

## **TAX-EXEMPT PROPERTY IMPACT ON SCHOOL DISTRICTS - BACKGROUND MEMORANDUM**

House Concurrent Resolution No. 3044 (attached as an appendix) directs the Legislative Council to study the impact of tax-exempt property on school districts. The text of the resolution states that the amount of tax-exempt property within a school district has a direct impact on tax revenues available to the district, the tax burden on taxpayers in the district, and foundation aid allocations to the district and that property tax exemptions may be granted by the state, county, or city without approval of the school board of the district affected.

The existence of tax-exempt property within a school district affects the school district in two ways--by limiting the amount of property tax revenue the school district levy will generate (in some cases) and by excluding the value of that property from the equalization factor contained in the foundation aid allocation formula.

### **LEVY LIMITATIONS FOR SCHOOL DISTRICTS**

The Fargo School District has unlimited levying authority under North Dakota Century Code (NDCC) Chapter 15-51. Under Section 57-15-14, any school district with a population of more than 4,000 may be granted unlimited levying authority upon approval by a majority vote of electors and a school district with fewer than 4,000 population may be granted authority to levy any specific number of mills approved by a vote of 55 percent or more of electors.

School districts that have not been granted unlimited levying authority or authority to levy an excess levy are subject to a general fund levy limitation of 185 mills on the dollar of taxable valuation of property in the district under NDCC Section 57-15-14. A school district subject to this limitation which levied fewer than 185 mills for the prior school year may increase its levy by up to 18 percent in dollars from the prior school year, up to the 185-mill limitation. If a school district has an increase of 20 percent or more in total assessed valuation of property over the prior year, and as a result of the increase the school district is to receive less in state foundation aid payments because of the equalization factor, that school district may levy any specific number of mills more in dollars than was levied in the prior year to make up for the loss of foundation aid revenue, up to the 185-mill limitation.

School districts at or near the general fund mill levy limitation have been eligible for optional

percentage levy increases in dollars in years since 1981. From 1981 through 1996, taxing districts were allowed a percentage increase in dollars over the base year levy amount in dollars. Under NDCC Section 57-15-01.1, as amended in 1997, during taxable years 1997 and 1998 a county, city, township, or school district eligible for federal funds on a matching basis as a result of a disaster declared by the President of the United States may levy an amount in dollars equal to the amount required to match federal funds up to an increase of two percent more than the amount levied by the district in the base year. Except for this authority to match federal disaster funding, taxing districts that are levying at levels in excess of statutory mill levy limits are authorized to maintain the amount levied in dollars in the base year but have no authority to increase levies without voter approval. Many school districts in the state are levying an amount exceeding 185 mills for general fund purposes as a result of the compounding of percentage increase allowances during taxable years 1981 through 1996. However, the levy under Section 57-15-01.1 is not a levy in mills but is a levy of a specific amount in dollars which is converted to mills by the county auditor. The significance of this distinction is that levies under Section 57-15-01.1 are limited based on dollars levied and that amount is unaffected by increases or decreases in the taxable valuation of property within the district. If a district is levying under this authority, an increase in valuation in the district with the same number of dollars levied will result in a lower mill rate but no change in the amount of property taxes collected and a decrease in valuation will result in a higher mill rate but no change in taxes collected.

When a school district levy is limited to a certain number of mills, the maximum number of dollars the district can raise in property tax revenue rises and falls with the taxable valuation of property within the district. This allows the district to generate more revenue as property values increase while a district limited to a dollar amount will not be able to enjoy increased revenues as property values increase.

School districts are entitled to levy for an interim fund up to 75 percent of the current appropriation for the district plus \$20,000 under NDCC Section 57-15-27. The purpose of the interim fund levy is to allow the school district adequate funds on hand to carry over to the next fiscal year to meet cash requirements.

An alternative to an unlimited levy question for the voters is a question of approval of an excess levy under NDCC Chapter 57-16. If the governing board of the school district declares that the funds available at the maximum levy otherwise allowed by law are insufficient, the question may be placed on the ballot of increasing the legal limitation by a specified percentage, up to 75 percent. An excess levy may be authorized for up to five years and may be extended indefinitely in five-year increments by unanimous approval of the governing board of the school district. Discontinuing the excess levy may be accomplished by a petition presented to the board and disapproval of the excess levy by the voters of the district.

School districts have authority to levy for various special fund purposes. School districts may levy without limitation for board and lodging or transportation allowance for high school students sent to another school district, high school tuition, judgments, a compromise of judgment for injury, asbestos removal, special assessments on school property, and for bond sinking and interest funds. Upon approval by a vote of 60 percent or more of qualified electors, a school district may levy for a building fund in an amount up to 20 mills under NDCC Section 57-15-16. A school district may levy up to three mills for a special reserve fund under Section 57-19-04. The balance in the special reserve fund may never exceed the amount that could be produced by the maximum general fund levy for that year. School districts may levy for support of a junior college or off-campus educational center, municipal or regional airport authority, plant pest control, railroad purposes, a multiyear asbestos abatement fund, and for long-distance learning technology. The long-distance learning levy under Section 57-15-14.5 was amended by 1997 House Bill No. 1146 to allow use of funds from the levy for salary of a staff person to supervise educational technology.

### **EFFECT OF TAX-EXEMPT PROPERTY ON THE ABILITY OF THE SCHOOL DISTRICT TO RAISE PROPERTY TAX REVENUE**

The existence of tax-exempt property has a greater effect for school districts than for all other political subdivisions because school districts levy more property taxes than all other taxing districts combined. For taxable year 1995, school district property taxes exceeded \$230 million and comprised 54.5 percent of all property taxes collected in the state.

The effect of the existence of tax-exempt property within a school district depends upon how the maximum levy for the district is determined. In a district in which the limitation is determined in mills, a lower taxable valuation within the district means fewer tax dollars will be raised by the maximum levy.

In districts in which the levy is limited by relation to the number of dollars levied in a prior year, existence of tax-exempt property does not affect the amount that will be raised by a property tax levy because a specified number of dollars may be levied by that district without regard to the taxable valuation of property in the district. Districts with unlimited tax levies also are not restricted in tax revenues that may be raised by the existence of tax-exempt property. However, all taxing districts' taxpayers are affected by the existence of tax-exempt property. In districts with a limitation of a number of mills, reduced taxable valuation due to tax-exempt property means a higher number of mills must be imposed against each parcel of property. In districts in which the levy is unlimited or limited based on dollars levied in a previous year, the number of tax dollars raised could be spread against a greater amount of property if tax-exempt property was added to the tax rolls.

### **FOUNDATION AID FORMULA**

Foundation aid allocations are determined under NDCC Chapter 15-40.1 and the appropriation made for that purpose by the most recent Legislative Assembly. The foundation aid allocation formula for school districts takes into account a variety of factors. After application of the statutory provisions to determine the payments due to each school district for tuition apportionment, per student aid, special education aid, and transportation aid, an equalization factor is applied to reduce the payment to the school district. The factor is determined under Section 15-40.1-06, which provides that for the 1996-97 school year and thereafter 32 mills is multiplied times the latest available net assessed and equalized valuation of property in the school district and the resulting amount is subtracted from the payment to be made to the school district. For school years after 1996-97, the number of mills in the factor must be adjusted by determining a percentage by dividing the number of mills used in the computation in the previous year by the state average school district general fund mill levy plus 40 percent of the percentage increase in foundation aid distributions and multiplying the amount times the state average school district general fund mill levy. The number of mills used in the factor may not fall below 32 mills and may not rise above 25 percent of the state average school district general fund mill levy.

### **EFFECT OF TAX-EXEMPT PROPERTY ON THE EQUALIZATION FACTOR**

Because the equalization factor is multiplied times the assessed valuation of property in the taxing district, the more taxable property that exists in the district the greater the amount deducted from

foundation aid payments for the district. Property that is not on the tax rolls generates no revenue for a school district, unless payments in lieu of taxes are received, and does not decrease foundation aid to the district.

### **PROPERTY TAX EXEMPTIONS**

Property tax exemptions exist for property under many kinds of ownership. Thirty-nine subsections of NDCC Section 57-02-08 provide exemptions and several other provisions of law exempt property from taxation. The authority of the Legislative Assembly to exempt property derives from the Constitution of North Dakota. Article X, Section 5, provides, in part:

. . . The legislative assembly may by law exempt any or all classes of personal property from taxation and within the meaning of this section, fixtures, buildings and improvements of every character, whatsoever, upon land shall be deemed personal property. The property of the United States, to the extent immunity from taxation has not been waived by an act of Congress, property of the state, county, and municipal corporations, to the extent immunity from taxation has not been waived by an act of the legislative assembly, and property used exclusively for schools, religious, cemetery, charitable or other public purposes shall be exempt from taxation. . . .

The most prevalent exemptions are for property owned by the United States, the state, or a political subdivision; Indian trust lands; cemeteries; nonprofit schools; churches and related property; hospitals, nursing homes, and other institutions of public charity; fraternal and similar organizations; farmers, for residences and buildings; persons eligible for the homestead credit; and the builder or first owner after the builder for new residential and townhouse property. Other property may not be included on the tax rolls because it is subject to payments in lieu of taxes. Coal conversion facilities pay privilege taxes in lieu of property taxes under NDCC Chapter 57-60, certain lands held by the United States are subject to payments in lieu of taxes, lands held by the State Game and Fish Department and Bank of North Dakota are subject to payments in lieu of taxes in certain instances; passage of 1997 House Bill No. 1025 will make property acquired for the Devils Lake project subject to payments in lieu of taxes; and new industry property may be subject to payments in lieu of taxes if approved by the county or city in which the property is located. Rural telephone cooperatives have paid a gross receipts tax in lieu of property taxes with all revenue going to the school district. Under House Bill No. 1068 (1997), all telecommunications providers

will pay a gross receipts tax in lieu of property taxes. The new law allocates revenues among political subdivisions in the same proportion they received revenue under previous law, but the receipts of school districts will not be equalized under the mill deduct factor because property of telecommunications providers will be dropped from tax rolls. Property upon which payments in lieu of taxes are made is not equalized because the equalization factor is not applied to the value of the property even though the property may generate revenue to school districts.

For property subject to payment in lieu of taxes under NDCC Chapter 40-57.1, valuation of the property is not to be considered in valuation of the taxing district in which the project is located for purposes of determining the mill rate for the district. Payments in lieu of taxes must be subtracted from the taxing district's budget before the remaining amount is certified as a tax levy to be spread against valuation of property in the district. Revenue from payments in lieu of taxes cannot be used as "off budget" revenues and any amount received must be used to offset budgeted expenditures of the governing body of the city or county and any other political subdivision receiving the revenue. The occasions of the greatest property tax impact of a project making payments in lieu of taxes upon other taxpayers would be when payments in lieu of taxes received by the political subdivision are substantially more or less than budget expenditures that are attributable to services provided to the project.

### **VALUATION OF EXEMPT PROPERTY**

For many years state law has required establishing valuations for exempt property. However, assessment officials have concentrated efforts on assessments for property subject to taxation because of limited time, resources, and staff. Under Senate Bill No. 2081 (1995), assessment officials in the state were required to establish assessed valuations for all tax-exempt property in the state by 1998. Assessment officials expressed a number of concerns about this requirement, including a shortage of staff and budget, opposition of city and county governing bodies to paying the costs of these assessments, fear of property owners that assessment of exempt property is the first step toward taxing that property, and problems with assessing highway rights of way and other governmental property for which assessors perceive no benefit in determining values.

During the 1995-96 interim, assessment officials of 47 counties and 11 cities responded to a survey on exemptions allowed by law for new residential property, day care property, pollution abatement improvements, residential and commercial property improvements, and exemptions and payments in lieu

of taxes for new and expanding businesses. From these responses, it was estimated that more than \$261 million of property is exempt under these categories of exemptions, which totals about 1.4 percent of all valuation in the state. These categories were chosen because the exemptions are discretionary, requiring local government approval.

Passage of House Bill No. 1341 (1997) altered the requirement that all exempt property be assessed by

1998. The bill requires assessment of exempt property only when the exemption is for a new or expanding business, improvements to property, buildings belonging to institutions of public charity, new single-family residential or townhouse or condominium property, early childhood services property, or pollution abatement improvements.

ATTACH:1

**Fifty-fifth Legislative Assembly, State of North Dakota, begun in the Capitol in the City of Bismarck, on Monday, the sixth day of January, one thousand nine hundred and ninety-seven**

**HOUSE CONCURRENT RESOLUTION NO. 3044  
(Representative Freier)  
(Senator Freborg)**

A concurrent resolution directing the Legislative Council to study the impact of tax-exempt property on school districts.

**WHEREAS**, school districts of the state are the greatest beneficiaries of property tax revenues; and

**WHEREAS**, the amount of tax-exempt property within a school district has a direct impact on tax revenues available to the district, the tax burden on taxpayers in the district, and foundation aid allocations to the district; and

**WHEREAS**, property tax exemptions may be granted by the state, county, or city without approval by the school board of the district affected; and

**WHEREAS**, analysis is required of the impact of tax-exempt property on school districts and the feasibility and desirability of reducing that impact, and of methods of providing some form of benefit to school districts from tax-exempt property owners and providing school districts with a role in approval of property tax exemptions;

**NOW, THEREFORE, BE IT RESOLVED BY THE HOUSE OF REPRESENTATIVES OF NORTH DAKOTA, THE SENATE CONCURRING THEREIN:**

That the Legislative Council study the impact of tax-exempt property on school districts; and

**BE IT FURTHER RESOLVED**, that the Legislative Council report its findings and recommendations, together with any legislation required to implement the recommendations, to the Fifty-sixth Legislative Assembly.

Filed March 19, 1997