

# NORTH DAKOTA LEGISLATIVE COUNCIL

## Minutes of the

### TAXATION COMMITTEE

Thursday, January 31, 2002  
Roughrider Room, State Capitol  
Bismarck, North Dakota

Senator Rich Wardner, Chairman, called the meeting to order at 9:00 a.m.

**Members present:** Senators Rich Wardner, Dwight Cook, Kenneth Kroepflin, Ronald Nichols, Randy A. Schobinger, Herb Urlacher; Representatives Michael Brandenburg, Al Carlson, Byron Clark, David Drovdal, Michael Grosz, Gil Herbel, Frank Klein, Joe Kroeber, Edward H. Lloyd, Kenton Onstad, Dennis J. Renner, Dan Ruby, Arlo E. Schmidt, Ray H. Wikenheiser

**Members absent:** Senator Ben Tollefson; Representatives Eugene Nicholas, Earl Rennerfeldt

**Others present:** See Appendix A

Chairman Wardner invited comments on the minutes of the previous meeting.

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

#### **TOBACCO, ALCOHOL, AND FUELS TAX COMPLIANCE AND JURISDICTION STUDY**

Chairman Wardner called on Ms. Joan Galster, Supervisor, Motor Fuels Tax Division, Tax Department, for comments on motor fuels tax questions raised by the committee at the previous meeting. Ms. Galster said at the previous meeting there was discussion about the status of a retail fuels outlet owned and operated by the Wahpeton-Sisseton Sioux Tribe. She said there is a convenience store with a retail fuels outlet located on the premises of the Dakota Magic Casino. She said a corporation formed by the tribe also owns a fuel-blending facility that purchases from out-of-state sources and sells fuel to the tribe's retail facility. She said it is estimated that the volume of retail sales of gasoline at the facility will be approximately 100,000 gallons per month.

Ms. Galster said the Tax Department is cross-checking available information on purchases and sales by the tribe. She said at this time the Tax Department has not identified any bulk fuels sales from the tribal wholesaler to other retailers in the area.

Senator Wardner asked whether the retail outlet is collecting state fuels taxes on sales at the pump. Ms. Galster said the Tax Department is uncertain

about whether taxes are being collected. She said the Tax Department has collected some tax from fuels sales to this station.

Ms. Galster said the state has a tax collection agreement with the Standing Rock Reservation. She said the tribe imposes a tribal tax at the same rate as the state tax and under the contract the state administers tax collections and returns 75 percent of the collections to the tribe. She said on other reservations in the state, state taxes are collected on sales in bulk to retail outlets. She said tribal agencies are eligible for refunds for fuels used in their vehicles. She said there have not been substantial claims for refunds for these uses.

Representative Herbel asked what the Tax Department knows about bulk fuels sales by the wholesale fuels distributorship operated by the Wahpeton-Sisseton-Sioux Tribe. Ms. Galster said she believes bulk fuels sales are made but the Tax Department does not have solid information on the amounts of those sales.

In response to a question from Senator Urlacher, Tax Commissioner Rick Clayburgh said under the tax collection agreement with the Standing Rock Reservation, the tribe uses its fuels tax revenues to maintain roads under the tribe's jurisdiction.

Representative Carlson asked Ms. Galster why the Tax Department does not know whether state taxes are being collected at the retail fuels outlet operated by the Wahpeton-Sisseton-Sioux Tribe. Ms. Galster said the Tax Department does not receive information from retail outlets on tax collections. She said motor vehicle fuels tax reports are filed by wholesalers. She said from the wholesale reports for the distributor operated by the Wahpeton-Sisseton-Sioux Tribe, some taxes have been reported and paid but it is not possible to determine whether all fuels handled by the distributor have been subjected to state taxes.

Senator Wardner asked if it would be correct to say that on the gallons of fuel the Tax Department has been able to track, the state is collecting tax but there is still some unknown information on possible out-of-state fuels purchases by the tribal distributor. Ms. Galster said that is correct and the department still has work to do to determine whether untaxed fuels are being sold.

Committee counsel asked Ms. Galster whether she has knowledge of the price per gallon for unleaded fuel at the pump at the Wahpeton-Sisseton tribal retail outlet. Ms. Galster said the outlet was charging \$1.03 per gallon on January 30. She said retail prices in the region range from approximately \$1.09 per gallon to as high as \$1.40 per gallon.

Representative Ruby asked whether the Tax Department is continuing to monitor the wholesale and retail arrangement operated by the tribe. Ms. Galster said the department is monitoring the situation to the extent allowed by law.

Chairman Wardner called on Commissioner Clayburgh for comments on legal issues in tribal fuels sales and tribal-state motor fuels tax agreements. He reviewed a memorandum distributed to committee members which was prepared by Mr. Robert W. Wirtz, chief counsel for the Tax Commissioner.

Commissioner Clayburgh said the Tax Department continues to monitor tribal fuels sales and associated legal issues in hopes that a level playing field can be maintained between tribal and nontribal fuels dealers. He said there are legal issues still unsettled with regard to tribal fuels sales and taxes. He said a recent court decision from Idaho is being appealed to the United States Supreme Court regarding levy of state motor fuels taxes against fuel sold to an Indian tribe on its reservation. He said this decision is being followed by several states and North Dakota will probably join in the appeal in support of the state position.

Commissioner Clayburgh said the state does not have very good access to information on fuels purchases by tribal wholesale and retail businesses. He said the state probably lacks jurisdiction to seek reports on fuels acquisition from out-of-state sources in some cases. He said the Tax Department will continue to monitor legal issues and developments in this field and provide information to the committee.

In response to a question from Senator Urlacher, Commissioner Clayburgh said only on the Standing Rock Reservation are state tobacco taxes being collected under a collection agreement with the state. He said the other tribes in the state do not collect state tobacco taxes. He said North Dakota law allows possession of one carton of untaxed cigarettes. He said the state has discussed with tribes the mutual advantages of tobacco and fuels tax collection agreements. He said the state continues to seek to work with tribes in this respect but tribes have not embraced the idea.

### **CORPORATE INCOME TAX STUDY**

Chairman Wardner called on Commissioner Clayburgh for comments on the corporate income tax study. Commissioner Clayburgh said at the previous committee meeting he discussed with the committee the importance of the corporate income tax as a business location factor. He said there are numerous

sources of studies on business location factors and the conclusions of these studies differ. He said the Department of Commerce has commissioned a study on this issue and could report to the committee on its findings. Commissioner Clayburgh said his review of studies on the topic of business location factor importance indicates that the imposition and level of corporate income taxes is not a major factor in business location decisions. He said his review of studies has convinced him that once a location decision by a corporation has been narrowed to a few states, it then becomes important to the corporation to seek tax breaks from competing states in making a final location decision. He said when these comparisons are made by corporations, it is not only corporate income taxes that are considered but also workers' compensation rates, property taxes, and other costs of doing business.

Chairman Wardner called on Ms. Mary Loftsgard, Supervisor, Corporate Income Tax Section, Tax Department, for testimony on corporate income tax issues for which information was requested by the committee at the previous meeting. A copy of Ms. Loftsgard's prepared testimony is attached as Appendix B.

Representative Ruby asked if all savings from eliminating corporate income taxes were paid as dividends to shareholders, whether those dividends would be taxable income to investors. Ms. Loftsgard said those dividends would be taxable for investors but would be taxable by the state of North Dakota only for North Dakota resident investors. She said residents are a small percentage of corporate shareholders, so only a small part of eliminated corporate income taxes would be recouped as individual income taxes.

Senator Schobinger said he has been reviewing information on the question of corporate income tax as a business location incentive. He distributed and reviewed a paper urging elimination of the corporate income tax prepared by Mr. Bruce Bartlett, Senior Fellow, National Center for Policy Analysis. A copy of the paper is on file in the Legislative Council office.

Senator Kroeplin said the concern that corporate earnings are subject to double taxation is not a strong argument against corporate taxes. He said if he as an individual earns income, he pays income tax on that income. He said if he hires a carpenter, he pays the carpenter with aftertax dollars and the carpenter then pays income tax on those earnings, so that stream of income has been taxed twice.

Representative Ruby said in the example given, payments to the carpenter would be a deductible business expense. Senator Kroeplin said his payments to the carpenter are for services to him as an individual which would not be deductible business expenses.

Senator Cook said he is also interested in comparing a for-profit corporation to a cooperative.

He said a for-profit corporation exists to make a profit for shareholders. He said that corporation pays corporate income tax on profits before distribution. He said shareholders then pay income taxes on distributions they receive. He said a cooperative distributes its earnings among shareholders without payment of corporate income taxes.

Chairman Wardner called on Ms. Linda Butts, Director, Economic Development and Finance Division, Department of Commerce, for comments on the corporate income tax study. Ms. Butts said the Economic Development and Finance Division would be able to do some research for the benefit of the committee if the committee desires that assistance. She said the division has retained a site selector expert to analyze decisionmaking of businesses regarding location of facilities. She said the Arthur Andersen study is interesting but seems to be deficient in some aspects. She said that study also appears to show North Dakota as a high tax state, which is not an accurate representation.

Ms. Butts said one issue for investigation is the elimination of corporate income taxes in South Dakota. She said economic development officials in South Dakota have said that eliminating corporate income taxes really boosted the South Dakota economy. She said the Economic Development and Finance Division could gather information on these effects if the committee wishes.

Senator Wardner asked whether the Arthur Andersen study indicates that North Dakota has a high corporate income tax. Ms. Butts said the Arthur Andersen study shows North Dakota as a high corporate income tax state and does not reflect the fact that federal income taxes are deductible in North Dakota, which is a major factor.

Representative Ruby said he would like the committee to receive further information as described by Ms. Butts regarding the corporate income tax as a location decision factor. He said he would also appreciate receiving information indicating the combined burden of state-imposed costs, including income taxes, workers' compensation, property taxes, and other expenses of doing business. He said this would provide the most accurate measure of states' relative economic status for businesses.

Chairman Wardner told Ms. Butts the committee would welcome information on these topics from the Economic Development and Finance Division for its next meeting.

Representative Schmidt said he has heard reports that the cooperative venture in Carrington may change its status to a for-profit corporation. He asked why the entity would change if corporate income taxes are such a significant consideration. Ms. Butts said she is not sure of the reason for this change. She said it must involve factors that outweigh corporate income tax imposition.

Senator Schobinger said he would like to invite some experts on business location decisions to attend a future committee meeting. He said he could communicate to the Legislative Council staff who the experts are so a formal invitation could be extended. Chairman Wardner said that approach is acceptable, and he anticipates that the next meeting of the committee will be scheduled for early April.

Senator Cook said a question he believes the committee should investigate is whether there has been a loss of corporate income tax revenue in recent years from activity in rural areas and what comparisons could be made for corporate income tax collections in recent years versus the rate of inflation. Senator Wardner asked Ms. Loftsgard whether the Tax Department could make these comparisons. Ms. Loftsgard said it may be difficult, but the Tax Department staff can review available data to see what information might show these differences.

Representative Onstad asked whether it would also be possible to compare corporations domiciled in North Dakota and in other states. He said it would also be interesting to compare cooperatives versus for-profit corporations.

Representative Drovdal said related questions that should be examined are reasons and considerations for business decisions of whether to incorporate or choose some other form of doing business.

Representative Carlson said he has served as chairman of the Electric Industry Competition Committee for several years. He said that committee has encountered substantial difficulties because electric utilities are either cooperatives, for-profit corporations, or under municipal ownership. He said the committee has found that these are substantially different forms of business and tax environments and it is extremely difficult to attempt to restructure the tax environment to place all these utilities on an equal footing. He said each of these forms of business should be reviewed.

Representative Ruby said he would also be interested in a review of reasons for choosing to do business as a corporation or some other legal entity. He said liability concerns and other factors are involved in these decisions and the committee should review factors businesses consider.

### **HOMESTEAD PROPERTY TAX CREDIT**

Chairman Wardner called on committee counsel to review a memorandum entitled *Homestead Property Tax Credit - Background Memorandum*.

Senator Cook said he would support reviewing a bill draft to include inflation indexing. He said he would also be interested in reviewing information to compare Minnesota homestead credit application. He said Minnesota has a homestead credit provision that applies to all resident property owners. He said it appears the effect of the Minnesota law is to discriminate against nonresidents by lowering property taxes

for only Minnesota residents. He said perhaps North Dakota should consider this kind of approach.

Chairman Wardner requested comparison of North Dakota and Minnesota provisions on homestead credit to illustrate the point made by Senator Cook. He also requested preparation of a bill draft on the homestead credit to add a provision to index the amounts for inflation.

Chairman Wardner called on Mr. Leon Samuel, Director of Tax Equalization, Morton County, for comments on the homestead property tax credit. Mr. Samuel said the committee should bear in mind that it is not only the income limits under the homestead property tax credit law that should be reviewed. He said the maximum reduction in taxable valuation as shown on the memorandum has not been adjusted in many years. He said this reduction in the past provided a complete property tax exemption for most homes. He said the reduction would exclude taxes on about \$44,000 of true and full value, so homeowners whose homes are valued at more than that amount would have to pay some property taxes. He said the committee should consider increasing these maximum reductions to restore the benefit that was previously available.

Representative Renner asked Mr. Samuel whether he thinks income limits should be increased or maximum reductions should be increased. Mr. Samuel said he is not recommending either course of action but wants to point out that maximum reductions do not cover as much property as they did in the past.

Representative Lloyd asked why the maximum amount of reduction could not simply be eliminated. Mr. Samuel said a maximum amount is included in the formula because if a person has a very expensive home, the limit keeps the full value of the home from being exempt. Mr. Samuel said he pointed out this consideration because the maximum reduction was last changed many years ago when property values were much lower than they are at present.

## **AGRICULTURAL PROPERTY ASSESSMENT**

Chairman Wardner called on Mr. Dwight Aakre, Department of Agricultural Economics, North Dakota State University, for comments on agricultural property assessment issues raised at the previous meeting. Mr. Aakre said he was requested to provide further information on issues he raised at the previous meeting for consideration on adjustments to the agricultural property valuation formula. A copy of Mr. Aakre's prepared testimony is attached as Appendix C.

Mr. Aakre said current law reduces conservation reserve program (CRP) payments by 50 percent before including the statistics in the model. He said a reasonable estimate of costs for CRP land would be approximately 20 percent of revenue. He said to be

equitable with treatment of other agricultural land, approximately 80 percent of CRP payments should be included in the model rather than the current 50 percent.

Mr. Aakre said one revenue stream for farmers that is not considered in the present formula is crop insurance indemnity payments. He reviewed his computations of including these payments in the formula. He said his estimate is that including crop insurance indemnity payments would result in an increase of approximately 7.1 percent for cropland statewide.

Mr. Aakre said he had suggested that a six-month grazing season as assumed in the formula is not appropriate for the entire state and that a longer grazing season usually exists in the west. He said he discussed this observation with an extension range specialist at North Dakota State University who suggested that although the grazing season may be longer in the west, the quality and quantity of grazing decreases, so using six months for the entire state is a fair assessment of the grazing season.

Mr. Aakre said the formula ignores the cost of feeding cattle for a portion of a year.

Mr. Aakre said the other point he raised for consideration is using cash rent as the landlord's share of gross returns. He said the current system of estimating production value is cumbersome and difficult to understand. Attached to Mr. Aakre's prepared testimony are maps showing comparisons of property valuations through use of the current system and capitalizing average cash rent rates. He reviewed the results and said a significant variation of effect for different counties would result from this change in approach. He said it might be difficult to institute this change and perhaps consideration could be given to phasing in the effect over a period of years to avoid substantial fluctuations in county valuations in a single year.

Representative Renner asked whether increasing CRP payments included in the valuation formula would increase the value of property that is not under CRP. Mr. Aakre said that would occur, because it would increase countywide agricultural property values somewhat.

Representative Renner asked where cash rent data for farm property comes from. Mr. Aakre said the North Dakota Agricultural Statistics Service gathers this data. Mr. Bill Meyer, Deputy State Statistician, North Dakota Agricultural Statistics Service, said the North Dakota Agricultural Statistics Service surveys 3,000 farm operators in North Dakota each year. He said mail surveys are sent and the results are reviewed by machine and by hand and a telephone followup survey is conducted to check accuracy.

Chairman Wardner called on Mr. Meyer for testimony on statistics used in the agricultural property valuation formula. He distributed copies of two

prepared handouts entitled *County Estimates Program* and *Prices Received Program*. Copies are attached as Appendices D and E, respectively. Mr. Meyer reviewed the county estimates program material.

Senator Kroeplin asked why these surveys are conducted when the Farm Service Agency already has this information. Mr. Meyer said the Farm Service Agency collects agricultural statistics but does not have all the information that the North Dakota Agricultural Statistics Service wants to gather. He said the information collected is compared for reliability with Farm Service Agency statistics.

Senator Kroeplin said a problem with the agricultural property assessed valuation that has troubled him is that increases in valuations in the northern part of the Red River Valley are excessively high compared to farm income. He said the existence of inundated acreage and differences in yields and planted acres versus harvested acres may be the root of the problem. He asked whether Mr. Meyer is aware of problems in statistics that might result in these valuation problems. Mr. Meyer said North Dakota Agricultural Statistics Service information is based on production from harvested acres. He said the object of the statistics gathered is to determine county yield per harvested acre. Senator Kroeplin asked whether that estimate is then applied to each acre in the county. Mr. Meyer said the yield per harvested acre statistic applies only to harvested acres.

Senator Kroeplin asked Mr. Aakre whether he can suggest a reason for agricultural property assessed valuations increasing so much in the northern part of the Red River Valley. Mr. Aakre said the provision in the law relating to inundated land is of recent origin and may not be fully utilized in some counties. He said several counties report zero inundated acres and he suspects this should not be occurring.

Representative Herbel said each year residents of Walsh County get substantial increases in agricultural property assessed values but cash rents have not increased. Mr. Aakre said there are some counties, such as Walsh County, where changing to cash rent as a basis for valuation would result in a great reduction in agricultural property assessed values.

Representative Herbel said the committee needs assistance to understand the reasons why Walsh County and similar counties continue to have increases in agricultural property assessed valuation by large degrees when market valuations and cash rents do not increase and profits are not up.

Representative Brandenburg asked Mr. Aakre how preventive planting acreage is treated in the formula. Mr. Aakre said these acres do not produce income except government payments received, which are included in the calculations. He said the net effect of preventive planting acreage is to lower average valuations of agricultural property for the county.

Representative Schmidt said the capitalization rate continues to cause agricultural property assessed valuation increases. He said there are several people in attendance at the meeting who would like a review of how the agricultural property assessed valuation formula works. Senator Wardner requested Mr. Aakre to review the formula with examples on the dry erase wallboard. Mr. Aakre reviewed a hypothetical county example for purposes of illustrating how the agricultural property assessed valuation operates.

Senator Kroeplin said including a factor for the cost of production in the formula offsets some of the increase from the capitalization rate. Mr. Aakre said that is correct and the present effect is that about two-thirds of the effect of the capitalization rate is offset by the cost of production factor. He said the state will see the capitalization rate turn around and begin to increase. He said when this occurs there will be two factors pushing valuations down because the cost of production factor will continue to have that effect and an increasing capitalization rate will have that effect.

Representative Ruby asked whether changing the formula to use only five years of production statistics instead of 10 years would have a more desirable effect. Mr. Aakre said that is an option for consideration but a few years ago the years of production factor in the formula was increased from 6 years to 10 years because it was deemed to stabilize the agricultural property valuations.

Representative Schmidt said he has been told in the past that the capitalization rate would begin to increase and trend agricultural property values downward. He said this has not occurred, and he asked when Mr. Aakre expects interest rates will begin to rise for purposes of the formula. Mr. Aakre said he expects that in the next two years the new interest rate injected into the formula will be higher than the rate for the year that drops out of consideration. He said he expects this trend to continue and that will push the capitalization rate up.

Senator Wardner asked whether he is correct in assuming that in two years or so the property valuation formula will begin to reduce average agricultural property assessed values. Mr. Aakre said that is correct but other factors could intervene. He said based on the production cost index and rising capitalization rates, there will be two factors tending to push valuations down.

Representative Carlson said it is important to remember that property valuation is not the only factor in the tax bill farmers receive. He said if land valuations are reduced, the tax bill can still go up because it is controlled by decisions of local governments and how many dollars of taxes they levy.

The chairman called on Mr. Elder Daugherty, Director, Tax Equalization, Foster County, for comments on the agricultural property valuation study. Mr. Daugherty distributed copies of a sheet

showing computation of the capitalization rate for the years 1996 through 2002. He said Foster County has seen a 30 percent increase in assessed valuation of agricultural property since 1994. He said he believes this is an excessive increase, and he thinks most of the blame for this unreasonable increase in valuation lies with the capitalization rate. He said he suggests a limit on the capitalization rate in the valuation formula so that the rate could not fall below 9 percent.

Mr. Daugherty said attached to the sheet he distributed is a copy of a newspaper article stating that Ward County commissioners reluctantly went along with the agricultural property assessed valuation increase determined under the formula because the county must follow state law. He said commissioners in Foster County also believe that they reluctantly must go along with the increase determined under the valuation formula.

Senator Wardner said counties can keep taxes down by reduction of mill rates in spite of increased valuation. He asked whether, if property values stay the same, political subdivisions would raise taxes. Mr. Daugherty said some political subdivisions would not raise taxes, but he is certain that school districts would raise taxes and taxes would increase despite stable property valuation.

Chairman Wardner called on Mr. Allan Braaten, North Dakota Corn Growers Association, for comments on agricultural property assessment issues. Mr. Braaten said in Richland County where he lives there have been hail disasters, floods, poor market prices, and other problems faced by farmers but property valuation under the formula keeps rising. He said he thinks there is a problem with the formula and perhaps part of the problem is that planted acres are used in calculations even though not all of those acres ever get harvested.

Chairman Wardner called on Mr. Dolar LaPlant, Binford, for comments on the agricultural property assessment study. Mr. LaPlant said he farms in Griggs County. He said the issue that has been discussed regarding cash rent per acre for farmland might not be uniformly interpreted by farmers. He asked whether it is uniformly applied in gathering statistics on cash rent. Chairman Wardner asked whether Mr. Meyer could address this question. Mr. Meyer said survey respondents are asked a uniform question regarding cash rent information. He said the survey form contains a definition for cash rent, intended to provide uniform guidance in responding to the survey.

Chairman Wardner said the committee's attention was diverted to other topics and Mr. Meyer did not present the information on prices received for crop and livestock which he distributed earlier to the committee. Mr. Meyer reviewed the distributed information on the prices received program, attached as Appendix E.

Senator Nichols said he believes using cash rent as a tool for valuing agricultural property seems to be a better measure of value than the current formula. He asked whether it would be possible to phase in use of cash rents in the formula over a period of years and achieve more accurate valuations. Mr. Aakre said it should be possible to structure the formula to phase in use of cash rent values. Senator Nichols asked whether Mr. Aakre believes the current formula or use of cash rent would be a more accurate method of valuation. Mr. Aakre said he believes cash rent would be a more accurate valuation tool because it involves a single factor. He said the current formula incorporates several factors, each of which must be accurate and reliable for the formula to yield an accurate and reliable result.

Chairman Wardner called on Mr. Douglas Geier, Heaton, for comments on the agricultural property valuation and assessment study. Mr. Geier said he farms in Wells County and in that county soil survey maps have been used to establish land values for agricultural land for tax purposes for several years. He said valuations are applied to every parcel of agricultural property based on its soil type and there is no distinction made in valuation between cropland or noncropland.

Chairman Wardner called on Mr. Robert W. Wirtz, Chief Counsel, Tax Department, for information on a question raised by the committee at its previous meeting. Mr. Wirtz said the committee requested information on the legal basis for the State Board of Equalization limitation that agricultural property may not vary by more than 5 percent from the valuation determined under the valuation formula. Mr. Wirtz said the Pembina County state's attorney has asked the same question of the Attorney General and an opinion of the Attorney General on this issue is pending. He said the opinion on this question has not been issued by the Attorney General so it is not appropriate to comment on these issues at this time. He said he expects the opinion of the Attorney General to be issued soon. Chairman Wardner said the committee will carry this item for consideration at the next committee meeting.

### **SPECIAL ASSESSMENTS STUDY**

Chairman Wardner called on Mr. John M. Schmisek, Director, Finance and Administrative Services, City of Grand Forks, for information on imposition of Grand Forks flood control assessments. A copy of Mr. Schmisek's prepared testimony is attached as Appendix F. The attachments from his prepared testimony are on file in the Legislative Council office.

Mr. Schmisek said the Grand Forks flood protection project original estimated cost was \$350.4 million. He said the federal project cost share was estimated to cover \$176 million of the total cost. He said the city of East Grand Forks project cost share was estimated

to be \$59.35 million. He said the city of Grand Forks project cost share was estimated to be \$114.99 million. He said the state of North Dakota agreed to fund \$52 million of the cost of the project, leaving the city of Grand Forks with a \$62.99 million cost for the project. He said the city faces additional city-funded improvements not shared in the project at a cost of \$11 million and city administration costs of \$3 million. He said the estimated total city cost was originally \$76.99 million. He said \$13.4 million of this amount will be funded by a 15-mill levy for a general obligation bond and \$11.4 million will be funded from sales and use tax revenues. He said the city of Grand Forks undertook this project with a net amount required to be assessed through special assessments of \$52,195,000.

Mr. Schmisek said all property within the entire city limits of Grand Forks is subject to the special assessment with the exception of federal and state property. He said by law federal property is beyond reach of special assessments. He said state property is excluded from special assessments for this project because of specific legislation enacted in 2001. He said the city has some concerns with the 2001 legislation because of unanticipated developments regarding private commercial projects proposed for location on University of North Dakota property.

Mr. Schmisek said notice of the project was given to city residents and property owners as required by state statute. He said the protest period on the establishment of the special assessment district expired October 2, 2000.

Representative Herbel asked whether there will be any vote of city residents on the special assessments. Mr. Schmisek said there will not be a vote of city residents because there was no protest of the project.

Senator Cook asked whether anyone protested the project. Mr. Schmisek said no formal protest was filed but there was extensive discussion by concerned citizens regarding the costs of the project and the costs to be assessed against each parcel of property.

Mr. Schmisek said the Special Assessment Commission spent a great deal of time considering how to equitably assess benefit for the flood protection project among property owners. He said the commission began discussion of the project in December 1998 and has spent a great deal of time considering and discussing benefited properties, primary benefits to property, secondary benefits to property, the formula for assessing benefits, alternative assessment methods, and special considerations for agricultural land, cemeteries, and property of higher elevation.

Mr. Schmisek said it was decided to levy special assessments in stages. He said the initial assessment totals approximately \$20 million.

Senator Cook asked whether construction on the project has begun. Mr. Schmisek said acquisition of property and construction has started. Senator Cook

asked whether the final stage of assessments will cover the final costs of the project. Mr. Schmisek said that is correct and the city probably will not know the total cost until that stage is assessed. He said project costs are subject to change as the project continues. Senator Cook said he is concerned with providing property owners with estimated costs of special assessments per parcel of property at the time they have an opportunity to protest the project. Mr. Schmisek said that could be difficult to accomplish. He said the Special Assessment Commission had not been established by the time the opportunity to protest had expired. He said in the case of Grand Forks, the Special Assessment Commission did a great deal of work before arriving at what it believed to be the fairest method of allocating project costs among properties. He said the other problem he sees with providing estimated costs to property owners is that once a dollar amount estimate is provided, people will perceive the estimate as the actual cost.

Mr. Schmisek said special assessment laws of the state have served the special assessment process in Grand Forks very well. He said he believes the city has followed all the legal requirements and kept the citizens of Grand Forks informed on the project. He said one area of concern is the exemption for state-owned land. He said this is not a major concern except there is a privately owned bookstore on University of North Dakota property and discussion of further private development on University of North Dakota property, including a hotel, grocery store, and possibly other projects. He said the commercial entities located on state property would have a substantial competitive advantage over other businesses because they would be exempt from the special assessment levies. He said he believes this is a potentially unfair situation that should be addressed during the next legislative session.

Mr. Schmisek said another concern is that the city recently received word from the United States Corps of Engineers on revised cost estimates for the project. He said the increased cost presents an additional burden. He said the city of Grand Forks believes it can handle the additional costs, but if unanticipated cost increases continue to develop, the city may be forced to seek state assistance again.

Representative Schmidt asked whether a state law providing that if University of North Dakota property is leased to a private entity that property would be subject to special assessments would solve the problem with leases to commercial ventures. Mr. Schmisek said he believes that would solve the problem and prevent unfair competitive advantage to those commercial ventures.

Committee counsel said if a bill is drafted to apply special assessments to certain ventures on University of North Dakota property, it will be necessary to know if there are other leaseholders that might be affected

who are using University of North Dakota property for other purposes. He asked whether Mr. Schmisek knows if the University of North Dakota has property under lease to other private entities. Mr. Schmisek said he is not certain and it would be advisable to contact University of North Dakota officials to find out whether other leases exist.

Chairman Wardner called on Mr. Jerry Hjelmstad, North Dakota League of Cities legal counsel, for testimony on the special assessments study. Mr. Hjelmstad said the North Dakota League of Cities was requested to provide information on specific special assessment issues. He said one issue is how often citywide assessments are levied. He said there are 360 incorporated cities in this state and most of these cities are quite small, so a special assessment levy would cover the entire city in most cases because of the small amount of property involved. He said for larger cities it is quite rare to levy citywide special assessments.

In response to a question from Senator Cook, Mr. Hjelmstad said he believes the city of Bismarck has never levied a citywide special assessment. He said Wahpeton has not had a citywide special assessment since the 1970s. He said the city of Minot has never levied a citywide special assessment and other larger cities have rarely levied citywide special assessments.

In response to a question from Senator Cook, Mr. Hjelmstad said a city has authority to impose previously levied special assessments against annexed property added to the city. He said when this is done, the special assessment against the annexed property is based on the depreciated value of the improvement.

Senator Cook said there are several different chapters in state law relating to special assessments. He asked which procedures for levying special assessments are followed. Mr. Hjelmstad said the assessment method used depends on the type of project. He said some projects base assessments on property frontage and some use square foot assessments. He said usually street improvements are assessed based on property frontage.

Senator Cook said his review of the laws on special assessments makes him think it would be possible to eliminate some of these statutory provisions to reduce confusion. Ms. Connie Sprynczynatyk, Executive Director, North Dakota League of Cities, said information was provided to the committee at its last meeting reviewing the provisions of law regarding special assessments. She said she believes the statutory provisions work well for city officials who are familiar with them. She said the North Dakota League of Cities can analyze the statutory provisions for the committee to try to identify areas in which duplication exists or obsolete or confusing provisions exist.

Ms. Sprynczynatyk said it was mentioned earlier in the meeting that there is potential danger in providing estimates of special assessments for property at the time of notice of a special assessment project. She said she agrees that problems would exist. She said if estimates are provided, there would be a need for disclaimers and exclusions and lengthy explanations that the information is merely an estimate. She said the value of these estimates would be limited because they probably would not be very accurate. She said another concern is when an estimate is provided to property owners, they will expect the number to be correct so changes that become necessary as the project progresses will cause problems.

Senator Cook asked how cities would react to a requirement for approval by voters of any citywide special assessment. Ms. Sprynczynatyk said it is difficult to predict reactions but she believes cities would not look favorably on such a requirement. She said different cities have different positions on special assessment projects but for the most part they believe their process works just fine.

Representative Schmidt said he has received complaints from people residing in a small city about being assessed special assessments for pavement projects on a county road that runs through the city. He said the city residents do not believe they should be charged special assessments to pay for improvements to a county road.

Mr. Wade Williams, North Dakota Association of Counties, said he believes the portion of a road lying within city limits is city property. He said since the road is city property, improvements to the road would be the responsibility of the city, to be funded either through property taxes or special assessments.

Senator Cook said the committee should review information on whether all states allow levy of special assessments. He said he believes there are states that do not.

Senator Cook said the committee should consider a bill draft to require that a city of 5,000 population or more must have approval by the city voters if more than 75 percent of the property in the city would be subject to special assessments for a project.

Senator Cook said the committee should consider a bill draft that would require the newspaper notice of a special assessment project to contain an estimate of the probable cost per parcel of property in the city.

## **SUBSIDIZED HOUSING ASSESSMENT STUDY**

Chairman Wardner called on Mr. Gary L. Stenson, President, MetroPlains Development, for comments on the subsidized housing assessment study. A copy of Mr. Stenson's prepared testimony is attached as Appendix G. He reviewed his testimony and urged the committee to support the income approach for valuing affordable multifamily housing.

Representative Lloyd asked Mr. Stenson for an example of how the income approach to valuation would work. Mr. Stenson said generally the net operating income from a project is capitalized at 9 to 12 percent. He said a property with \$10,000 net operating income and a 10 percent capitalization rate would have an income approach valuation of \$100,000.

Chairman Wardner called on Mr. Steven Hart, St. Cloud, Minnesota, for comments on the subsidized housing assessment study. Mr. Hart said he has a property tax consulting firm that does consulting work in 14 states. He said most of the states in which his firm works use the cost approach to valuation of property. He said the market approach or income approach are optional valuation methods.

Mr. Hart said most people think the money from the tax credit under Internal Revenue Code Section 42 is money in the developer's pocket. He said that is an incorrect assumption. He said the tax credit is discounted in value and sold to investors and the money received from investors becomes equity in the housing project. He said without this infusion of equity, the projects would not be possible.

Senator Urlacher said he owns an interest in property in Taylor, North Dakota, that is subject to rent restrictions. He said there was no subsidy provided by federal law at the time the property was constructed. He said the property has been a losing investment.

Chairman Wardner called on Mr. Pat Fricke, Director, North Dakota Housing Finance Agency, for information on subsidized housing unit vacancy rates in the state. Mr. Fricke distributed copies of information to address these issues. A copy is attached as Appendix H. He said the graph on the top of the handout shows vacancy rates for Department of Housing and Urban Development (HUD Section 8) property and the chart on the bottom of the handout provides information on Internal Revenue Code Section 42 subsidy property in the state.

Mr. Fricke said it is also significant to point out that there are differences in reporting dates for the two kinds of property and there is some degree of overlap of projects because projects in limited instances may qualify for both programs.

Chairman Wardner called on Mr. Ben Hushka, City Assessor, Fargo, for testimony relating to the subsidized housing assessment study. A copy of Mr. Hushka's prepared testimony is attached as Appendix I.

Mr. Hushka said if the Legislative Assembly determines that part of the value of subsidized housing should be exempt from property taxes, he believes the best way to achieve that objective is not to reduce valuation by changing the assessment method but to create an exemption. He said recent legislation in Iowa was described at the previous committee meeting. He said problems of interpretation have

developed under the Iowa legislation and one Iowa commentator has said that some form of exemption would have been better than redefining the method of assessment for these properties.

Representative Carlson asked whether under existing law an assessor could use the income approach in valuation of subsidized housing properties. Mr. Hushka said he believes the income approach could be used under the language of existing law.

Senator Kroeplin asked how long rent limitations must remain in place for subsidized housing. Mr. Stenson said the rent limits originally were 15 years but have since been increased to 30 years and in some cases longer than 30 years.

Committee counsel asked Mr. Hushka how he would suggest measuring the amount of the exemption Mr. Hushka proposed as an option for consideration. Mr. Hushka said his concept for the exemption is that two components would be included, one of which is the value of the tax credit and the other is based on rent restrictions and their effect on property market value.

Committee counsel said because the valuation reduction would be appropriate in years rent restrictions are in place, it might be appropriate to limit an exemption to the number of years rent restrictions exist for the property. Mr. Hushka said he would agree that such a limitation is appropriate.

Senator Urlacher suggested that a bill draft based on Mr. Hushka's suggestion should be prepared. He said consideration should also be given to other subsidy programs. He suggested the Legislative Council staff work with Mr. Hushka, Mr. Stenson, the Tax Department, and others to refine the concept for bill draft purposes.

Chairman Wardner said the bill draft suggested by Senator Urlacher would be prepared for the next committee meeting. He asked whether committee members have any other requests for information for the next meeting.

Senator Nichols said a bill draft should be prepared to change the agricultural property assessed valuation formula from a landlord's share basis to a cash rent basis over a period of five years. He said he envisions 20 percent of valuation based on cash rent in the first year and an additional 20 percent in each subsequent year until the full basis of the formula is cash rent.

Representative Kroeber said a bill draft should be prepared to eliminate the federal income tax deduction for corporate income tax purposes and to reduce corporate income tax rates accordingly to a revenue-neutral rate.

Representative Drovdal said he would work with the Legislative Council staff to develop a bill draft on the homestead credit exemption with an inflation factor based on the federal poverty level.

Chairman Wardner said he would like Mr. Aakre and Mr. Meyer to collaborate to provide expert analysis of the agricultural property valuation formula operation in sample counties to determine what is causing property values to rise so much in some counties.

Chairman Wardner said a bill draft should be prepared to address the extension of special assessments to private commercial property on University of North Dakota land.

**It was moved by Representative Klein, seconded by Representative Carlson, and carried on a voice vote that the meeting be adjourned.**

The meeting was adjourned at 3:45 p.m.

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John Walstad  
Code Revisor

ATTACH:9