

NORTH DAKOTA LEGISLATIVE COUNCIL

Minutes of the

TAXATION COMMITTEE

Tuesday, October 30, 2001
Roughrider Room, State Capitol
Bismarck, North Dakota

Senator Rich Wardner, Chairman, called the meeting to order at 8:00 a.m.

Members present: Senators Rich Wardner, Dwight Cook, Kenneth Kroepin, Ronald Nichols, Randy A. Schobinger, Ben Tollefson, Herb Urlacher; Representatives Byron Clark, Michael Grosz, Gil Herbel, Frank Klein, Joe Kroeber, Kenton Onstad, Dennis J. Renner, Earl Rennerfeldt, Dan Ruby, Arlo E. Schmidt, Ray H. Wikenheiser

Members absent: Representatives Michael Brandenburg, Al Carlson, David Drovdal, Edward H. Lloyd, Eugene Nicholas

Others present: See Appendix A

Chairman Wardner invited comments on the minutes of the previous meeting. Committee counsel said Ms. Marcy Dickerson, State Supervisor of Assessments, pointed out an error on page 4 of the minutes in the description of 2001 legislation which increased the mileage allowance for the medical expense deduction under the homestead credit law. The 2001 amendment allows homestead credit claimants to deduct from income the amount allowed for state officer and employee use of a motor vehicle under North Dakota Century Code (NDCC) Section 54-06-09. **It was moved by Senator Urlacher, seconded by Representative Klein, and carried on a voice vote that with the amendment noted the minutes of the previous meeting be approved as distributed.**

TOBACCO, ALCOHOL, AND FUELS TAX COMPLIANCE AND JURISDICTION STUDY

Chairman Wardner called on Tax Commissioner Rick Clayburgh for comments regarding information prepared for the committee by his staff. Commissioner Clayburgh said several presentations will be made by Tax Department staff and he introduced Ms. Joan Galster, Mr. John Quinlan, Ms. Mary Loftsgard, Ms. Dickerson, and Ms. Beth Boustead.

Commissioner Clayburgh said there is information unrelated to committee studies of which he wants to advise the committee. He said 2001 legislative changes to individual income taxes have been implemented. He said his staff spent the summer working on design of forms and questions governing

administration for the income tax changes. He said he thinks taxpayers will be pleased with the ease of using the new forms. He said a couple of problems were encountered that the committee should be aware of, including withholding being based on 21 percent of the federal income tax withholding amount. He said three options existed with regard to calculating withholding and the easiest for employers was selected. He said it may appear that 21 percent of the federal amount is an increase, but this is not the case. He said the other issue is with long-term capital gains. He said at high income levels, there may be increased tax liability for some taxpayers with long-term capital gains. He said this was the result of decisions made on the 2001 legislation, because of the need for revenue neutrality and recognition that the exclusion chosen for capital gains was not revenue neutral for each taxpayer.

Commissioner Clayburgh said another issue the committee should be aware of is the result of an Attorney General's opinion concluding that land subject to permanent easements under the United States Department of Agriculture Natural Resources Conservation Service emergency watershed protection program are exempt from property taxes only if the land is inundated and a permanent easement has been granted.

Chairman Wardner called on Ms. Galster, Tax Department motor fuel tax section supervisor, for testimony on motor vehicle and special fuels tax compliance and administration issues. A copy of Ms. Galster's prepared testimony is attached as Appendix B.

Ms. Galster said her testimony indicates that the Internal Revenue Service (IRS) checked vehicles in North Dakota and Minnesota. She said this check involved 300 to 400 vehicles in the Red River Valley during spring fieldwork and only one North Dakota driver was found in violation of the federal dyed fuel law.

Senator Schobinger asked how the IRS compliance checks were done. Ms. Galster said she believes the IRS sets up checkpoints and stops and checks all vehicles coming past. Representative Schobinger said legislators had hoped the IRS would not be doing the dyed fuel enforcement for North Dakota. Ms. Galster said the IRS enforcement efforts

were done under federal law and did not have any state involvement. She said she is merely reporting the findings from the IRS field checks.

Chairman Wardner called on Captain Neil Johnson, North Dakota Highway Patrol, for testimony on dyed fuels enforcement issues. A copy of Captain Johnson's prepared testimony is attached as Appendix C.

Representative Herbel said constituents have complained to him about being stopped by Highway Patrol officers and not being issued citations. Captain Johnson said if a vehicle stop is made, there has been an observed violation so there would be at least a warning issued. He said he could provide information to Representative Herbel on warnings and citations issued.

Senator Schobinger asked whether all inspections and enforcement of North Dakota dyed fuels laws are done by the North Dakota Highway Patrol. Captain Johnson said with regard to all state and local enforcement, the North Dakota Highway Patrol is responsible for all enforcement efforts. He said federal law also prohibits use of dyed fuels in highway vehicles, so the federal government has its own enforcement agents. He said federal officers do not notify the North Dakota Highway Patrol of their enforcement efforts.

Chairman Wardner called on Mr. Quinlan, Tax Department sales and special taxes section, for testimony on tobacco tax compliance and administration issues. A copy of Mr. Quinlan's prepared testimony is attached as Appendix D.

Senator Urlacher asked what efforts are being made by Canadian officials to stop tobacco smuggling. Mr. Quinlan said the Royal Canadian Mounted Police have been doing checks of border crossings and retail outlets. He said they have also worked with North Dakota retailers and wholesalers to try to identify smuggling of tobacco.

In response to a question from Representative Herbel, Mr. Quinlan said the Tax Department conducted field reviews in February 2000 for tobacco tax compliance purposes. He said the department obtained a list of licensed tobacco retailers and audited locations within 50 miles of an Indian reservation in the state to see whether they were in compliance with state law. He said the businesses covered were gas stations, convenience stores, bars, restaurants, grocers, and other outlets for tobacco sales. He said this audit effort did not find evidence that retailers were selling cigarettes obtained on reservations without payment of taxes.

Senator Kroepelin asked how much tobacco Canadian citizens are entitled to take back to Canada with them. Mr. Quinlan said he believes a Canadian citizen is entitled to one carton of cigarettes to be taken across the border tax-free, but he believes Canada has recently added a duty of \$10 per carton of cigarettes.

Chairman Wardner called on Commissioner Clayburgh for presentation of testimony relating to tribal tax collection agreements. A copy of Commissioner Clayburgh's prepared testimony is attached as Appendix E.

Commissioner Clayburgh said under the tribal tax collection agreement, an assumption has been made that 25 percent of sales are taxable by the state and 75 percent are taxable by the tribal authority. He said based on this assumption, the agreement provides for a 75 percent and 25 percent split of tax revenues. He said a 3 percent administrative fee is paid to the Tax Department for collection of the taxes and this administrative fee is payable from the tribe's share of tax revenues.

Commissioner Clayburgh described the requirements to enter agreements with tribal governments. He said there have been discussions with all Indian tribes in the state. He said he would advise the committee of any further developments in this area.

Commissioner Clayburgh said a situation has arisen which should be pointed out to the Taxation Committee. He said a tribe in North Dakota has acquired ownership of a retail motor vehicle fuel station and has a source of untaxed wholesale fuel. He said sales at this station will not involve collection of the 21 cents per gallon state motor vehicle fuels tax but instead will have an imposed four cents per gallon tribal tax. He said the resulting reduced price of fuel will certainly be an incentive for customers to purchase fuel from this station. He said other states have been faced with a similar situation and have taken differing approaches in addressing these situations.

Senator Urlacher asked what other states do when there are tribal fuel sales to the public without collection of state taxes. Commissioner Clayburgh said some states, such as New York, have wrestled with this problem for several years. He said Minnesota, South Dakota, and Montana have sought agreements with tribes regarding these kinds of sales.

Representative Schmidt said the gas station in question would do a lot of business. He said similar sales locations may spread to other reservations. He asked whether there is anything the state could do to limit the loss of taxable fuel sales. Commissioner Clayburgh said options are being investigated, but it appears there is very little the state can do because it is a question of federal law and tribal sovereignty that governs taxation of sales from such locations. He said reservations in North Dakota are not near major population centers so sales would be limited to some extent but could still represent a substantial fuels tax revenue loss.

Chairman Wardner said he believes the state has to work with tribal representatives as the Tax Department has been doing. He asked the Tax Commissioner to keep the committee informed on this topic.

Representative Herbel said he would like to know what retail price per gallon is being charged by the station in question.

Senator Schobinger said there may be options available to the state to deal with loss of tax revenues to tribal sales. He said one possibility could be toll roads if the state has road improvement costs on reservations but no revenue. He said he would not support that option now, but it might be something to examine in the future.

Representative Onstad said tribes are not subject to state taxes unless they agree. He said the state has road costs to meet on reservations and reservation customers would use roads funded by the township, county, city, or state. He said if these road costs are to be funded without revenue to the state and political subdivisions, there could be potential problems.

Representative Ruby said if state funding for roads is reduced by tribal fuel sales, an option for state consideration might be to make up for the loss by reducing funds going to reservations for roads or other purposes.

Senator Urlacher said fuels taxes are collected at the wholesale level, and he inquired how the tribe is able to acquire fuel without payment of state taxes. Commissioner Clayburgh said in the case described, the tribe has an untaxed fuel source from Nebraska.

In response to a question from Senator Wardner, Commissioner Clayburgh said the state has tried to be forthcoming in sharing information with tribes on state money going back to reservation purposes. Senator Wardner asked the Tax Commissioner to provide further information on this issue to the committee at its next meeting. Commissioner Clayburgh said information would be provided, including information from a position paper being compiled with cooperation from the Governor's office. Senator Wardner asked that information on this topic and what other states have done in similar situations be provided.

Commissioner Clayburgh said one other area of information for the committee involves alcohol tax collection. He said 2001 legislation transferred alcohol tax collection responsibilities from the State Treasurer to the Tax Commissioner. He said the transition has proceeded smoothly, so there are no problems to report. He said cooperation from the beverage industry and the State Treasurer has made the transition workable.

Representative Kroeber said he still has concerns with a Nebraska fuel supplier selling tax-free fuel to a tribal fuel station. He asked whether there is a legal loophole that is being used to avoid taxation. Commissioner Clayburgh said there are several legal issues that he and his staff are investigating.

CORPORATE INCOME TAX STUDY

Chairman Wardner called on Ms. Loftsgard, Tax Department corporate income tax section supervisor, for testimony on questions presented by the committee. A copy of Ms. Loftsgard's prepared testimony is attached as Appendix F.

Senator Schobinger asked Ms. Loftsgard for her observations on elimination of corporate income taxes as a factor in business location decisions in North Dakota. Ms. Loftsgard said there have been substantial amounts of information examined on this topic and it appears that state corporate income taxes are not a major factor in business location decisions. She said it is difficult to gauge the importance of state corporate income taxes, but she could attempt to provide information on this topic to the committee at a future meeting. Senator Schobinger said he believes what North Dakota is doing now to attract business is not working and that eliminating corporate income taxes could certainly bring North Dakota to the attention of corporations considering business location decisions.

Representative Ruby said there are states that do not have corporate income taxes and asked whether there is a way to identify whether those states have attracted more businesses than states that impose corporate income taxes. Ms. Loftsgard said it would be hard to determine why business location decisions are made, but the Tax Department could seek information on this topic.

Commissioner Clayburgh said there is information that the Tax Department can examine. He said it is important to remember that in a state like South Dakota, which has no corporate income tax, other taxes are imposed that may make the tax burden on a business equal to or greater than the burden imposed by North Dakota corporate income taxes.

Representative Kroeber asked how hard it would be to require water's edge filers to supply information on what they would have paid without making that election. Commissioner Clayburgh said the state cannot require that information now, but if legislation is approved it could be required.

Senator Tollefson said some former corporations and new businesses now do business under different legal forms such as a limited liability company or limited liability partnership. He said some entities that did pay or would have paid corporate income taxes avoided those taxes because of these changes. Ms. Loftsgard said that is true in some instances. She said there is no way to gauge the amount of lost corporate income tax revenue from these changes, but it is now an option for businesses to use another legal entity as a form of doing business.

Representative Ruby said the committee should obtain information from the Division of Economic Development and Finance to provide information on business location decisions, particularly with regard to imposition of corporate income taxes.

Senator Kroeplin said the committee discussion of reducing or eliminating corporate income taxes should also include consideration of how to replace lost revenues to the state if the tax is reduced or eliminated.

Representative Onstad said corporations are mostly multistate operations. He said if North Dakota does not impose taxes on corporations, the money saved by the corporation will not stay in North Dakota but will be transferred out of state to other enterprises of the corporation.

Senator Schobinger said the state has given local governments the authority to allow corporate income tax exemptions of up to five years for business development purposes. He said he believes it is clear that the Legislative Assembly believes corporate income taxes are an important incentive for economic development.

SPECIAL ASSESSMENTS STUDY

Chairman Wardner called on Ms. Connie Sprynczynatyk, Executive Director, North Dakota League of Cities, for comments on the committee special assessments study. Ms. Sprynczynatyk said several representatives of the League of Cities will provide information to the committee. She distributed copies of prepared testimony to be used as a basis for the League of Cities presentation, a copy of which is attached as Appendix G.

Mr. Jerry Hjelmstad, North Dakota League of Cities legal counsel, reviewed the statutory provisions involved in the special assessment process. He said the initial phase of a special assessment project is establishment of a special assessment district to include all property to be benefited by the project. He said after the district is established, a resolution of necessity must be approved and, in most cases, published once each week for two successive weeks in the official newspaper of the city. He said owners of property within the special assessment district have a period of 30 days after publication in which to file written protests with the governing body of the special assessment project. He said the governing body of the city must meet to determine whether sufficient protests have been filed to bar the proceeding. He said the standard for petitions is that owners of a majority of property within the district must petition to bar the project. If protests are not sufficient to bar the project, bids are let and construction proceeds. When the project is completed, costs are spread against all benefited property by the special assessment commission. Amounts assessed against each benefited property are either published in the official city newspaper or sent to property owners. After costs have been provided, property owners have an opportunity to protest assessments against their properties to the special assessment commission. He said property owners dissatisfied with the decision of the special assessment commission may appeal the decision to the governing body of the city. He said

counties have authority to levy special assessments in certain circumstances. He said the statutory provisions granting this authority provide that the statutory provisions governing city special assessment projects are to apply for county special assessment projects.

Representative Ruby asked whether it is possible for a landowner to be assessed for a part of the cost of a project that may be several blocks away from the landowner's property. Mr. Hjelmstad said that is possible if the special assessment district is broad enough to include the property and a part of the benefit of the project has been assessed to that property.

In response to a question from Representative Schmidt, Mr. Hjelmstad said he believes the statutory maximum time to pay off special assessments is 30 years.

Senator Urlacher asked whether there are criteria to assess benefits to vacant lots or recognize other factors for differentiating benefits to properties. Mr. Hjelmstad said on street projects, benefits are generally spread among properties on the basis of the length of frontage of the property on the street in question regardless of values of properties. He said the assessment commission is allowed by law to recognize variations among properties, with the objective of assessing against each property its just proportion of the total cost of the project to be paid by special assessments.

Senator Cook asked what information is provided to interested members of the public in the published resolution of necessity. Mr. Hjelmstad said the resolution informs the public that a project is under consideration and informs them that the engineer's report shows the total cost of the project and how they may obtain a copy of the engineer's report. Senator Cook asked whether the published resolution is required to state the cost of the project assessed against each individual parcel of property. Mr. Hjelmstad said individual assessments are not shown in the published resolution and are not available at the time of the publication.

Senator Cook said property owners will not know the cost of a project against their property at the time they have an opportunity to protest. He said he thinks property owners should be informed of their potential costs while they have an opportunity to protest the project. He said he also believes there is a limit on how much a project may exceed estimated costs. Mr. Hjelmstad said that is correct and the law allows the actual cost of a project after bids to exceed the engineer's original estimate by up to 40 percent. He said if the actual cost is more than that limitation, it is necessary to rebid the project or begin the process again.

Senator Cook asked whether on the Grand Forks dike project the first publication of a resolution of necessity must include the total cost of the project. Mr. Hjelmstad said that information must be included.

Senator Cook said owners of property will not be informed of their individual assessments at the time they can protest the Grand Forks dike project. Mr. Hjelmstad said that is correct. Senator Cook asked when a Grand Forks property owner will find out the amount of assessment against his property and have the right to appeal. Mr. Hjelmstad said after the assessment commission has spread the benefit by assessments against individual parcels of property, owners will be aware of the amount assessed. He said at that time, property owners have the right to appeal the assessment to the special assessment commission and, if still dissatisfied, may appeal that decision to the city governing body.

Senator Cook said the reason he has so many questions on this topic is that he probably receives more telephone calls from irritated citizens regarding special assessment issues than any other issue. He asked whether there is a way for a part of a city to protest out of a special assessment project. Mr. Dennis Schlenker, City of Bismarck, said when a citywide special assessment district is created, it would take 50 percent or more of the entire city to successfully protest the project. He said only when a city is divided into units in the initial creation of the district is it possible for one or more units to be separately considered so that a part or parts of a city may successfully protest out of a special assessment project.

Senator Cook said he believes the checks and balances in the special assessments process require review. He said if the city of Grand Forks is looking at spreading \$50 million of flood control costs by special assessments, one can imagine the difficulty of fairly apportioning the costs. He said the next committee meeting should involve participation of Grand Forks officials to provide the committee information on how they will accomplish this.

Representative Ruby said he believes the initial opportunity to protest should involve an informed estimate of the potential cost of a project for property owners. He said you do not really get peoples' attention until you show them their individual costs.

Senator Cook said he also has concerns with the quality of notice that is provided to property owners. He said perhaps mailed notice should be required in some cases, based on the amount of cost for individual properties. Ms. Sprynczynatyk said cities have the option to use mailed notice in addition to newspaper advertising. She said the question of whether to require mailed notice in certain instances is a policy question for the Legislative Assembly.

Senator Tollefson said he also believes it is important to determine the benefit for each property from a special assessment project. He asked whether there is an established method to allocate benefit among properties. Mr. Hjelmstad said NDCC Section 40-23-07 provides that special assessments are to be based upon the amount each parcel of property will

be "especially benefited" by the special assessment project.

In response to a question from Senator Cook, Mr. Hjelmstad said the majority of property area in a special assessment district controls whether a protest can successfully be made. He said if a political subdivision owns a majority of the property area in the district, owners of other property in the district could not successfully protest the project.

Senator Wardner said this was an issue in 2001 legislation and this should be considered at the next committee meeting.

Committee counsel distributed copies of a newspaper article from the *Devils Lake Daily Journal*. He said the article indicates disagreement among groups in Ramsey County regarding a proposed special assessment project. He said Ramsey County representatives could be invited to discuss this situation at the next committee meeting. Chairman Wardner said it appears that would be a useful review of existing law on this topic.

AGRICULTURAL PROPERTY ASSESSMENT STUDY

Chairman Wardner called on Dr. Dwight Aakre, North Dakota State University Department of Agribusiness and Applied Economics, for presentation of information requested by the committee on the property tax valuation formula for agricultural property. Dr. Aakre distributed copies of information to accompany his remarks. A copy is attached as Appendix H.

Dr. Aakre reviewed the valuation formula for agricultural property. He said agricultural property is assessed under a statutory formula directing assessment of agricultural property based on its value of production. He said agricultural value is the capitalized average annual gross return for property. He reviewed computation of annual gross return under the statutory formula for various types of agricultural property.

Dr. Aakre reviewed the data gathered and used in computation of valuation components under the formula.

Dr. Aakre said the capitalization rate used in the formula is a very significant component because gross revenue is divided by the capitalization rate to determine valuations. He said as the capitalization rate drops, property values under the formula will increase. He said capitalization rates have declined each year since 1994 and this trend has contributed significantly to agricultural property valuation increases. He said the capitalization rate that will be used for 2002 is 8.91 percent as compared to 9.18 percent in 2001. He said he was asked to compare agricultural property valuations for 2001 at these two capitalization rates to illustrate the effect on property valuations statewide. He said the comparison for each county is shown in a table in the materials

distributed and, if no other factors are changed, results in a statewide agricultural property valuation increase of approximately 3.2 percent. He said it appears interest rates are still declining so the capitalization rate used in the formula has probably not reached its lowest point. He said further declines in the capitalization rate will probably translate into further increases in agricultural property valuations.

Dr. Aakre said he was also asked to compare agricultural property valuations as they exist under current law with valuations that would exist without the cost of production index that was added to the formula in 1999. He said the table of valuations on the final page of the material he distributed shows these computations for each county. He said on a statewide basis, agricultural property valuation is 5.2 percent lower for 2001 than it would have been without the cost of production index.

Dr. Aakre distributed a separate sheet, a copy of which is attached as Appendix I, showing valuations determined for 2001 assessment purposes for all agricultural land and with breakdowns of valuation for cropland and noncropland. He said this information shows valuations for each county and on a statewide basis. He said there has been some confusion that North Dakota State University has something to do with valuation of individual parcels of property and this is not correct. He said North Dakota State University calculations do not go below a countywide basis. He said these calculations do not include any consideration of soil type information or classifications. He said the information in the calculations is derived from known production divided by known acreage.

Senator Urlacher said for noncropland there is probably a 30 percent variance for animal unit carrying capacity. Dr. Aakre said the information computed by North Dakota State University arrives at a countywide average valuation for noncropland. He said that information is provided to each county and local decisions are then supposed to recognize differing valuation of property in the assessment process. He said he is not familiar with how that process works because it is a matter of local application.

Dr. Aakre said the information he distributed includes some observations he made regarding the valuation formula as it currently exists. He was requested to include any such observations regarding operation of the formula or information used in the formula. He said one area of consideration is that all income of agricultural producers is counted in the formula except in the case of CRP payments, which are reduced by 50 percent before being included in the model. He said this understates the actual income of the landowner in these situations. He said another concern is that crop insurance indemnity payments are not included in income for agricultural property even though they have become a significant source of revenue. He said the formula assumes that the grazing season for the entire state for

noncropland is six months. He said in reality, the grazing season probably differs moving south to north or east to west in the state and consideration might be given to changes in the length of the grazing season used in computations. He said another issue had come to his attention in discussions with the Agricultural Economics Department at South Dakota State University. He said this concern is with regard to value of calves and cull cows counted as revenue for noncropland possibly being duplicated because winter feed comes from cropland and is already included in cropland revenue. He said his final suggestion is that cash rent might be a more direct and accurate approach to determine a landlord's share of gross returns. He said over half of the agricultural land in the state is rented.

Senator Kroeplin asked whether the data used in the formula comes from surveys sent to agricultural producers on yields, acres, and crops. Dr. Aakre said the data used comes from the annual summary prepared by North Dakota Agricultural Statistics Service. He said the majority of its data comes from the surveys to which Senator Kroeplin referred. He said other sources also are used, including surveys of elevators and perhaps the committee should obtain information from a representative of North Dakota Agricultural Statistics Service to get a better understanding of how the data is compiled. Senator Kroeplin said the Farm Service Agency (FSA) office has information on all the acreage and everything that is raised in the county is recorded at that office. He asked why that information is not used as input data for the formula calculations. Dr. Aakre said since the 1995 farm bill, FSA data has not been as accurate as it was previously because reporting is now voluntary. He said there is cross-checking of data between the National Agricultural Statistics Service (NASS) and FSA in the agricultural statistics service computations.

Representative Herbel said he is concerned with the operation of the formula because of the differences in valuation increases among Red River Valley counties. He said information made available to him indicates that since 1980 agricultural property taxable valuation has increased a total of 3.6 percent in Cass County as compared to 62.19 percent in Pembina County. He asked Dr. Aakre how the variations could be so substantial under the formula. Dr. Aakre said a variety of factors could account for differences in valuation changes from one county to another. He said he cannot think of adequate reasons for a variation of the size cited by Representative Herbel for the two counties in question. Representative Herbel said he believes there must be some connection between frequent flooding in Pembina County and the substantial valuation increases that have occurred as compared to other counties in the Red River Valley.

Senator Kroeplin asked where the statistics originate for the number of acres of cropland in each county. Dr. Aakre said the number that is used to

calculate average values is the number that originates with NASS. He said historically that number has not matched the numbers that are on the tax rolls. Dr. Aakre said to address this problem he surveys the Director of Tax Equalization for each county each year to obtain the number of acres of cropland, noncropland, and inundated agricultural land for each county. Senator Kroepelin said something has gone astray in the formula because agricultural property values are rising at times when fewer acres are being planted. He said acres that cannot be planted because of water should be reducing values but values continue to increase.

Representative Schmidt said the cost of production factor used in the formula appears to have helped hold down agricultural valuations. He said it appears that capitalization rate decreases still cause increases in overall agricultural property valuations. He said it appears the capitalization rate outweighs the cost of production factor. Dr. Aakre said that is correct. Representative Schmidt said he believes the state needs to put a limitation on the capitalization rate because of its substantial impact on overall valuations.

Senator Tollefson said he believes the committee should address in detail each of Dr. Aakre's observations on his prepared remarks.

Senator Nichols asked whether Dr. Aakre believes the capitalization rate used in the formula is a good indicator of value of agricultural property. Dr. Aakre said the capitalization rate is not a bad component of agricultural property valuation but it is not perfect. He said he does not have any suggestion to make it better.

Chairman Wardner called on Mr. Mac Halcrow, Pembina County Commissioner, for comments on the agricultural property assessment study. Mr. Halcrow said one concern he has is illustrated by the September yield survey 1998, and he distributed a copy to committee members. He said the survey asks for information on acres harvested and to be harvested for various crops. He said the survey is to be returned by September 11. He said the problem with the survey is that for row crops harvest has not been completed by September 11, so the information reported on harvested acres and yield is unknown at the time the report is filled out.

Mr. Halcrow said Pembina County has been declared a disaster area by the President for nine consecutive years because of flooding problems. He said farm foreclosures have gone up each year. He said despite these things, agricultural property valuations for Pembina County continue to increase each year by substantial amounts.

Mr. Halcrow said that state law requires the State Board of Equalization to equalize values of property statewide. He said he believes that when the statutory formula yields an unjust valuation of agricultural property, the State Board of Equalization should allow

relief from that determination. He said the State Board of Equalization does not permit an adequate degree of variance from the formula-driven valuations. He said he believes the State Board of Equalization does not operate as was intended.

Mr. Halcrow said his problem with the operation of the formula for agricultural property assessment is that it is hard to look a farmer in the eye who has only been able to plant a crop once in the past four years because of water problems and tell that farmer that his property valuation is going up again.

Mr. Halcrow said another problem he perceives with agricultural valuation is that in his county substantial amounts of topsoil have been carried away by Red River floods. He said soil surveys for the county are substantially out of date as a result. He said his investigation of the statistical information and soil survey information used in valuing agricultural property does not give him confidence that the determinations are accurate.

In response to a question from Representative Herbel, Ms. Dickerson said the State Board of Equalization has taken the position that on property valuations a county is allowed a 5 percent margin of error above or below the agricultural property valuation determined under the formula. She said this is not provided by state law but was determined as a policy matter to be an appropriate margin of error. She said if a county exceeds the 5 percent limitation, the State Board of Equalization will adjust the county valuation back to a 3 percent difference from the amount determined under the formula.

Mr. Halcrow said another area for consideration is that the formula includes consideration of acreage that farmers are prevented from planting. He said acres that cannot be planted are not considered in the formula. He said this tends to concentrate formula valuation on the best agricultural property in the state. He said acres that cannot be planted because of water problems or other natural disasters should not simply be ignored because they do have a substantial negative economic impact for farmers.

Chairman Wardner called on Ms. Dickerson for comments on the agricultural property assessment formula. She said it was mentioned earlier in the meeting that since 1980 Cass County agricultural property valuations have increased only 3.6 percent while Pembina County valuations increased 62.19 percent. She distributed copies of a chart comparing county average agricultural land values for the years 1982 through 2001. A copy of the chart is attached as Appendix J. She said the chart shows the percentage increase for Cass County agricultural property to be 16 percent for the years 1982 to 2001 and shows a 17 percent increase for Pembina County for the same time period. She said she is not certain what valuation basis was used in the previous comparison, but it may have been based on market

values of property which were used in 1980 and are a much different basis for comparison.

Chairman Wardner called on Mr. Wade Moser, North Dakota Stockmen's Association, for comments on the agricultural property assessment study. Mr. Moser said the Stockmen's Association supports the property valuation formula but believes adjustments might be appropriate in some areas.

Mr. Moser said one perceived difficulty with the formula is that it does not adequately reflect drought or wet conditions. He said the North Dakota Stockmen's Association also has some concerns about incorrect statistics being used as input for the formula.

Mr. Moser distributed copies of charts compiled comparing cattle prices in different categories at different times. He said the statistics are intended to show differences between NASS data and data compiled by the North Dakota Stockmen's Association. He said the Stockmen's Association has found that NASS statistics have overstated cattle prices substantially in some years. He said the estimates have improved, but because the formula uses several years of statistics, there is still some bad data in the mix.

Mr. Moser said another concern of the North Dakota Stockmen's Association is that it appears reporting problems exist with regard to amounts paid as cash rent for pasture. He said the Stockmen's Association believes people report numbers that are higher than actual cash rents.

Senator Wardner said he understands concerns with data that is used as input for the formula. He said he believes the committee needs to thoroughly examine gathering and use of the statistics that are presently being used.

Dr. Aakre said with regard to livestock statistics for the years 1994 and earlier, statistics were based on Agricultural Reporting Service data and he was suspicious of the accuracy of those numbers. He said since 1995 NASS data have been used in the formula but the earlier numbers still have an effect on the formula because they are within the 10 years considered under the formula.

Representative Klein said crop insurance information might be a more accurate source of data. He said he believes crop insurance information would be accurate if it can be compiled.

Chairman Wardner called on Ms. Sandy Clark, North Dakota Farm Bureau, for comments on the agricultural property assessment study. Ms. Clark said the Farm Bureau supports continuation of the agricultural property valuation formula. She said the Farm Bureau would be interested in participating in discussions of appropriate adjustments to the formula. She said the Farm Bureau has concerns about freezing valuations or locking down the capitalization rate. She said the Farm Bureau is concerned that the integrity of the formula would be compromised by arbitrary changes. She pointed out that it is not only

property valuation that determines the property tax bill for property and it should be remembered that mill rates are supposed to be adjustable at the discretion of local governing bodies.

Chairman Wardner called on Mr. Cleveland Watts, United States Department of Agriculture Natural Resources Conservation Service (NRCS), for information on soil surveys in North Dakota. Mr. Watts said he was requested to provide status information on soil surveys in North Dakota. A copy of information he distributed as a statistical basis for his comments is attached as Appendix K. Mr. Watts reviewed the information compiled with regard to completion of soil surveys.

Mr. Watts said flooding does affect soil quality in some cases but not all cases. He said the degree of effect depends upon a number of factors, including the type of material deposited by flood waters. He said salt in soils is often changed by flooding.

Committee counsel asked how often county soil surveys are updated to reflect flooding changes to soil types. Mr. Watts said the intended soil survey cycle is to provide for resurveys within each 30-year period. He said the NRCS recognizes that surveys should be completed more often but budget and staffing realities limit the ability to complete resurveys. He said the NRCS has eight people in the field working on soil surveys in North Dakota, which does not allow increased frequency of resurveys.

In response to a question from Senator Urlacher, Mr. Watts said if the NRCS is made aware of special problems in certain areas of the state, efforts might be concentrated on those areas if feasible and this might help to provide more current survey information. Senator Urlacher said he believes updating of soil survey information statewide is necessary. Mr. Watts said he agrees and the NRCS is trying to accomplish that objective.

Chairman Wardner called on Ms. Dickerson for comments regarding the effect of commercial, private, or personal hunting use on property classified as agricultural for property tax purposes. A copy of Ms. Dickerson's prepared testimony is attached as Appendix L.

In response to a question from Senator Cook, Ms. Dickerson said income from hunting is considered nonfarm income. She said the point at which reclassification would be necessary is when use of the property changes so that its primary use is for hunting or other nonfarming activity.

Chairman Wardner called on Ms. Dickerson for presentation of information on property tax valuation of subsidized housing. A copy of her prepared testimony is attached as Appendix M.

Chairman Wardner called on Mr. Jim Knutson, Valley City, for comments on the study of property tax valuation of subsidized housing. A copy of Mr. Knutson's prepared testimony is attached as Appendix N.

Senator Tollefson asked whether market values of subsidized housing would be a reasonable basis for assessment because market prices would reflect restrictions on rent. Mr. Knutson said that is correct, but there have been very few sales statewide of subsidized housing so previous sales do not provide a good measurement for market value of properties subsidized under Section 42 of the Internal Revenue Code.

Chairman Wardner called on Senator Larry Robinson for comments on the study of property tax valuation of subsidized housing. Senator Robinson said this issue is important to his constituents. He said the issue of valuing subsidized housing becomes difficult because there are very few sales of these properties to use as a guide in determining market value. He said the subsidy received under federal law for construction of these facilities is more than offset by high operating costs and restrictions on rent that may be collected from the property. He asked the committee to give careful consideration to provisions that will treat subsidized housing property owners fairly.

Chairman Wardner called on Mr. Steve Stoner, Fargo, for comments on the subsidized property valuation study. A copy of Mr. Stoner's prepared testimony is attached as Appendix O.

Chairman Wardner called on Mr. Pat Fricke, Executive Director, North Dakota Housing Finance Agency, for comments on the subsidized housing valuation study. A copy of Mr. Fricke's prepared remarks is attached as Appendix P.

Senator Cook asked whether subsidized housing units compete for the same renters as other rental properties. Mr. Fricke said there is competition between subsidized and nonsubsidized housing to a certain extent.

In response to a question from Senator Kroeplin, Mr. Fricke said the credit provided by Section 42 of the Internal Revenue Code runs for 10 years and has a present value that can be calculated at approximately seventy-five cents on the dollar.

Chairman Wardner called on Mr. Ben Hushka, Fargo City Assessor, for comments on the subsidized property valuation study. Mr. Hushka said he is impartial on the issue, but a matter for consideration is to perhaps provide that the amount of the subsidy is not to be included in property tax considerations. Senator Cook asked whether Fargo allows a five-year property tax exemption for subsidized housing. Mr. Hushka said Fargo has recently done that as a way to deal with these kinds of properties and this is the exemption generally considered to be used for economic development projects. Mr. Stoner said the exemption for economic development has been used for subsidized housing projects but is not a direct method of dealing with the valuation problem that exists under current law.

PROPERTY TAX ASSESSMENT STUDY

Chairman Wardner called on Ms. Dickerson for comments regarding the effect of special assessments on the true and full valuation of property for property tax purposes. A copy of Ms. Dickerson's prepared testimony is attached as Appendix Q.

Senator Cook said his concern with special assessments effects on property tax valuations is whether there is always an increase in valuation. He said the question may be simply stated as whether \$1,000 in special assessments necessarily adds \$1,000 to assessed true and full valuation of the property. Ms. Dickerson said in most cases that increase is assumed. She said there are circumstances when a special assessment amount would not appropriately be added in its entirety to the valuation of the property for property tax purposes.

Chairman Wardner called on Ms. Dickerson for testimony relating to concerns presented at the previous committee meeting regarding valuation of property and inclusion of personal property valuation. A copy of her prepared testimony is attached as Appendix R.

Chairman Wardner called on Ms. Dickerson for a presentation of testimony relating to use of sales ratio study information in smaller communities. A copy of her prepared testimony is attached as Appendix S.

Chairman Wardner called on Ms. Dickerson for presentation of information on administration of homestead credit claims. A copy of her prepared testimony is attached as Appendix T.

Chairman Wardner called on committee counsel for presentation of a memorandum entitled *Circuit Breaker Property Tax Provisions in North Dakota and Surrounding States*. Committee counsel said comparisons among North Dakota and surrounding states are difficult. He reviewed the information in the memorandum.

Chairman Wardner called on Mr. Leon Samuel, Morton County Director of Tax Equalization, for comments on the homestead credit study. Mr. Samuel said income limits under the homestead credit law have been increased in recent years but the valuations allowed as reductions against property values have not been changed. He said the effect of this is that people who previously were able to receive complete exemption of their homestead property are now subject to taxes on part of the value of the property because the maximum reduction does not cover the valuation of the property.

COMMITTEE DISCUSSION AND DIRECTIVES

Senator Cook said the North Dakota League of Cities should be requested to check on larger city special assessment projects with regard to the question of how often those projects result in citywide assessments as opposed to assessments limited to specific parts of cities. He said another question that

should be addressed by the League of Cities is with regard to annexed areas brought into a city and whether they are required to pick up a share of special assessments paid previously by other city properties.

Senator Cook said another issue for exploration is whether it is possible to determine the vacancy rate of existing properties that have received subsidy under Section 42 of the Internal Revenue Code.

Senator Tollefson said he is interested in the observations made by Dr. Aakre and said further exploration of each suggestion should be made before the next committee meeting. He said Dr. Aakre should be asked to explore these subjects in greater detail and give thought to suggestions for changes.

Senator Kroeplin said the statistics gathered for the agricultural property productivity formula are important. He said it is important to also understand how the statistics are used. He said the committee should receive further information on the origin and gathering of statistics and how they play into the formula.

Senator Nichols said he agrees that a better grasp of statistical information is necessary and the committee should receive testimony from a representative of NASS regarding some of the statistical issues discussed at this meeting.

Representative Herbel said Pembina County was dissatisfied with the decision of the State Board of Equalization regarding agricultural property valuations and the limitation placed on county flexibility by the State Board of Equalization. He said the committee should be provided an explanation of why the State Board of Equalization limits county authority as it has done and precisely what legal authority exists for that limitation.

No further business appearing, Chairman Wardner adjourned the meeting at 3:20 p.m.

John Walstad
Code Revisor

ATTACH:20