

NORTH DAKOTA LEGISLATIVE COUNCIL

Minutes of the

TAXATION COMMITTEE

Tuesday, April 9, 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 Kroeplin, Ronald Nichols, Randy A. Schobinger, Herb Urlacher; Representatives Michael Brandenburg, Byron Clark, David Drovdal, Gil Herbel, Frank Klein, Joe Kroeber, Eugene Nicholas, Kenton Onstad, Dennis J. Renner, Earl Rennerfeldt, Dan Ruby, Arlo E. Schmidt, Ray H. Wikenheiser

Members absent: Senator Ben Tollefson; Representatives Al Carlson, Michael Grosz, Edward H. Lloyd

Others present: See Appendix A

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

CORPORATE INCOME TAX STUDY

Chairman Wardner called on Ms. Linda Butts, Director, Economic Development and Finance Division, Department of Commerce, for presentation of information on business location decision factors. A copy of Ms. Butts' prepared testimony is attached as Appendix B.

Chairman Wardner called on Mr. Cory Finneman, Vice President, Research, Economic Development and Finance Division, Department of Commerce, for further comments on corporate income tax and economic development issues. A copy of Mr. Finneman's prepared testimony is attached as Appendix C.

Mr. Finneman said one aspect of the topics researched by the division was application of the Regional Economic Model, Inc., model to measure the positive economic effect of eliminating the North Dakota corporate income tax. He said the model indicates that the positive economic activity generated by eliminating the corporate income tax would not generate adequate revenue to offset the lost corporate income tax revenue to the state.

Senator Schobinger asked whether there would be a positive effect to eliminating the five-year abatement that may be granted to economic development projects from the corporate income tax. Mr. Finneman said that question was not addressed in the research. Senator Schobinger asked whether it

would be possible to measure revenue effect of eliminating or creating exemptions. Mr. Finneman said that would be possible, but the positive revenue effects would not be of the magnitude in the chart presented for consideration because the chart compares complete elimination of corporate income taxes.

Representative Ruby asked whether Mr. Finneman believes it would be advantageous to economic development efforts to reduce the corporate income tax rate and eliminate the federal income tax deduction to remain relatively neutral in revenue. Mr. Finneman said he believes reducing the corporate income tax rate would benefit the state in competitive considerations of businesses.

Senator Kroeplin said the Economic Development and Finance Division has identified errors in comparisons of state corporate income tax rates. He asked whether the division tries to correct these errors when they are found. Mr. Finneman said the department tries to correct errors when they are discovered, but errors are frequent and the damage of misinformation may be done before the correction can be made.

Representative Schmidt said some companies pay property taxes and income taxes, but some companies doing business in the state pay only income taxes. He said eliminating income taxes would mean that those companies would pay no taxes. Mr. Finneman said he is not able to address that issue and said it might be necessary to ask the Tax Department to consider this question.

In response to a question from Representative Brandenburg, Mr. Finneman said reducing corporate income tax rates would make the state more competitive in attracting businesses. Representative Brandenburg asked whether it would be possible to estimate the new jobs that might be created if the corporate income tax rate is reduced. He said that information might assist the committee in considering these issues. Mr. Finneman said it might be difficult to make such an estimate, but the issue could be considered.

Chairman Wardner called on Ms. Kathryn Strombeck, Tax Department, for information on several corporate income tax issues raised by the committee at the previous meeting. A copy of Ms. Strombeck's prepared testimony is attached as

Appendix D. A copy of statistical information comparing urban and rural corporate income tax sources and inflation statistics is attached as Appendix E. A copy of Ms. Strombeck's analysis of the fiscal effect of recently enacted H.R.3090 (Job Creation and Worker Assistance Act of 2002) is attached as Appendix F.

Senator Kroeplin said the data presented indicates business growth in rural areas has outpaced growth in urban areas, and he asked whether it is possible to identify what kinds of businesses have grown in rural areas. Ms. Strombeck said it is not possible at this time to identify kinds of businesses that have grown and there may be some confidentiality problems with identifying information on some businesses, but the department could look into that issue if the committee wishes. Senator Kroeplin said that would be useful information, and he asked whether that review could include consideration of whether some of the change is from family corporate farming.

Representative Kroeber said previous attempts to eliminate the federal corporate income tax deduction and reduce rates accordingly caused some corporations to oppose the change because they have a large stake in the federal income tax deduction. He asked whether the reduction in federal corporate income taxes could reduce some of that resistance. Ms. Strombeck said that is correct because it would reduce the amount available for the federal corporate income tax deduction, but she is not sure whether such a change is measureable.

Chairman Wardner called on Ms. Mary Loftsgard, Corporate Income Tax Section Supervisor, Tax Department, for presentation of information prepared in response to questions raised by the committee at its previous meeting. A copy of Ms. Loftsgard's prepared testimony is attached as Appendix G. Ms. Loftsgard reviewed her testimony relating to the issue of income tax status of cooperatives as compared to "C" corporations.

Chairman Wardner called on committee counsel for presentation of a memorandum entitled *Corporations - Considerations in Choosing the Form of a Business Entity*. Committee counsel said the memorandum reviews factors influencing business decisions of whether to operate as a corporation or some other legal entity. He said the choice of business form can be a very complicated question and the memorandum intends only to briefly review the most significant reasons for determining the legal entity to use for operation of a business.

Chairman Wardner called on committee counsel to review a bill draft to eliminate the corporate income tax deduction for federal income taxes paid and to reduce corporate income tax rates by an amount intended to be revenue-neutral. Committee counsel said the bill draft makes changes in the financial institutions tax to adjust cross-references to redesignated provisions in the bill draft. He said the financial institutions tax was partially modeled after the corporate

income tax. He said the committee could consider changing the financial institutions tax but, because the committee has not addressed that issue, the bill draft does not change the financial institutions tax and retains the deduction of federal income taxes. He said the bill draft eliminates the corporate income tax deduction for federal income taxes paid and reduces corporate income tax rates by approximately 30 percent. He said the bill draft is probably not revenue-neutral because of recent federal legislation and a provision relating to water's edge filings. He said a corporation electing to use the water's edge method must elect not to take the deduction for federal income taxes paid. He said eliminating the deduction will make it more likely that more corporations will choose the water's edge method, which would have a negative fiscal effect that has not been considered.

Senator Schobinger asked Ms. Strombeck whether the rates in the bill draft were designed as revenue-neutral based on projected revenues. Ms. Strombeck said the rates were determined based on projections that existed at that time. She said as updated information becomes available estimates must be updated. She said the recent federal changes and the effect on water's edge filers were not accounted for in the rates included in the bill draft. Senator Schobinger asked whether a flat rate corporate income tax might be considered. Ms. Strombeck said she is not certain of the effects of a flat rate tax, but she knows that most corporate income is taxed at the highest bracket rate. Senator Schobinger asked that when the computations are made of revenue-neutral rates based on updated information, computation also should be made of what flat rate tax would be revenue-neutral.

Representative Kroeber asked whether it is possible to identify corporations that would have an increased tax burden by the approach in the bill draft. Committee counsel said corporations with a larger than average federal corporate income tax deduction would see a tax increase as a result of this approach. He said a bill was introduced in 1987 to make a similar change and Montana-Dakota Utilities was strongly opposed to the bill at that time. He said he does not know whether Montana-Dakota Utilities would still be in opposition to this kind of change.

Representative Ruby said the issue of rate reduction raises interesting questions regarding marketability of North Dakota as a business location. He said it appears from information received by the committee that as corporate income tax rates decrease there is an increase in economic development activity. He said he questions whether it could be determined at what rate of tax would the benefit of rate reduction offset the loss of tax collections from the reduced rate. He said perhaps consideration could be given to looking at reducing the rate to a point that would not be revenue-neutral in terms of tax

collections but could be revenue-neutral with consideration of enhanced economic development.

Representative Onstad said it must be remembered that tax collections are a predictable amount and economic development is not a sure thing to generate increased revenue to the state.

In response to a question from Representative Schmidt, Ms. Strombeck said the approach in the bill draft can be summarized by the statement that corporations in North Dakota currently deduct about 30 percent of their federal taxable income in the form of the federal corporate income taxes paid deduction. She said that because of this fact, eliminating that deduction allows a 30 percent reduction in corporate income tax rates while retaining the same revenue to the state.

Representative Kroeber asked whether it is correct to state that H.R.3090 reduces federal corporate income taxes and, because of that reduction, this bill draft would increase state income tax collections. Ms. Strombeck said it is correct that the bill draft now has a positive effect to the state and the estimates in this bill draft were made before passage of the federal legislation.

Ms. Loftsgard said there are some technical aspects of the bill draft to which the Tax Department might suggest changes. She said North Dakota Century Code (NDCC) Section 57-38-34.3 requires reporting changes to federal income tax liability, which would not be necessary if federal income tax liability is not deductible. She said another consideration is that the tax rates in the bill draft were based on excluding consideration of changes for water's edge filers. She said the issue of whether to keep water's edge filers on the same basis as they are presently or change their rates also is an issue for committee consideration. She said the committee must consider how to treat water's edge filers in the bill draft.

Representative Schmidt said H.R.3090 has provided a substantial corporate income tax reduction. He said he thinks the public would have a problem with providing an additional corporate income tax reduction at the state level.

Representative Clark said he does not know about public perception of tax breaks for corporations. He said the other side of the coin is the existing misunderstanding of the public that North Dakota has a high corporate income tax under current law.

Representative Brandenburg said he would hope that the Legislative Assembly could present the concept in the bill draft to the public as a way to create jobs and promote economic growth.

Representative Herbel said he agrees that economic development is an important consideration for North Dakota. He said he has seen articles stating that North Dakota is a high corporate income tax state and this approach might dispel such misinformation.

Senator Schobinger said the committee should obtain followup information on flat rate application and

what kind of corporations would be impacted if lower rate brackets are eliminated.

Representative Kroeber said the committee should also obtain further information regarding impact on water's edge filing effects.

Senator Kroeplin said he is concerned that a flat rate corporate income tax would adversely impact small corporations and beginning businesses.

Senator Schobinger said that concern is why he requested information on who would be impacted in lower corporate income tax rate brackets.

HOMESTEAD CREDIT STUDY

Chairman Wardner called on committee counsel for presentation of a memorandum entitled *Minnesota Property Tax Relief Programs*. Committee counsel said the program called a homestead credit in Minnesota is substantially different from the program called a homestead credit in North Dakota. He said the Minnesota circuit breaker program is closer in spirit to the North Dakota homestead credit. He said the Minnesota homestead credit is really only a buydown of property taxes for resident property owners, which has been funded at different levels since it was created in 1967. He said the Minnesota circuit breaker program is available for persons 65 years of age or older, which is similar to the North Dakota homestead credit, but the Minnesota program is only a property tax deferral rather than a reduction. He said he questions the constitutionality of Minnesota property tax rebates that have the effect of lowering property taxes for Minnesota residents but not for any other property owners.

Senator Cook said he requested information on the Minnesota property tax relief programs because he thinks consideration should be given to adopting an approach similar to Minnesota's, in which the state would rebate property taxes to North Dakota residents.

Chairman Wardner called on committee counsel for presentation of a bill draft relating to eligibility for and application of the homestead property tax credit. Committee counsel said at the previous committee meeting Representative Drovdal agreed to work with the Legislative Council staff to develop a bill draft to use the federal poverty level as a basis for income limits under the homestead property tax credit. He said this bill draft is the product. He said the bill draft establishes income limits in five categories of eligibility based on income. He said if the person's income does not exceed the federal poverty level, the person is entitled to a reduction of 100 percent of taxable valuation of the person's homestead. He said maximum valuation reductions are eliminated by the bill draft, so the entire value of even a very valuable home could be exempted. He said the federal poverty level current income limitations would be \$8,860 for a single person and \$11,940 for a married couple. He said the income limitations cited are based on

February 2002 guidelines from the United States Department of Health and Human Services. He said the second category is up to 110 percent of the federal poverty level, which entitles the person to a reduction of 80 percent of the taxable valuation of the person's homestead. He said the 110 percent limit is equivalent to \$9,746 for a single person and \$13,134 for a married couple. He said the third gradation of income is up to 120 percent of the federal poverty level, which entitles the person to a reduction of 60 percent of the taxable valuation of the person's homestead. He said the equivalent dollar amounts for the 120 percent level are \$10,632 for a single person and \$14,328 for a married couple. He said the next category is up to 130 percent of the federal poverty level, which entitles the person to a reduction of 40 percent of the taxable valuation of the person's homestead. He said the 130 percent level is equivalent to \$11,518 for a single person and \$15,522 for a married couple. He said the highest income category of eligibility is up to 140 percent of the federal poverty level, which entitles the person to a reduction of 20 percent of the taxable valuation of the person's homestead. He said the equivalent income at 140 percent of the federal poverty level is \$12,404 for a single person and \$16,716 for a married couple.

Committee counsel said the bill draft makes some changes in the statutory provision to clarify application of the credit. He said persons residing together as spouses or when one or more is a dependent of another are entitled to only one exemption between or among them. He said coowners of property who reside together are each entitled to a percentage of a full exemption equal to their ownership interest in the property. He said the bill draft retains the current limitation of \$50,000 of assets, excluding the value of the homestead, to qualify for the credit. He said a provision is added to disallow a renter's refund for a person who has received a homestead credit exemption in the same year.

Committee counsel said the bill draft provides that for renters, the maximum \$240 rent refund per year remains available, but the same income categories are applied as were used for the homestead credit, based on the federal poverty level. He said in the five categories of income eligibility, the lowest income level individuals are eligible for a \$240 refund and the refund is reduced by 20 percent in each stage as income increases, up to the maximum of 140 percent of the federal poverty level, which allows a refund of \$48.

Committee counsel said that because the bill draft changes the income limitations for homestead credit and renter's refund eligibility and because the state reimburses political subdivisions for property tax revenues excused by the exemption, an analysis was requested of the fiscal effect of the bill draft.

Senator Cook asked how the credit applies for people who are coowners and only one qualifies

under the income limitations. Ms. Marcy Dickerson, State Supervisor of Assessments, Tax Department, said if only one coowner qualifies under the income limitations, that person receives the homestead credit, but it is applied only to the percentage of value of the homestead owned by that person. She said the bill draft provides this treatment specifically and current law has been interpreted to provide this treatment.

Representative Drovdal said he came up with the basis for this approach for several reasons. He said the federal poverty level as an income measure is used because it will change each year based on income statistics developed by the federal government. He said the current statutory provision must be adjusted frequently by legislation or it will not keep pace with the economy. He said the current law limits the amount of reduction available against taxable valuation of property. He said in reality this limits the complete exemption of a homestead to valuation of approximately \$44,000. He said the bill draft removes limits on valuation reductions. He said he does not believe this will cause too much benefit to wealthy individuals because of the annual income limitations and the limitation on \$50,000 of assets other than the homestead. He said he does not believe individuals with an extremely high-value home could qualify for exemption. He said he has not seen an analysis of the fiscal effect of this bill draft yet so the committee should understand that he proposed the provisions in the bill draft as a starting point for discussion.

Chairman Wardner called on Ms. Dickerson for testimony relating to the homestead credit bill draft. A copy of Ms. Dickerson's prepared testimony is attached as Appendix H. Ms. Dickerson said it is estimated that the bill draft approach would result in a 30 percent increase in the cost to the state of the homestead credit, which would require an increase of \$1,362,244 per biennium as compared to the current appropriation.

Ms. Dickerson said the bill draft will reduce the qualifying income for single individuals. She said under current law there is no distinction between the income limit for a single person or a married couple and the bill draft would establish separate income limits for single and married individuals.

Ms. Dickerson said annual changes in the poverty level and the income limitations will complicate administration of the homestead credit program. She said it will be necessary to publish a new brochure or guideline every year to reflect current income limitations. She said under present law, publications are usable for at least one biennium.

Ms. Dickerson said homeowners apply for the credit for the current taxable year and renters apply for refunds based on the previous taxable year, so different poverty levels will have to be used for homeowners and renters at the same time.

Ms. Dickerson said she would suggest retaining maximum taxable valuation reductions for

homesteads in the statutory provision. She also made suggestions for technical changes in language in the bill draft.

Representative Drovdal said he would suggest that the bill draft be amended to incorporate Ms. Dickerson's suggestions, including suggested limitations on taxable valuation reductions and technical changes. Chairman Wardner requested that the Legislative Council staff revise the bill draft accordingly for the next committee meeting.

Chairman Wardner called on Ms. Dickerson for review of an opinion of the Attorney General relating to the State Board of Equalization. A copy of Ms. Dickerson's prepared testimony is attached as Appendix I. Ms. Dickerson said the opinion of the Attorney General reviews the duties of the State Board of Equalization in equalizing valuation of property across the state. She said the State Board of Equalization has determined that agricultural property valuations by counties must be within plus or minus 5 percent of the county values determined by North Dakota State University under the statutory valuation formula. She said the North Dakota Supreme Court has ruled that determinations of the State Board of Equalization will not be disturbed by a court unless they are arbitrary, capricious, or unreasonable. She said the Attorney General determined that the plus or minus 5 percent tolerance adopted by the State Board of Equalization appears to be reasonable.

SPECIAL ASSESSMENTS STUDY

Chairman Wardner called on Dr. Charles Kupchella, President, University of North Dakota, for comments on the special assessments study. A copy of a summary of Dr. Kupchella's testimony is attached as Appendix J. Dr. Kupchella said the Legislative Assembly appropriated over \$50 million for flood control efforts in Grand Forks on behalf of the state and state institutions. He said this appropriation is greatly appreciated by the university and the city of Grand Forks. He said state property is generally subject to special assessments and special legislation was enacted to exempt state property in Grand Forks from city flood control special assessments.

Dr. Kupchella said Grand Forks city officials suggested that flood control special assessments should apply to certain proposed commercial ventures to be located on University of North Dakota property. He said Grand Forks city officials suggested that these proposed ventures would enjoy an advantage over competitors if they are not subject to flood control special assessments. Dr. Kupchella said the University of North Dakota position is that the university will not assist a commercial venture to gain competitive advantages over other commercial enterprises.

Dr. Kupchella said the Legislative Council requested the University of North Dakota to provide information on properties at the university in which a private entity has an ownership or leasehold interest.

He said there are no properties in which a private entity has an ownership interest. He said the only property in which a private entity has a leasehold interest is the Ralph Engelstad Arena, which was built with private funds and is owned by a private entity and located on land leased from the state. He said profits from this enterprise benefit the University of North Dakota.

Dr. Kupchella said there are two university properties that are currently being considered for potential lease to private entities for commercial use. He said one property is located on the corner of Columbia Road and Gateway Drive and an agreement has been entered with a developer who is seeking to lease that property to commercial enterprises. He said the other property would be the site of a proposed Hilton Hotel.

Dr. Kupchella said areas of concern to the University of North Dakota include the University Bookstore, Memorial Union, Hyslop Sports Complex, campus housing, and the Energy and Environmental Research Center. He said the University of North Dakota suggests that any legislation should avoid subjecting these properties to flood control special assessments. Dr. Kupchella suggested that state land and state buildings on state land should be exempt from flood control special assessments. He said as new buildings are built on state land and operated by commercial ventures, those buildings should be subject to flood control special assessments if they are owned by a private, for-profit entity and used for commercial purposes.

Senator Schobinger said the University Bookstore competes with other bookstores in the community and asked whether that should subject that property to special assessments. Dr. Kupchella said it is true that the bookstore competes to some degree with other bookstores in the community. He said it is also true that there is some degree of competition in other operations of the university, such as residence halls and dining facilities. He said the question of special assessments should not be decided only on the basis of competitive considerations because of the complexity of university operations but should instead be based on building ownership and commercial use.

Senator Schobinger asked if privately owned buildings on university property are assessed, whether the university would have to pay the assessment. Dr. Kupchella said he believes it would be appropriate for the assessment to be made directly against and paid by the business operator.

Committee counsel said as the Engelstad Arena is owned by a private entity, if ownership is the measure of application of special assessments, the Engelstad Arena could be subject to assessments. Dr. Kupchella said by contract the Engelstad Arena becomes property of the University of North Dakota in the future and in the interim any profits from the operation of the facility inure to the benefit of the university. He said this facility should not be subject

to special assessments because it is not operated with a view to profit by the private entity.

Representative Schmidt asked whether the University of North Dakota has paid special assessments on its property for other than flood control purposes. Dr. Kupchella said the university is not exempt from general special assessments. He said as special assessment projects are completed and assessments are levied against university property, the university must seek appropriation authority from the Legislative Assembly for payment of those assessments.

Chairman Wardner called on committee counsel who reviewed a bill draft to allow city flood control special assessments to be applied against property or land owned or leased by a private, for-profit entity and used by it for commercial purposes. He said he believes the bill draft would require adjustments to be compatible with the suggestions made by Dr. Kupchella. He said it appears that removal of land and leases from the new language would comply. He said it appears that language should be added to make clear that the Engelstad Arena is not subject to special assessments.

Dr. Kupchella said he believes the suggested changes would agree with the university's concept of how assessments should be applied.

Senator Nichols asked whether a lien for special assessments could attach to a privately owned building located on state-owned land. Committee counsel said he believes this would be legally acceptable, but research should be done on this question.

Mr. Jerry Hjelmstad, North Dakota League of Cities, said it might also be advisable to specify in the language of the bill draft that the owner of property subject to special assessments is responsible for payment of assessments.

Chairman Wardner called on committee counsel to review a bill draft to provide for voter approval of city-wide assessments in larger cities. Committee counsel said the bill draft creates a new section of law to require that in a city of 5,000 or more population, if an improvement district contains 75 percent or more of the area of property in the city, a call for bids for a special assessment project may not be issued unless the project has been previously approved by a majority of city voters. He said the section specifically provides that it may not be superseded by a city home rule charter or ordinance. He said the bill draft was prepared in consultation with Senator Cook, who agreed at the previous meeting to work on development of the bill draft. Committee counsel said it was decided to require voter approval before a call for bids so that the voter approval will come after the engineer's report, resolution of necessity adoption, two newspaper publications of the resolution, and expiration of the time to protest the project. He said this would add one additional requirement before bids are requested.

Representative Herbel asked why 5,000 population was chosen as the point when a vote is required. Senator Cook said he chose the population and area percentage levels because they seemed like reasonable amounts. He said he did not intend to affect smaller cities with this requirement, and he did not intend to affect projects that do not affect a large percentage or all of a city.

Representative Schmidt asked whether there is any requirement for city voter approval of special assessment projects. Senator Cook said existing law provides no opportunity for voter approval of a special assessment project affecting all or most of a city. He said the only opportunity of taxpayers who object to a special assessment project is to protest out of the project by petition.

Senator Cook said it appears that citywide assessments are used by some larger cities but not by others. He said he does not know why some cities seem to use citywide assessments regularly and others do not. He said this bill draft intends to add extra protection for taxpayers.

Chairman Wardner called on committee counsel to review a bill draft to require a resolution of necessity for a special assessment project to include estimated assessments against property. Committee counsel said the bill draft was suggested by Senator Cook at the previous committee meeting and the bill draft was prepared in consultation with Senator Cook. He said at the time a resolution of necessity is published the probable cost of the work in the engineer's report and the amount of property included within the district are known. He said the bill draft requires the resolution to show the estimated assessment against each affected parcel of property, based on these known facts. He said current law requires that assessments be spread against property by the special assessment commission, which is not in existence at the time of adoption of the resolution of necessity. He said it would be necessary for the special assessment commission to be established to make these estimates or for another city official to make these estimates for each parcel.

Senator Cook said he thinks there are two benefits that would exist in approving this change to special assessment procedures. He said at the time a property owner has an opportunity to protest a special assessment project, the person has no way of knowing the amount of assessment against his property. He said under current law when the cost of a project for a parcel of property is determined, there is no way to stop the special assessment proceeding and the only option is to protest the amount of assessment against your property. He said the approach in the bill draft would allow a basis for intelligent decisions by taxpayers during the special assessment process. He said the special assessment commission could meet earlier than under

current procedures to spread estimated assessments against property.

Chairman Wardner called on Mr. Hjelmstad for comments on alternative methods of determining special assessment benefits. Mr. Hjelmstad said discussion at the previous committee meeting focused on reasons for the existence of a separate chapter of law on the alternative method of determining special assessments and the reason this law was created. Mr. Hjelmstad said spreading of assessment benefits is a difficult task that usually involves use of a set standard such as frontage feet of a lot. He said 1967 legislation adopted an alternative method, known as the Washington state method, which allows spreading of assessments on the basis of the size or number of square feet in a lot of real property. He said this law is permissive and may be used by a city as an option to the method otherwise provided by law.

Committee counsel distributed to committee members copies of NDCC Chapters 40-22 through 40-27, relating to special assessments. Senator Cook said he asked for distribution of the statutory provisions to illustrate that the provisions seem archaic and hard to follow. He said some of the statutory provisions are puzzling. He said the last sentence in Section 40-22-08 provides that "nothing herein shall prevent a municipality from making and financing any improvement and levying special assessments therefor under any alternate procedure set forth in this title." He said he questions what purpose this language serves. He said Section 40-22-43 provides that defects and irregularities in special assessment proceedings, unless there is fraud or a constitutional violation, do not invalidate the proceedings and an action may not be commenced based on defects or irregularities unless it is commenced within 30 days of adoption of the resolution awarding sale of warrants to finance the project. He said it appears to him that this provision means that unless fraud can be proven, a city does not have to comply with the statutory requirements laid out for the special assessment process. He suggested committee members read through the statutory provisions and question the reasons for existence of some of the provisions.

Senator Cook said he believes cities are allowed to add a certain percentage to special assessment projects as fees to cover administrative and engineering costs for the city. He said there does not appear to be a statutory limit on fees that may be added to project costs by a city. He asked Mr. Hjelmstad whether there is a certain amount that cities add as fees on special assessment projects. Mr. Hjelmstad said cities are allowed to add administrative costs to projects, but he does not believe there is a percentage limitation. Senator Cook said he believes there should be a statutory limit on the imposition of fees on a special assessment project for city administrative and engineering expenses.

Chairman Wardner called on committee counsel for information on special assessments in other states. Committee counsel said at the previous meeting it was requested that information be gathered on whether all states allow imposition of special assessments. He said a copy of a chart prepared by the United States Bureau of the Census was distributed to committee members. He said the chart shows that special assessments are levied in each state. He said the information in the chart raises a number of questions. He said there is a substantial variation in the per capita amount of special assessments among states. He said North Dakota appears rather high in per capita special assessments and surrounding states are also at comparable high levels of per capita amounts for special assessments. He said the question is why some states are substantially lower in use of special assessments on a per capita basis. He said extensive efforts were made by the Legislative Council staff to obtain information comparing provisions for special assessments in other states. He said no information was found to allow comparison of special assessment laws of other states or the use of special assessments.

AGRICULTURAL PROPERTY ASSESSMENT

Chairman Wardner called on Mr. Dwight Aakre, North Dakota State University Department of Agribusiness and Applied Economics, for testimony on agricultural property assessment. A copy of Mr. Aakre's prepared testimony is attached as Appendix K. Mr. Aakre said he was requested to provide information comparing changes in agricultural property valuations in Pembina, Walsh, and Grand Forks Counties relative to other counties in the state.

Mr. Aakre said he calculated valuation changes for all agricultural land for all counties in North Dakota for the years 1983 through 2002. He said the change in agricultural property value for the three counties in question has been typical of the average for the state during this time period. He said the statistics used to determine landowner share of gross returns for the three counties in question have not changed much in recent years so if there has been an increase in property valuations, it is the result of a declining capitalization rate.

Senator Kroeplin said the Agribank annual mortgage rate shown in the chart shows a 6.48 percent rate for 2001. He said this rate seems unrealistic. Mr. Aakre said that rate seemed unrealistic to him also. He is not sure why the rate declined by such a large amount in 2001, but it is the amount reported by Agribank. He said he can contact Agribank to inquire about how the rate is determined and why the rate declined by such a substantial amount in one year.

Representative Renner asked what rate of interest is required for a capitalization rate in the valuation formula. Committee counsel said the statutory

requirement is use of a 10-year average of the gross Federal Land Bank mortgage rate of interest for North Dakota. He said the 10-year average is computed from the most recent 12 years and the highest and lowest years are excluded from consideration. He said the Federal Land Bank no longer exists and this statutory provision has not been updated, but Agribank as the successor to the Federal Land Bank has been used in place of the Federal Land Bank.

Chairman Wardner requested that information be presented to the committee on the capitalization rate used under the formula and how those rates are determined by Agribank.

Representative Herbel said it appears to him that it is necessary to stabilize the capitalization rate because of its influence on agricultural property valuation. He asked whether Mr. Aakre has ideas on how that might be accomplished. Mr. Aakre said there is no question that the capitalization rate is a huge influence on agricultural property valuation under the formula. He said he is not sure there will ever be an agreement on what the correct capitalization rate should be. He said he could give some consideration to ways to stabilize changes in property valuation from year to year.

Representative Schmidt said he believes the mortgage interest rates used to determine the capitalization rate are based on 15-year loans. He said he is not sure that is the appropriate basis for the capitalization rate.

Representative Clark asked whether we are overweighting the cost of borrowing in the formula by use of the capitalization rate in the manner provided by statute. He asked whether it would be possible to give the cost of borrowing less weight in the formula. He said he also questions whether the increases in the consumer price index have been as high as the increases in agricultural property valuation under the formula. Mr. Aakre said increases in agricultural property values under the formula have been less than increases in the consumer price index during the same time period. He said he is not prepared to address the question of whether different weighting could be used for the capitalization rate.

Representative Renner said he would like to see a comparison of these Federal Land Bank and Agribank mortgage rates of interest to national prime interest rate changes during the same time period.

Representative Onstad said the profitability of farming has not trended along with the cost of borrowing. He asked whether the rationale behind the agricultural property valuation formula has changed from the time it was established.

Chairman Wardner called on Mr. Doug Hartwig, State Statistician, North Dakota Agricultural Statistics Service, for testimony on data used in the agricultural productivity valuation formula. He distributed copies of a 2002 county rents and values data report compiled by the North Dakota Agricultural Statistics

Service. A copy of Mr. Hartwig's handout is attached as Appendix L.

Mr. Hartwig said the North Dakota Agricultural Statistics Service data is used heavily in the model to determine agricultural property valuations. He said the letter he received from the Legislative Council staff requested information on two specific questions. He said the September report of acreage harvested or "to be harvested" was a concern because it was suggested by some observers that this requires predicting the harvest for crops that are still in the field. He said this is not a cause for concern because the September report is for only small grains and the harvest is complete for small grains, so the use of estimates of acres "to be harvested" should be minimal to none. He said the other question specifically presented is the effect of preventive planting acres in the statistical information generated by the North Dakota Agricultural Statistics Service. He said this should be of no effect on the data because preventive planting acres are excluded from statistics collected by the North Dakota Agricultural Statistics Service.

Senator Kroeplin said everything at the Farm Service Agency (FSA) office is public information, and he asked whether Mr. Hartwig compares FSA information to the North Dakota Agricultural Statistics Service information. Mr. Hartwig said the North Dakota Agricultural Statistics Service obtains and compares the FSA statistics for use as control data and it proves to be quite close on a comparison basis.

Chairman Wardner called on committee counsel to review a bill draft to phase in reliance on cash rent data under the agricultural property valuation formula. Committee counsel said at the previous committee meeting it was suggested that it might be possible to phase in over a five-year period use of cash rent data in the valuation formula. He said the bill draft phases in use of cash rent data as the component to determine annual gross return for agricultural property and the bill provides that after the phase-in period ends in 2006, annual gross return would be based entirely on cash rent data. He said he questions whether it would be necessary to add to the new language a reference to reducing cash rent data by estimated property taxes.

Representative Renner asked where cash rent statistics would come from. Committee counsel said current law does not provide where cash rent statistics are to originate and the bill draft does not make any provision either.

Senator Nichols asked Mr. Aakre how he would envision the operation of the bill draft changing the basis of statistics to cash rent. Mr. Aakre said the North Dakota Agricultural Statistics Service gathers cash rent statistics. He said during the phase-in period the statistics could be weighted and used in the formula by using a number of years of cash rent

statistics and a number of years of production statistics.

Mr. Hartwig said the North Dakota Agricultural Statistics Service survey is done annually and is sent to 3,100 agricultural producers. He said approximately 2,400 responses were received, which is believed to be an excellent response rate. He reviewed the data in the report he distributed.

Representative Clark said the statutory formula has a reference to a reduction of annual gross return by crop marketing expenses. He asked what crop marketing expenses are used in the formula. Mr. Aakre said this was included when the formula was originated and was assumed to be about one-third of the cost of the crop.

Senator Urlacher said cash rents are going up for reasons that are not related to what the land will produce. He said he questions whether it is appropriate to change the basis of the determination of returns to use of only cash rent.

Senator Kroeplin said in his area cash rents have trended downward or remained flat while land values have increased in the past 20 years.

Representative Rennerfeldt said he also questions use of cash rent because gathering of statistics and accuracy might be in doubt. He said it could be necessary to make cash rent reporting mandatory, which would not be popular among agricultural producers.

Senator Urlacher said he thinks use of cash rent exclusively would also introduce less stability in the formula. He said he thinks cash rents could change rapidly and substantially change valuations.

Representative Renner said he believes the current formula is more dependable than exclusive use of cash rents. He said the current formula appears to be most questionable in its use of the capitalization rate.

Representative Herbel said reliability of cash rent surveys might be in question if farm operators know the information they provide will be the basis for taxable valuation determinations.

Ms. Dickerson said that for 2001 there were 14,231 homestead credit claims from property owners totaling \$1,814,130. She said that for 2001 there were 1,417 homestead credit renter refund claims totaling \$178,406.

Chairman Wardner called on Ms. Dickerson to address agricultural property assessment issues. Ms. Dickerson distributed prepared testimony addressing two questions raised by the committee at its previous meeting. A copy of her prepared testimony is attached as Appendix M.

Ms. Dickerson said a comment was made at the previous committee meeting that in Wells County valuations are applied to every parcel of agricultural property based on soil type without distinction between cropland and noncropland. She said she contacted the Wells County director of tax

equalization and reviewed the method used, which appears to comply with statutory requirements.

Senator Urlacher said soil surveys have gotten better over the years. He said some of the older surveys may not be as good. Mr. Aakre said some soil surveys are old, some have been redone, and there are some weaknesses in some soil surveys.

Representative Schmidt said soil surveys have questionable value as assessment tools. He said the last county soil survey completed was the subject of a lot of complaints.

Mr. Ron Haugen, Department of Agribusiness and Applied Economics, North Dakota State University, said there is developing technology that will be applied to gather soil survey data. He said global positioning system and satellite imaging technology will be applied to soil surveys to improve reliability.

Chairman Wardner called on Ms. Sandy Clark, North Dakota Farm Bureau, for comments on the agricultural property assessment study. Ms. Clark said the North Dakota Farm Bureau believes the agricultural property valuation formula has worked well over the years. She said the Farm Bureau does not favor a change to exclusive use of cash rent data to determine gross returns. She said the Farm Bureau suggests that cash rents are of limited value because they might be subject in part to emotional considerations, personal relations, and honesty of responses to surveys.

Ms. Dickerson reviewed the remainder of the information she distributed to the committee in Appendix M. She said she was requested to compare taxable values and taxes levied on various classes of property from 1990-2000. She said that from 1990-2000, agricultural property has declined from 43 percent to 38 percent of total valuation of property in the state and has declined from 34 percent to 29 percent of total property taxes levied. She said during the same period residential property has increased from 29 percent to 35 percent of total property valuation and from 34 percent to 41 percent of total taxes levied. She said other property types have remained fairly constant in terms of the percentage of valuation and taxes levied during the period 1990-2000. She said there has been a substantial shift in property tax burden from agricultural property to residential property during this time period and substantial increases in total property taxes levied on all classes of property.

SUBSIDIZED HOUSING VALUATION

Chairman Wardner called on committee counsel to review a bill draft to provide a partial property tax exemption for certain subsidized housing properties. Committee counsel said the bill draft was developed in consultation with Mr. Ben Hushka, Fargo City Assessor, and other interested parties as suggested at the previous committee meeting. He said the bill draft creates a partial property tax exemption, which

was suggested to be an easier approach than changing the method of valuation of these properties. He said these properties would be valued under normal procedures and then an amount would be subtracted from the value as determined under this exemption. He said there are two components to the exemption. He said the first component is the value of a leasehold rent limitation under Section 42 of the Internal Revenue Code. He said this value is the value to the renter of having restrictions on rent. He said the second component of the exemption is the amount of or value received for the income tax credit under Section 42 of the Internal Revenue Code. He said consideration might be given to adding language to provide that this component is the "lesser of" the amount of, or value received for, the income tax credit. He said the final sentence of this exemption provides that the exemption ceases when rent restrictions no longer apply to the property. He said the bill draft is to become effective for the 2004 taxable year and it could be speeded up by one year if the committee believes it appropriate.

Committee counsel said the operation of the bill draft is difficult to envision for a layman and it might be useful to seek assistance from Mr. Hushka or Ms. Dickerson to walk through an example of how valuation and this exemption would work.

Senator Urlacher said there are different programs in the state for subsidized housing assistance. He said the bill draft deals only with subsidies under Section 42 of the Internal Revenue Code. He said from information he has been able to obtain there is approximately a 15 percent vacancy rate statewide in subsidized housing and that rate is much higher in small towns and certain areas of the state. He said he does not think it is fair to provide valuation reduction for one type of subsidized housing and not for other types.

Chairman Wardner called on Ms. Dickerson for testimony regarding the bill draft providing a property tax exemption for subsidized housing. A copy of Ms. Dickerson's prepared testimony is attached as Appendix N. Ms. Dickerson said the exemption as provided in the bill draft would work with the income approach to valuation but would be difficult under the cost approach or market approach. She said the bill draft does not require the assessor to use the income approach.

Senator Urlacher asked whether under current law assessors could arrive at the same result as under the bill draft. Ms. Dickerson said a proper assessment should recognize the factors in the bill draft as limitations on valuation under either the income or market approach.

Chairman Wardner called on Mr. Jim Knudson for comments on the bill draft. Mr. Knudson said he has met with Mr. Hushka and with Mr. Gary Stinson and Mr. Steve Stoner regarding the bill draft. He said they

have gone over the bill draft and believe it accomplishes what was intended.

Senator Cook asked whether Mr. Knudson has applied as a developer for a subsidized housing property tax exemption under the new industry exemption. Mr. Knudson said he has done that and Fargo will approve that kind of exemption. He said the difficulty with this approach is that the exemption is for a limited time and it is approved on a case-by-case basis.

COMMITTEE DISCUSSION

Representative Brandenburg said that under the committee property tax assessment study, information should be requested on railroad property tax rates and how railroad property is assessed. He said comparison of North Dakota railroad property taxes against comparable taxes in other states would be useful. Ms. Dickerson said there may be secrecy provisions that apply to some railroad tax information.

Representative Renner said a comparison should be made of mortgage interest rates used in agricultural property valuation and the New York prime rate of interest.

Senator Kroeplin said a bill draft should be prepared to redefine the interest rate under the agricultural property valuation formula to use long-term interest rates rather than the rates used in the existing formula.

Senator Cook said a bill draft should be prepared to limit the amount of fees a city may add to a special assessment project.

Senator Kroeplin said recent legislation brought cost of production into the agricultural property valuation formula. He said that change has had a good effect but has not been fully phased into the formula. He said he would like to see a bill draft to freeze agricultural property valuation for two years so the cost of production statistics can catch up to the rest of the formula.

Representative Kroeber asked whether it is known what fiscal effect the bill draft would have regarding assessment of property on University of North Dakota land. Committee counsel said that question should be presented to the University System and the bill draft will have to be revised to clarify its application.

It was moved by Senator Urlacher, seconded by Senator Schobinger, and carried on a voice vote that the meeting be adjourned subject to the call of the chairman. The meeting was adjourned at 4:04 p.m.

John Walstad
Code Revisor

ATTACH:14