some time before the report is available.

Chairman Hogue called on Ms. Mary Loftsgard, Assistant Director of Tax Administration, Tax Department, for information on corporate income taxes. Ms. Loftsgard said angel fund credit transfers and administration are being considered by Tax Department staff. She said the staff is working out how reporting of transfers will be administered.

Ms. Loftsgard distributed copies of an outline on corporation income tax issues ([Appendix C](#)).

Ms. Loftsgard reviewed the information distributed to the committee. She said apportionment of income for corporations that conduct business in multiple states or countries is subject to an equally weighted three-factor apportionment formula in North Dakota. She said the equal weighting of the formula is based on the original provisions of the Uniform Division of Income for Tax Purposes Act. She said equal weighting of apportionment factors has been changed in several states to favor existing businesses or encourage location of new businesses in the state.

Senator Hogue said it appears apportionment factors for a corporation doing business among states will change as a corporation changes location of business activity to new states. He asked if oil company apportionment factors will increase as their presence in North Dakota grows. Ms. Loftsgard said she will look into that and provide information to the committee.

Representative Nelson inquired about the property factor of the apportionment formula and whether it is limited to real property or if it also includes intellectual property. Ms. Loftsgard said intangibles such as intellectual property are not included. She said the

property factor is based on tangible personal property without depreciation.

Senator Cook said the Uniform Division of Income for Tax Purposes Act was adopted in 1965. He asked how many states still use equal weighting of the three apportionment factors. Ms. Loftsgard said only three states still use equal weighting among the three factors. Senator Cook said it appears the trend is for states to change the weight of factors. Ms. Loftsgard said that is correct, and some states use higher weighting on sales and some use only the sales factor. Senator Cook said apportionment factors used by neighboring states are of concern to North Dakota because they affect North Dakota citizens. Senator Hogue requested Ms. Loftsgard to provide information to the committee on apportionment factors used in neighboring states.

Representative Headland said it appears to be a business decision whether to do business in another state. In response to a question from Representative Headland, Ms. Loftsgard said no deduction is allowed for corporate income taxes paid to another state.

Senator Cook said he believes in the most recent legislative session the Tax Department provided information on corporate income taxes paid based on corporations with apportionment factors of one, one-half, and less than one-half and determination of an average overall apportionment factor. He requested that information be reviewed for the committee's benefit. He said it appears other states have moved to combined reporting for corporate income tax. Ms. Loftsgard said that is true. Senator Cook said Congress is considering the Business Activity Tax Simplification Act of 2011, which would change nexus requirements so that physical presence of a corporation in a state is required before the business is taxable by that state.

Mr. Cory Fong, Commissioner, Tax Department, said the Business Activity Tax Simplification Act of 2011 legislation is being monitored by the Tax Department, and if it is enacted North Dakota will have to make some changes in law. He said he believes states' rights are a major issue in the federal legislation. He said the Tax Department can provide a report and discussion on the implementations of the Business Activity Tax Simplification Act of 2011 legislation at a future meeting. Chairman Hogue asked that the Tax Department provide that information.

Representative Drovdal requested information for the committee showing the number of filers whose highest income falls within each bracket for corporate and individual income taxes plus the number of individuals and corporations that have no tax liability or are not required to file returns.

Committee counsel said part of the committee study directive asks for determination of the effectiveness of each income tax credit. He asked if Mr. Fong can suggest how to make that determination. He said that determination will be very

difficult. He said perhaps the staff at the Department of Commerce would be a good source of information.

Representative Kasper said along those lines a request should also be made for analysis by the Department of Commerce of the effectiveness of local business development tax credit under income and property taxes. He said information should be obtained on how much tax revenue is given away and what measurable benefit has been received.

SALES TAX EXEMPTION STUDIES

Chairman Hogue called on Mr. Blane Braunberger, Compliance Supervisor, Sales and Special Taxes, Tax Department, for information on the sales tax exemption studies assigned to the committee. Mr. Braunberger distributed a copy of information on the North Dakota sales and use tax exemptions estimated biennial fiscal effect ([Appendix D](#)). He said the information reflected is based on the 5 percent state sales and use tax rate and does not include consideration of local sales taxes.

Representative Streyle said it appears that if all sales and use tax exemptions were eliminated, it could be possible to reduce the sales tax rate to 2.5 percent or 3 percent without a revenue loss. Mr. Braunberger said he is not certain what rate could be used to be revenue-neutral, but it may be in the area of 3 percent.

Mr. Braunberger distributed copies of testimony relating to sales tax exemption status of health-related clinics ([Appendix E](#)). He said North Dakota provides a sales tax exemption for nonprofit voluntary health associations exempt from federal income tax and recognized by the National Health Council as a nonprofit organization. He said none of these North Dakota clinics were recognized by the National Health Council, and all medical clinics are subject to sales taxes. He said hospitals are exempt from sales taxes.

Representative Bellew asked what the National Health Council is and why its approval is needed. Mr. Braunberger said recognition by the National Health Council is a condition added to the statute, and it appears a clinic must become a member of the National Health Council to qualify for the exemption.

Senator Hogue said consideration of the possible exemption of these clinics during the legislative session did not yield a consensus that the legislation should be enacted. He said there is an element of competition between taxable clinics and the activities of the nonprofit clinics.

Representative Nelson said there is another aspect of this study issue that should be considered. He said a merchant who makes a sale to a supposedly exempt entity is responsible for payment of the sales taxes if the entity fails to furnish proper documents of entitlement to the exemption. He said a refund system would be fairer to merchants and would be based on the entity applying for a refund to the Tax Commissioner. He said this would relieve the merchant of possible liability for uncollected taxes.

Senator Cook said sales tax exemptions have been enacted over many years. He said sales tax exemptions are sometimes based on who the buyer is and sometimes based on potential economic development or other factors. He said each sales tax exemption should be examined to determine the rationale, and whether it is appropriate in current conditions.

Representative Meyer said information should be provided on the National Health Council. She said an understanding should be gained on what the organization does and who they recognize.

TOBACCO TAX STAMP STUDY

Chairman Hogue called on committee counsel for presentation of a memorandum entitled [Tobacco Tax Stamp - Background Memorandum](#). Committee counsel said tobacco tax stamps were required by North Dakota law from 1925 until 1991. He said since 1991 three bills have been introduced which would have reinstated the requirements for the use of tobacco tax stamps. He said each bill was enacted, but the provisions requiring the use of tobacco tax stamps was removed.

Chairman Hogue called on Mr. Allan Stenehjem, Reynolds American Incorporated, for comments on the tobacco tax stamp study. A copy of prepared testimony presented by Mr. Stenehjem is attached as [Appendix F](#).

Senator Hogue asked if the United States Food and Drug Administration is contemplating requiring tax stamping for cigarettes. Mr. Stenehjem said he believes the Food and Drug Administration is contemplating requiring tax stamping.

Senator Cook said the estimated \$5 billion revenue loss to black market cigarette sales appears to be most likely to affect high-tax states. Mr. Stenehjem said it is probably correct that high-tax states are where the major impact occurs, but all across the country federal, state, and local taxing integrity is an issue.

Representative Headland asked if information can be provided on where black market cigarettes originate. Mr. Stenehjem said the tobacco industry should be able to provide information.

Senator Oehlke asked who would apply tobacco tax stamps. Mr. Stenehjem said distributors in North Dakota would apply stamps. Senator Oehlke asked if sales on American Indian reservations would be stamped. Mr. Stenehjem said reservation sales would be stamped because they acquire cigarettes from North Dakota distributors, who would stamp the packages if required in the state.

Representative Hatlestad said it appears stamping would cost money to the state and to distributors and asked what is the upside for North Dakota from stamping. Mr. Stenehjem said enhanced compliance with tax laws would be a benefit to the state.

Chairman Hogue directed committee counsel to request a fiscal note and compliance suggestions from the Tax Department.

Representative Headland said information should be obtained to determine how the state would track the origin of counterfeit cigarettes, especially if those products do harm to the public.

Chairman Hogue called on Mr. John Olson, Philip Morris USA Inc., for comments on the cigarette tax stamp study. Mr. Olson distributed copies ([Appendices G, H, and I](#)) of documents submitted on behalf of Philip Morris USA.

Chairman Hogue called on Mr. John Job, Amcon Distributing Company, for comments on tobacco tax stamp issues. A copy of prepared information distributed by Mr. Job is attached as [Appendix J](#).

Mr. Job said tax stamping increases labor and equipment costs for distributors for all states that require stamps, but not in North Dakota. He said if North Dakota requires stamp taxing, distributors will need to raise the price of the product to North Dakota retailers in order to recover production costs.

In response to a question from Representative Owens, Mr. Job said in 1991 Pitney-Bowes went out of the tax stamping machine business. He said Meyercord and R.E.D. Stamp, Inc., are the companies that currently make cigarette tax stamping machinery.

Chairman Hogue called on Mr. Kelly Kaiser, O.K. Distributing Company, Inc., for comments on the tax stamping issue. A copy of Mr. Kaiser's prepared comments is attached as [Appendix K](#).

In response to a question from Representative Owens, Mr. Kaiser said O.K. Distributing currently does stamping of cigarettes for Montana sellers.

Representative Headland asked how we can protect citizens against contraband cigarettes. Mr. Kaiser said he does not think contraband cigarettes are a big issue for North Dakota. He said he has never seen contraband cigarettes, and he knows what to look for. Representative Headland said some groups would promote a substantial tax increase and asked if a substantial increase in North Dakota taxes would change Mr. Kaiser's view of the need for cigarette tax stamping. Mr. Kaiser said a substantial tax increase would be a factor to consider, but under existing conditions he does not think stamping should be instituted just because 47 states do it.

OIL EXTRACTION TAX STUDY

Chairman Hogue called on committee counsel for presentation of background information on a study assigned by the chairman of the Legislative Management relating to oil extraction tax. Committee counsel reviewed a memorandum entitled [Oil Extraction Tax - Background Memorandum](#). He reviewed the history of oil and gas gross production tax and oil extraction tax.

Committee counsel said the study assignment is to examine feasibility and desirability of oil extraction tax rate reductions and elimination of selected exemptions which would take effect at certain levels of increased production and revenue. He said amendments offered to 2011 Engrossed House Bill

No. 1467 were not adopted by the Senate Finance and Taxation Committee but follow a format similar to the one described in the study assignment. He distributed copies of the [amendments](#). He said the proposed amendments would have reduced the oil extraction tax rate by one-half percentage point at certain statewide daily production benchmarks. He said when the first production benchmark is reached, the amendments would remove eligibility for the stripper well exemption for the new wells drilled on a Bakken pool stripper well property until the actual production from that individual well declines to a level that meets the statutory requirements for an individual stripper well.

Chairman Hogue said it appears it will be necessary to obtain information from the Oil and Gas Division on the demographics of Bakken wells production declines, aging, projections on future production, and other factors.

Representative Meyer asked if the 2011 funding for oil and gas impact grants was required to be allocated in equal amounts in each year of the biennium. Committee counsel said he will provide information on that question.

Representative Meyer said information should be provided on the number and production levels of stripper well properties that are now exempt from extraction taxes, the number of new wells being drilled on stripper well properties, and projections on statewide drilling and production levels.

Representative Kasper said information should be provided on current export capacity for oil and gas and future plans for export handling.

Representative Headland said an analysis should be provided of possible Environmental Protection Agency action and effects and the interplay of such action with triggered reductions of tax rates.

No further business appearing, Chairman Hogue adjourned the meeting at 2:15 p.m.

John Walstad
Code Revisor

ATTACH:11