

# NORTH DAKOTA LEGISLATIVE COUNCIL

Minutes of the

## TAXATION COMMITTEE

Thursday, July 19, 2001  
Roughrider Room, State Capitol  
Bismarck, North Dakota

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

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

**Members absent:** Representatives Al Carlson, Byron Clark, Joe Kroeber, Edward H. Lloyd, Eugene Nicholas

**Others present:** Dean Peterson, North American Coal, Bismarck

Mark Geiger, Mandan

Bob Graveline, Utility Shareholders of North Dakota, Bismarck

Connie Sprynczynatyk, North Dakota League of Cities, Bismarck

Scott D. Stromme, City of Bismarck

Marcy Dickerson, Tax Department, Bismarck

Chairman Wardner called on Mr. John D. Olsrud, Director, Legislative Council, for review of the *Supplementary Rules of Operation and Procedure of the North Dakota Legislative Council*.

Chairman Wardner welcomed committee members. He said he believes the committee has a good composition of members with experience in the taxation field. He said the issues to be studied by the committee include some issues that have been studied previously and some that have not been studied for quite some time. He said the primary reason for the meeting today is to focus the direction of committee efforts on each study topic so that information can be gathered and presented on specific topics in which the committee is interested.

### PROPERTY TAX ASSESSMENT STUDY

Chairman Wardner called on committee counsel for presentation of a memorandum entitled *Property Tax Assessments and Abatements - Background Memorandum*. Committee counsel said the study appears to be focused on determination of the value of property for taxation purposes. He said the study appears to be broad enough to include other aspects of law governing property taxes because property tax liability is determined by consideration of mill rates,

taxable value of property, and the tax status or exemption of property.

Committee counsel said the mill rate for a taxing district is established through the budget process as limited by statutory mill levy limitations. He said each taxing district prepares a proposed budget based on anticipated expenditures and conducts public hearings on the budget. He said mill levy limitations are summarized in the schedule of levy limitations prepared biennially by the Tax Commissioner's office. He said a copy of this schedule was distributed to committee members for background information. He said it is important to remember that mill levy limitations are one form of limitation, and since 1981, the Legislative Assembly has provided by law an optional method of determining levy limitations based on the base year levy amount in dollars of a political subdivision. He said for the years 1981 through 1996, percentage increases were allowed by law over the base year levy in dollars. He said compounding of these permissible increases allowed some taxing districts to increase levies well beyond the amount they would be able to levy under mill levy limitations. He said as a result of this optional method, changes in taxable valuation of property may have differing effects, depending on which approach is applied.

Committee counsel said true and full value of property is defined as the value determined by considering the earning or productive capacity of property, the market value of property, and all other matters that affect the actual value of the property to be assessed. He said for purposes of agricultural property, a statutory formula exists that is the subject of a separate memorandum. He said taxable valuation of property is a percentage of assessed valuation, which is 9 percent for residential and 10 percent for agricultural, commercial, and centrally assessed property. He said taxable valuation is the amount against which the mill rate for the taxing district is applied to determine the tax liability for each parcel of property.

Committee counsel reviewed assessment of centrally assessed property and property subject to payments in lieu of taxes.

Committee counsel described the equalization process and the abatement process, which are alternative avenues of appeal for property owners dissatisfied with assessment of their property.

Committee counsel reviewed legislation enacted and defeated during the 2001 Legislative Assembly relating to property tax assessment and abatement. He said legislation specifically mentioned in the study directive to the committee includes 2001 Senate Bill No. 2348, which would have provided for valuation of subsidized housing under the income approach and would have required the assessor to consider restrictions imposed on property rentals under the subsidy program. He said the bill failed to pass, and he suggested participants in the debate on the bill be invited to the next committee meeting to discuss these issues. He said during committee discussion on House Bill No. 1206, an issue was raised with regard to the effect of improvements by special assessment on property tax valuation of property. He said the question raised related to a situation when unimproved lots are served by a new road to be paid by special assessments against the property and whether the value of the special assessment against the property should be added to the valuation of the property for property tax purposes. He said assessment officials will be asked to address this issue.

Chairman Wardner reviewed the terminology and the process through which property tax liability is determined. He said the valuation process and the budget process combine to determine tax liability. He said the valuation process is governed by assessment officials who apply statutory provisions to determine valuation of property. He reviewed the budget process by which anticipated expenditures are determined, funds on hand and anticipated revenue from other sources are subtracted, and the amount remaining to be gathered from property taxes is determined. He said the amount of property tax required is applied against the valuation of taxable property to determine the mill rate that applies to property in a taxing district. He said it appears that determination of true and full value by assessment officials is the focus of the study directive.

Senator Tollefson said he questions how extensive the effect of market value is in influencing the assessment value of property. Senator Wardner said his observations lead him to believe that as market value increases, assessment valuations follow closely, but as market value decreases, there is a lag in reduction of assessed valuations.

Senator Cook said he believes valuations must be close to market value because there is a statute requiring 95 percent valuation of property for assessment purposes. Ms. Marcy Dickerson, Acting State Supervisor of Assessments, Tax Department, said there is a statutory requirement that all property must be valued at 100 percent of its true and full value. She said the State Board of Equalization allows each county a 5 percent variance from values as determined under the sales ratio study.

In response to a question from Senator Urlacher, Ms. Dickerson said the sales ratio study is not applied

to limit market value for agricultural property because the statutory formula for agricultural property valuation determines proper assessment levels.

Senator Wardner said it is becoming common in western North Dakota for people to buy agricultural land for use for hunting or recreational purposes. He asked whether acquisition for these purposes affects the value of surrounding land for assessment purposes. Ms. Dickerson said use of property does not affect valuation of surrounding land. She said the property itself may change classification and valuation based on use but that does not affect the status or valuation of surrounding agricultural property.

Senator Urlacher asked whether property loses its status as agricultural property if the farmer leases the property for hunting use. Ms. Dickerson said property use must be determined on a case-by-case basis, and the primary use of the property determines its classification for property tax purposes.

Representative Herbel said soils in the Red River Valley have changed composition due to the extremely wet weather cycle and resulting loss of topsoil. He asked whether that soil change is reflected in soil surveys. Ms. Dickerson said soil surveys are conducted at varying times, and she is not certain how often they are updated. She said she could seek information on this question.

In response to a question from committee counsel, Ms. Dickerson said when agricultural property ceases to be used for agricultural purposes, such as when it is used primarily for hunting purposes, the property becomes classified as commercial property and is valued based on its market value or productive capacity, which is a higher valuation. She also said changing the use of the property changes its classification and probably increases its taxable valuation.

Representative Drovdal said one of the issues he hopes the committee will investigate involves assessed valuation of property in small communities. He said the problem he sees is that value of property in small cities may be overstated. He said when these properties are to be sold, appraised values and sales prices are much less than anticipated. He said assessed valuations are not reduced in these situations because that would require reduced valuations for much of the property in the community and the tax base would be seriously impacted. He said another aspect of this problem is that if property valuations are not reduced to realistic levels, under the school funding formula, the 32-mill deduct will cause an unrealistically large reduction in school funding for school districts. Ms. Dickerson said this issue is supposed to be addressed by the sales ratio study. She said the study is intended to gather recent sales information for property to allow comparison with assessed valuations to determine whether valuations are higher or lower than they should be. She said reduced valuation would not reduce the property tax revenue available to a political subdivision because the option

exists to levy the same amount in dollars as was levied in the base year, which would mean that with a reduced valuation an increased mill rate would result, but the taxing district could still generate the same amount of property tax revenue.

Representative Ruby said he has heard complaints from residents of small communities that they cannot maintain or generate additional property tax revenues because their populations have not increased. He asked whether population has any effect on the amount of property tax revenue available to a community. Ms. Dickerson said population per se is not a factor in determining the amount of property tax revenue available to a taxing district except to the extent that population requires construction or occupancy of additional housing.

Representative Schmidt said he would like the committee to receive testimony and examples on how soil survey analysis is done and the degree to which detailed soil surveys have been completed. He said he thinks there are errors in the method of soil surveys, and the committee should gain an understanding of how this is done.

Senator Urlacher said information should be reviewed by the committee on when soil surveys were conducted, how current they are, and whether changes in agricultural technology affect soil survey and classification methods.

Representative Herbel asked whether part of a parcel of property could be classified and assessed as commercial property while another part is assessed as agricultural property. Ms. Dickerson said that would be possible but would have to be determined on an individual property basis and may involve several considerations.

Senator Tollefson asked whether home rule authority for a city or county would affect property valuations for taxation purposes. Ms. Dickerson said under home rule authority, a county or city could supersede mill levy limitations under state law, but valuation of property should not be affected by home rule.

Senator Cook said during the last legislative session, he received comments on property valuation difficulties. He said one individual who contacted him is present at the meeting and could explain the difficulties he has encountered. Chairman Wardner said comments would be welcome.

Mr. Mark Geiger, Mandan, distributed to the committee copies of a letter (attached as an appendix) and copies of correspondence with the city of Mandan regarding valuation of his property. He said part of his concern regarding assessment is that it appears some personal property has been included in the valuation of his real property subject to real estate taxation. He said another concern he has with valuation of his property is that the property was valued for an amount that exceeds the purchase price he paid for the property. He said he was advised by

local tax officials that he got a good deal on the property, and the price paid does not determine the assessed valuation. Mr. Geiger said he believes that in the case of a personal residence, the true and full value should be determined based on the purchase price minus the value of any personal property included in the purchase price. He said another issue relates to special assessments because the city of Mandan automatically adds any assumed special assessments to the tax base for a purchase. He said not all special assessments increase the value of the property in the amount of the assessment. He said he did not believe it is proper to add a special assessment to the value of property for property tax purposes.

Senator Cook said he has received correspondence from other citizens of the state, and he believes this is an issue of statewide significance which the committee should investigate.

## **AGRICULTURAL PROPERTY ASSESSMENT**

Chairman Wardner called on committee counsel for presentation of a memorandum entitled *Property Tax Assessment of Agricultural Land - Background Memorandum*. Committee counsel said assessment of agricultural land has been one of the most common study topics for interim committee review, having been the topic of specific study directives or as part of another study directive during each interim from 1989 through 1998. He said it appears dissatisfaction persists because agricultural property market values have declined while property tax valuations have increased, and fluctuations in agricultural property assessments have not been uniform across the state.

Committee counsel said true and full value of agricultural property for property tax purposes is based on productivity, as established through computation of the capitalized average annual gross return of the land as determined by the North Dakota State University Department of Agricultural Economics as required by North Dakota Century Code (NDCC) Section 57-02-27.2.

Committee counsel said the Department of Agricultural Economics determines annual gross return for property based on the best statistical information available. For minor production crops, such as lentils and field peas, production statistics are not available so values based on known crops are substituted. Canola was in this unknown category until 2000, when the National Agricultural Statistics Service recognized the growth in canola production and began gathering production data. He said it is not believed that lack of data on minor crops has a substantial impact on countywide valuations.

Committee counsel reviewed the formula for determination of true and full value for agricultural property.

Committee counsel reviewed legislation considered by the 2001 Legislative Assembly relating to

valuation of agricultural property. He said Senate Bill No. 2068 was enacted and made adjustments for classification of inundated land and was the product of a study by the Tax Commissioner and local tax officials and others during the 1999-2000 interim. He said House Bill No. 1246 would have locked the capitalization rate for agricultural property valuation within a range of 9.25 to 10.5 percent, but the bill failed in the House by a vote of 45-52. He said House Bill No. 1362 would have imposed a cap on the value of a parcel of agricultural property for tax years 2001 and 2002 at not more than the valuation of that property for taxable year 1999. He said the bill failed in the House by a vote of 46-52.

Committee counsel said he has discussed this study with Dr. Dwight Aakre, North Dakota State University Department of Agricultural Economics. He said Dr. Aakre will be invited to the next committee meeting and asked to review the gathering of statistics and operation of the valuation formula. He said any specific questions about the formula that committee members have may also be directed to Dr. Aakre.

### **HOMESTEAD PROPERTY TAX CREDIT**

Chairman Wardner called on committee counsel for presentation of a memorandum entitled *Homestead Property Tax Credit - Background Memorandum*. Committee counsel said since 1969 North Dakota law has provided a property tax reduction for persons 65 years of age or older with limited income. He said this provision has been amended by 23 bills since 1969, and the income limitations for eligibility for the credit have been increased by legislation approved in 1973, 1975, 1977, 1979, 1981, 1985, 1989, 1993, and 1999. He said under the current provisions of NDCC Section 57-02-08.1, a person 65 years of age or older or who is permanently and totally disabled whose income is \$14,000 or less per year from all sources, including the income earned by any dependent, is entitled to a reduction in taxable valuation of the person's homestead. The exemption amount varies depending on income level, and the maximum reduction available is a reduction of \$2,000 in taxable valuation. He said there is also a maximum percentage reduction in valuation, which does not affect property valued at more than approximately \$44,000.

Committee counsel reviewed examples in the memorandum showing the reduction for hypothetical taxpayers with homes of differing values. He reviewed statistics on appropriations for reimbursement of the homestead property tax credit from 1977 through the current biennium and on the number of qualifying homeowners and renters and the amount paid to homeowners and renters for each year from 1975 through 1999. He also reviewed statistical comparisons for the years 1983 through 1999 illustrating the cumulative increase in homestead credit

income limits and those of other relevant statistical indicators.

Senator Urlacher said he believes the income limit under the homestead credit law allows a deduction of medical expenses. Committee counsel said that is correct, and a component of the medical expense deduction was affected by legislation approved in 2001 which increased the mileage allowance for the medical expense deduction to match the federal income tax deduction amount.

Senator Cook said the statistical information presented is useful information, and it would also be helpful to review the limitations and benefits of the homestead property tax credit in other states, especially surrounding states.

### **SPECIAL ASSESSMENTS STUDY**

Chairman Wardner called on committee counsel for presentation of a memorandum entitled *Special Assessments - Background Memorandum*. Committee counsel said one area in which a problem may exist is with regard to the new law allowing imposition of special assessments by townships. He said the difficulty that might exist involves the requirement that a freeholder affected by a proposed special assessment project is entitled to one vote for each dollar of the special assessment proposed against the freeholder's property. He said this requirement relates to the determination of whether to proceed with an improvement project, but the law does not require determination of the amount to be assessed against each property before the time of this vote so it may be difficult to determine how many votes a freeholder should be allowed to cast.

Committee counsel said one problem relating to special assessments was considered during the 2001 legislative session and was addressed by Senate Bill No. 2346, which was defeated. He said the bill related to excluding property of political subdivisions in determining whether sufficient protests have been received to bar a special assessment proceeding. He said the issue arose with consideration of a special assessment project in Grand Forks. He said a substantial amount of property within the proposed district was either state property or political subdivision property. He said the possibility exists that a special assessment district could contain a majority of property owned by the state or political subdivisions. He said this would make it impossible for private landowners to successfully protest a project without being joined by the political subdivisions or the state.

Senator Cook asked whether notice to property owners is required before their property is to be included in a special assessment district. Committee counsel said it does not appear there is such a statutory requirement.

Senator Cook said he is interested in receiving information on the Grand Forks dike financing project. He said there should be interesting discussion on

issues about determining what property is benefited and determining the amount of those benefits. He said it would be useful to invite citizens of Grand Forks to address this issue before the committee at its next meeting. Senator Cook asked whether Grand Forks residents have the right to vote on special assessments for the pending dike construction project. He said he would also like to know whether this vote, if any, is held after residents find out the individual property assessments for the project.

Senator Cook said it would also be useful to receive comments of concerned citizens and city officials about the time when notice should be received and is required by statute to be provided. He said he believes that in practice, when property owners find out the amount of their assessments, the opportunity to protest a project is over.

Senator Urlacher said differing procedures may be followed in different cities. He said the North Dakota League of Cities should be able to survey cities to determine whether procedures are uniform on special assessment projects in the state.

### **CORPORATE INCOME TAX STUDY**

Chairman Wardner called on committee counsel for presentation of a memorandum entitled *Corporate Income Tax Study - Background Memorandum*. Committee counsel said corporate income taxes were first imposed by 1919 legislation. He said the most recent change to corporate income tax rates occurred in 1983, when rates were increased by 50 percent in each income category.

Committee counsel said the study resolution states that consideration should be given to eliminating the corporate income tax, eliminating the deduction for federal corporate income taxes paid, or making other changes to reduce the corporate income tax rate to enhance the attractiveness of the business climate of the state. He said the current rate of 10.5 percent is considered by some to be unattractive for business location decisions.

Committee counsel reviewed the corporations that are exempt from payment of corporate income taxes. He reviewed computation of taxable income of corporations and combined reporting requirements for unitary businesses and the water's edge election available to unitary businesses. He said corporate income taxes can be extremely complex, and the memorandum is intended only to provide an overview of areas for consideration. He said it will be necessary to obtain direction from the committee on the areas for more specific examination.

Committee counsel reviewed deductions and additions to determine taxable income of corporations. He reviewed tax credits available under the corporate income tax. He reviewed activities that are exempt from the corporate income tax.

Committee counsel reviewed 2001 legislation relating to the corporate income tax. He reviewed

legislation defeated in 1991 and 1999 to eliminate the North Dakota state corporate income tax and 1987 defeated legislation that would have eliminated the federal income tax deduction under the state corporate income tax. He said a recommendation of eliminating the corporate income tax should be accompanied by a recommendation of how to offset the anticipated revenue loss of \$90 million to \$95 million per biennium. He said elimination of the corporate income tax deduction for federal income taxes paid could allow a reduction of corporate income tax rates by approximately one-third without a reduction in revenue. He said although this would be revenue neutral to the state, it would shift tax burdens among corporations depending on a variety of factors.

Representative Renner said review of the corporate income tax collections data in the memorandum indicates a substantial reduction in corporate income tax revenues from 1998 to 2001. He asked what is responsible for the revenue reduction. Committee counsel said the reduction is probably attributable to a variety of factors, including timing and collection of revenue from corporate income tax audit activities. He said the Tax Commissioner would be asked to provide information on this issue.

Senator Tollefson said elimination of the corporate income tax would be a substantial incentive for businesses to locate in North Dakota. He said phasing out the tax might be a way to soften the fiscal effect. He said another possible reason for the decline in corporate income tax collections might be attributable in part to cooperatives acquiring businesses previously owned by taxable corporations. He said an example would be the purchase of U S West Communications local exchanges by telephone cooperatives.

Senator Schobinger said he has read several articles recently emphasizing that corporations increasingly recognize there is a substantial advantage to locating in a state with little or no corporate income tax. He said in North Dakota we must lower the bottom line cost-of-doing business for corporations and find a way to make it clear to corporations that a reduced tax environment exists in North Dakota. He said he thinks he knows of experts who would be able to provide information on the topic of business location decisions.

Representative Ruby said consideration of only the fiscal effect of eliminating the tax should be offset by recognition that increased economic development benefits would result. He said the committee should bear this in mind in considering whether or not the taxes can be eliminated.

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

Chairman Wardner called on committee counsel for presentation of a memorandum entitled *Tobacco,*

*Alcohol, and Fuels Tax Compliance and Jurisdictional Issues - Background Memorandum.*

Committee counsel said the study directive is contained in Senate Bill No. 2448, which was introduced as a bill to reintroduce use of tobacco tax stamps on cigarettes. He said the sponsors expressed concern that evasion of state tobacco taxes was a reason for substantial declines in tobacco tax collections. He said a primary concern was that purchases from enrolled tribal members were being illegally resold outside reservation boundaries, although there is no evidence that such sales are occurring. He said tobacco distributors offered substantial opposition to reinstating tobacco tax stamps, and the bill was amended to provide for a study. He said it is not clear from the minutes on the bill why alcohol and fuels taxes were added to the study. Alcohol and fuels taxes are collected at the wholesale level, as is the tobacco tax, and this similarity may be the reason why the three issues were joined together for study.

Committee counsel said that with regard to taxation on Indian reservations, it is important to recognize existing and developing tribal tax collection agreements. He said a 1993 agreement was entered between the Tax Commissioner and the Standing Rock Sioux Tribe for tribal tobacco tax collection. He said an agreement also is in place for the Tax Commissioner to collect fuels taxes for the Standing Rock Sioux Tribe. He said he believes these are the only such agreements in existence in the state, but other agreements have been under discussion. He said it should be remembered that any agreement between the state and a tribe must be previously approved by the Governor, so relevant discussions should involve the Governor or the Governor's staff.

Committee counsel said the Tax Commissioner would be requested to address the committee at its next meeting with regard to existing tribal tax collection agreements and the issue of whether untaxed cigarettes are being sold outside reservation boundaries.

Senator Urlacher said at the end of the legislative session, he was under the impression that several tax collection agreements were in negotiation with tribes in the state. He said he would like to receive an update on developments in this area.

Senator Cook said it should be possible to examine tobacco tax records of distributors to determine whether untaxed cigarettes are being sold illegally. He asked whether tobacco tax records are confidential. Committee counsel said the question would be presented to the Tax Commissioner for discussion at the next meeting.

Representative Drovdal asked how tax officials would have any way of knowing whether cheating is occurring if cigarette packages are not marked with stamps. Committee counsel said without stamps on packages an untaxed package and a taxed package are undistinguishable.

Senator Urlacher said cigarettes are much more expensive in Canada and there is probably a substantial incentive to buy cigarettes on the reservation in North Dakota for subsequent illegal sale in Canada. He asked whether there is any way to determine whether this is occurring. The chairman said there is probably no way to know whether this activity is occurring, but the Tax Commissioner can be asked to address this issue.

Representative Schmidt said fuels tax jurisdiction issues are of interest to him. He said prices of gasoline decrease substantially as a traveler leaves North Dakota and goes east or south. He said gasoline prices at the pump are as much as 30 cents per gallon less in nearby states than in North Dakota. He said there is only a one cent per gallon difference in gasoline tax between North Dakota and Minnesota, and gasoline distributors and retailers should be asked for an explanation. He said there is concern about the differential in gasoline tax rates, but that concern is outweighed by the substantial price differences that exist.

Representative Drovdal said legislation was enacted in 1999 to prohibit use of dyed fuel in vehicles on highways. He asked whether we are enforcing our dyed fuel laws. He said he recalls information from the Highway Patrol that enforcement is limited. Committee counsel said Highway Patrol testimony on this issue during the previous interim indicated that legal advice to the Highway Patrol was to the effect that motorists cannot be stopped to check for the presence of dyed fuel in vehicles unless probable cause exists to believe an offense is occurring, which is similar to the probable cause required to stop a vehicle for a traffic offense such as driving while under the influence of alcohol. Representative Drovdal said the Highway Patrol and Tax Department should be asked to provide information on enforcement under the dyed fuel laws. He said information should also be obtained on how South Dakota is enforcing its dyed fuel laws.

Representative Ruby said he believes the Game and Fish Department has authority to stop vehicles and check for game violations without probable cause. He said he also believes the Truck Regulatory Division has this authority. He said a question should be addressed by the Highway Patrol and Tax Department on why random sampling cannot be done for dyed fuel law enforcement. Representative Herbel said he believes courts have upheld the validity of sobriety checkpoints for drivers under the influence of alcohol and the same principle would seem to apply to checking vehicles for dyed fuel compliance.

## **COMMITTEE DISCUSSION**

Chairman Wardner asked committee members to raise any other issues for investigation prior to the next meeting. Representative Schmidt said a cost-of-production factor has been blended into the formula

for agricultural property assessment. He asked if information can be presented on whether it has had any effect on valuations. He said he would also like specific information on how pervasive the effect of the capitalization rate is on valuations.

Representative Onstad said agricultural property soils-type values seem to be extensively based on cash rent information. He said it appears soils-type valuation is not accurate.

**It was moved by Representative Tollefson, seconded by Representative Rennerfeldt, and carried on a voice vote that the meeting be adjourned subject to the call of the chairman.** The meeting was adjourned at 1:30 p.m.

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John Walstad  
Code Revisor

ATTACH:1