

NORTH DAKOTA LEGISLATIVE COUNCIL

Minutes of the

TAXATION COMMITTEE

Wednesday, September 25, 2002
Roughrider Room, State Capitol
Bismarck, North Dakota

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

Members present: Senators Rich Wardner, Dwight Cook, Kenneth Kroeplin, Ronald Nichols, Randy A. Schobinger, Ben Tollefson, Herb Urlacher; Representatives Al Carlson, David Drovdal, Michael Grosz, Gil Herbel, Frank Klein, Joe Kroeber, Eugene Nicholas, Dennis J. Renner, Earl Rennerfeldt, Dan Ruby, Arlo E. Schmidt, Ray H. Wikenheiser

Members absent: Representatives Michael Brandenburg, Byron Clark, Edward H. Lloyd, Kenton Onstad

Others present: See Appendix A

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

AGRICULTURAL PROPERTY ASSESSMENT STUDY

Chairman Wardner called on Ms. Marcy Dickerson, State Supervisor of Assessments, Tax Department, for presentation of information requested relating to property tax data, analysis of property tax burdens as impacted by proposed adjustments to the capitalization rate in the valuation formula, and fiscal analysis of the subsidized housing property tax exemption bill draft being considered by the committee. Chairman Wardner said it is necessary for Ms. Dickerson to present all this information at this point on the committee agenda because her presence is required at a State Board of Equalization meeting in the afternoon.

Ms. Dickerson presented prepared testimony to review statistics from the Tax Department publication *2001 Property Valuations and Property Taxes Levied in North Dakota*. A copy of her prepared testimony is attached as Appendix B.

Senator Cook said it appears that over time there has been a shift of property tax burden statewide from agricultural property to urban residential property. He asked whether he is correct in drawing this conclusion from the statistics. Ms. Dickerson said Senator Cook is correct and Table 9 in the publication indicates that from 1992 to 2001 the increase in property taxes paid on city residential property has increased much more than taxes paid on agricultural property.

Senator Kroeplin said the committee's study was not intended to focus on increases in agricultural property taxes versus residential property taxes. He said the issue the committee has been addressing is that agricultural property is income-producing property and agricultural property assessed values continue to increase even though agricultural income has not continued to increase. He said the issue to be addressed is whether the agricultural property valuation formula results in fair property valuations based on agricultural income, as was intended when the formula was established.

Senator Cook said he thinks there are certain counties in the state where the problem described by Senator Kroeplin exists. He said it appears there are some other counties where the situation is different.

Senator Urlacher said it is true there are certain counties in which valuation increases appear to be excessive in light of what has happened to farm income in those counties. He said we have seen statistics of statewide increases in agricultural property valuations that show this is a matter of statewide concern.

In response to a question from Senator Urlacher, Ms. Dickerson said information has been provided to the committee at previous meetings on the operation of the agricultural property valuation formula. She said an attempt was made to isolate factors that produced valuation increases in counties in which decreases might be expected because of drought or excess moisture impacting production. She said Mr. Dwight Aakre, North Dakota State University, Department of Agribusiness and Applied Economics, observed at the previous committee meeting that it appears the capitalization rate and government payments, including disaster assistance payments, have been significant influences on recent valuation increases.

Representative Herbel said there is cause for concern in the fact that the agricultural property valuation formula has variable effects from county to county. He said in certain counties the formula results have forced greater agricultural property valuation increases than in other counties and over time the cumulative effect has been substantial valuation increases.

Ms. Dickerson presented prepared testimony relating to the potential shift in property tax burden if a minimum capitalization rate is instituted in the valuation formula. A copy of her prepared testimony is attached as Appendix C.

Ms. Dickerson presented prepared testimony relating to estimation of the fiscal effect of the committee bill draft to provide a partial property tax exemption for rental property developed and operated under Section 42 of the Internal Revenue Code. A copy of her prepared testimony is attached as Appendix D. She said fiscal analysis is complicated by the fact that it cannot be determined to what extent Section 42 credits have been included in or excluded from existing assessments of property. She said it appears there is a lack of uniformity among cities on this issue.

HOMESTEAD CREDIT STUDY

Chairman Wardner called on committee counsel to review a bill draft [30029.0300] relating to eligibility for and application of the homestead property tax credit. Committee counsel said the bill draft was reviewed at the April committee meeting. He said the bill draft uses the federal poverty level as a basis for income limitations under the homestead property tax credit. He said the bill draft establishes income limits in five categories of eligibility based on income. He said if the person's income does not exceed the federal poverty level, the person is entitled to a reduction of 100 percent of taxable valuation of the person's homestead up to a maximum reduction of \$80,000 in true and full valuation. He said based on February 2002 guidelines from the United States Department of Health and Human Services, the federal poverty level was \$8,860 for a single person and \$11,940 for a couple. He said the second category is available for income up to 110 percent of the federal poverty level, which would entitle the claimant to a reduction of 80 percent of the taxable valuation of the homestead, up to a maximum reduction of \$64,000 in true and full valuation. He said the 110 percent limit is equivalent to \$9,746 for a single person and \$13,134 for a couple. He said the third category of income is up to 120 percent of the federal poverty level, which would entitle the claimant to a reduction of 60 percent of the taxable valuation of the person's homestead, up to a maximum reduction of \$48,000 in true and full valuation. He said the equivalent dollar amounts for the 120 percent level are \$10,632 for a single person and \$14,328 for a married couple. He said the next category is up to 130 percent of the federal poverty level, which entitles the claimant to a reduction of 40 percent of the taxable valuation of the homestead, up to a maximum reduction of \$32,000 in true and full valuation. He said the 130 percent level is equivalent to \$11,518 for a single person and \$15,522 for a couple. He said the highest income category of eligibility is up to 140 percent of the federal poverty level,

which would entitle the claimant to a reduction of 20 percent of the taxable valuation of the homestead, up to a maximum reduction of \$16,000 in true and full valuation. He said the equivalent income at 140 percent of the federal poverty level is \$12,404 for a single person and \$16,716 for a couple. He said the current law limits the availability of the credit to claimants with income of \$14,000 or less and does not distinguish between single and married persons with regard to income limitations.

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

Committee counsel said because the bill draft changes the income limitations for homestead credit and renters refund eligibility and because the state reimburses political subdivisions for property tax revenues not received because of the exemption, the bill draft would have a fiscal effect on the state. He said Ms. Dickerson provided an estimate to the committee at the April meeting that the bill draft would have a fiscal effect of \$1,362,244 additional cost to the state, which would be in addition to the current cost per biennium of \$4,540,813.

Senator Tollefson said he questions the applicability of federal poverty guidelines in North Dakota. He said he believes these guidelines are based on economic statistics for the entire country and North Dakota's economy should be the basis of the income limitations.

Representative Drovdal said he suggested use of federal poverty guidelines for income limitations in the homestead credit law because it is more in keeping with economic reality than the current law, which is simply based on statutory dollar limitations and does not reflect changing economic circumstances. He said the federal poverty guidelines are used in social service programs in North Dakota. He said he recognizes that the guidelines are based on national economic statistics, which might be perceived as a weakness, but he is not aware of an index of poverty level determination targeted to North Dakota.

It was moved by Senator Cook, seconded by Senator Nichols, and carried on a roll call vote that the bill draft relating to eligibility for the homestead credit be approved and recommended to the Legislative Council. Senators Wardner, Cook, Kroeplin, Nichols, Schobinger, Tollefson, and Urlacher and Representatives Drovdal, Grosz, Herbel, Klein, Kroeber, Nicholas, Renner, Rennerfeldt,

Schmidt, and Wikenheiser voted "aye." Representatives Carlson and Ruby voted "nay."

SPECIAL ASSESSMENTS STUDY

Chairman Wardner called on committee counsel to review five bill drafts under committee consideration relating to the special assessments study.

Committee counsel reviewed a bill draft [30035.0200] relating to city flood control special assessments on privately owned structures, fixtures, and improvements used for private commercial purposes and located on state-owned land. He said the bill draft has been reviewed at previous committee meetings. He said the City of Grand Forks requested authority to impose city flood control special assessments against private commercial structures on state land and University of North Dakota officials stated they would not object to this approach if it is carefully structured to not impact existing facilities. He said city flood control special assessments have been imposed in Grand Forks, but state property is exempt from these assessments under North Dakota Century Code (NDCC) Section 40-23-22.1 in recognition of state financial assistance for flood control provided to the City of Grand Forks. He said the bill draft amends the exemption for state property to allow flood control special assessments to be imposed against a proposed hotel and grocery store to be located on University of North Dakota property. He said the bill draft was carefully worded to allow assessments against only these properties and not to have unintended consequences of applying assessments against other structures on University of North Dakota property. He said the bill draft contains a provision exempting a structure from assessments if the net profit is dedicated to the state institution, and this is intended to exempt the Englestad Arena at the University of North Dakota from assessments because the net profits from that facility are dedicated to the University of North Dakota. He said the bill draft requires that an assessment allowed under this provision must be against the structure, fixture, or improvement and not against the land on which the facility is located. He said this provision is included because NDCC Section 40-24-01 creates a lien against the property upon which an assessment is levied.

Committee counsel reviewed a bill draft [30182.0100] relating to cost estimates during projects for improvements by special assessments. Committee counsel said Mr. Steven Vogelpohl, Bismarck attorney and bond counsel, pointed out the potential for confusion in the state's special assessments laws regarding statutory use of the phrases "probable cost of the work" and "probable cost of the improvement." He said the bill draft is intended to make these usages uniform by providing that "cost of the work" refers to work for which proposals must be advertised under NDCC Section 40-22-19 relating to

calls for bids on construction. He said cost of the improvement is intended to describe all special assessments project costs, including cost of the work plus costs of extra work, fees, publication, and other associated expenses. He said the "cost of the improvement" is the amount ultimately assessed against property.

Committee counsel reviewed a bill draft [30034.0100] to require voter approval of special assessment improvements in a city of 5,000 or more population if the improvement district contains 75 percent or more of the area of property within the city. He said the bill draft requires voter approval before a call for bids, which would require an election after the opportunity to protest a project has passed and before the project is let for bids.

Committee counsel reviewed a bill draft [30088.0100] to limit expenses that may be added to a special assessment improvement project. Committee counsel said the bill draft amends three sections of existing law to provide that the expenses that may be added to a special assessment improvement project may not exceed the actual expenses for engineering and attorneys' fees, publication, and other administrative expenses.

Committee counsel reviewed a bill draft [30039.0100] that would require inclusion of estimated assessments against each affected parcel of property in the published resolution of necessity for a special assessment project. He said the bill draft uses the phrase "cost of the work" and the phrase should probably be amended to "cost of the improvement" to be consistent with the usage in the other bill draft under consideration.

Chairman Wardner said he would like comments and committee discussion on the special assessments bill drafts to be presented in the order in which the bill drafts were presented. Ms. Connie Sprynczyntyk, North Dakota League of Cities, introduced officials from several cities in attendance at the meeting. She said special assessments are a very important issue to cities and avoiding unintended consequences of legislation is their objective.

Chairman Wardner called on Mr. Howard Swanson, Grand Forks city attorney, for comments relating to the city flood control special assessment exemption for state property. Mr. Swanson said the City of Grand Forks generally supports this bill draft to provide for equal treatment of commercial properties. He said without this change a store or hotel on state land would be exempt from the assessment that applies to a competing business located across the street.

Mr. Swanson said the City of Grand Forks has some concerns with details of the bill draft. He said one concern is that the bill draft is limited to apply to "for-profit" entities and suggested that assessments should apply to any entity using property for commercial purposes. Committee counsel said the phrase

“for-profit” entity was chosen to limit application of assessments to the proposed hotel and store, which are known to be operated by for-profit entities. He said extending coverage to nonprofit entities was avoided because that might include activities of the University of North Dakota Foundation or other nonprofit groups that were not intended to be affected.

In response to a question from Representative Carlson, Mr. Swanson said flood control special assessments are generally levied based on square footage of land occupied by a facility. Mr. Swanson said it is not clear from the bill draft whether that method would be used for a structure on state-owned land.

Senator Tollefson said he believes nonprofit entities should also be covered by assessments when conducting commercial activities. Committee counsel said University of North Dakota officials have stated they have no objection to the bill draft as it applies to for-profit entities but have not had an opportunity to consider whether they would oppose elimination of the for-profit status of entities subject to assessment.

It was moved by Senator Tollefson, seconded by Representative Klein, and carried on a voice vote that the bill draft be amended by removing the underscored words “for-profit” on page 1, line 20.

It was moved by Representative Carlson, seconded by Representative Grosz, and carried on a voice vote that the bill draft be amended by inserting the underscored words “based on the square footage or front footage of land occupied by the structure, fixture, or improvement and” following the word “be” on page 1, line 22.

It was moved by Senator Tollefson, seconded by Representative Renner, and carried on a roll call vote that the bill draft, as amended, relating to city flood control special assessment application to certain structures on state land be approved and recommended to the Legislative Council. Senators Wardner, Cook, Kroeplin, Schobinger, Tollefson, and Urlacher and Representatives Carlson, Drovdal, Grosz, Herbel, Klein, Kroeber, Renner, Ruby, Schmidt, and Wikenheiser voted in favor of the motion. Senator Nichols voted “nay.”

Chairman Wardner called on Mr. Vogelpohl for comments on the bill draft relating to the cost estimate terminology. He said his legal practice concentrates on bond issues. He said review of bond issues requires issuance of an opinion on the legal status of bond issues, which may involve consideration of many issues. He said his job in reviewing bond issues is easier if statutory provisions are clear. He said it is for this reason he brought forward his concerns about statutory uses of the phrases “cost of the work” and “cost of the improvement.”

Senator Cook asked whether it would be necessary to add this language to the alternate methods of

assessment of benefits under NDCC Chapter 40-23.1 and any other alternate provisions. Mr. Vogelpohl said the alternate chapters relate to alternate methods of assessing costs against property and it would not be necessary to include the language in the bill draft in those chapters.

Mr. Vogelpohl said he would suggest one change in the bill draft. He said in the effective date clause, it is provided that the Act would be effective for resolutions adopted after July 31, 2003. He said he would suggest that the word “resolutions” be replaced by the words “improvement districts for which a resolution or ordinance creating the district was.”

Mr. Swanson said page 1, line 14, of the bill draft uses the phrase “estimated cost” and page 1, line 16, uses only “cost.” He said he would suggest that page 1, line 16, also state “estimated cost” to be consistent with the usage on page 1, line 14.

It was moved by Representative Kroeber, seconded by Senator Urlacher, and carried on a voice vote that the bill draft relating to special assessment project cost estimates be amended by inserting the word “estimated” after the second word “of” on page 1, line 16, and by replacing “resolutions” on page 2, line 5, with the words “improvement districts for which a resolution or ordinance creating the district was.”

It was moved by Senator Cook, seconded by Representative Renner, and carried on a roll call vote that the bill draft, as amended, relating to special assessment project cost estimates be approved and recommended to the Legislative Council. Senators Wardner, Cook, Kroeplin, Nichols, Schobinger, Tollefson, and Urlacher and Representatives Carlson, Drovdal, Grosz, Klein, Kroeber, Nicholas, Renner, Rennerfeldt, Ruby, Schmidt, and Wikenheiser voted in favor of the motion. Representative Herbel voted “nay.”

Chairman Wardner called on Mr. Vogelpohl for comments on the bill draft relating to voter approval of certain special assessments in larger cities. Mr. Vogelpohl said there might be a question under this bill draft regarding the relationship of the required election and the existing protest process. He said it appears that common sense suggests the election on the issue would follow the protest process, but it is not required in the language of the bill draft. He said he also questions whether this voter approval would be required in the case of sewer and water projects initiated by petition.

Ms. Sprynczynatyk said there are several questions that have been discussed by city officials regarding this bill draft. She said one issue perceived as a potential problem is that park districts may impose special assessments for certain projects and must do so on a citywide basis. She said park districts do not have authority to call an election on their own so this provision may preclude them from imposing special assessments.

Senator Cook asked whether Bismarck does city-wide special assessment projects. Ms. Sprynczy-natyk said she does not recall any citywide assessments in Bismarck.

Senator Cook said it appears this bill draft needs further consideration and modifications before it is introduced. **It was moved by Senator Cook, seconded by Senator Tollefson, and carried on a voice vote that the committee not recommend the bill draft relating to voter approval of certain special assessments in larger cities to the Legislative Council.**

Chairman Wardner called on Mr. Bruce Furness, Mayor of Fargo, for comments on the bill draft regarding determination of expenses under a special assessment project. Mr. Furness said Fargo has experienced great growth. He said this growth necessitates many special assessment projects to provide services and infrastructure for developing properties. He said Fargo adds a percentage estimate of additional costs on construction costs in special assessment projects. He said some people get the impression these added costs generate a profit for the city. He said this is not the case. He said Fargo city officials believe the estimates of additional costs are as accurate as possible. He said Fargo city officials are concerned about the possible effect of the bill draft that would require actual costs and fees to be determined and assessed on special assessment projects. He said sometimes it is impossible to determine actual costs and fees.

Mr. Furness introduced Mr. Kent Costin, Director of Finance, City of Fargo, to address questions directed to the City of Fargo relating to additional costs on special assessment projects. A copy of Mr. Costin's prepared testimony is attached as Appendix E.

Chairman Wardner called on Mr. Mark Bittner, City Engineer, Fargo, for presentation of information on determination of fees on special assessment projects in Fargo. A copy of information distributed by Mr. Bittner is attached as Appendix F.

Mr. Bittner said the office of the city engineer gets involved upfront in estimating costs on projects. He reviewed the information distributed. He said since 1975 he has been with the City of Fargo Engineering Department and these estimates of fees have always been used. He said fees vary on individual projects, but the percentage amounts determined prove to be quite accurate over time and over a variety of projects. He said the information distributed includes estimated final costs on special assessment projects and shows the percentage of expenditures for construction costs and fees and other costs. He said the examples show that engineering and other costs are variable on projects. He said a variety of factors may influence the level of expenditures for engineering and other services.

Mr. Pat Zavrol, City Administrator, Fargo, said growth in Fargo is wonderful, but it comes with costs to adequately provide infrastructure and services. He said it is important to remember that one possible problem with the bill draft that would limit assessments to actual costs incurred in addition to construction costs is that actual costs might in many cases exceed the estimated costs and actually increase assessments to property owners.

Chairman Wardner called on Mr. Arden Anderson, City Auditor, Wahpeton, for comments on the special assessment study. Mr. Anderson said Wahpeton does special assessment projects on a basis similar to the method described for Fargo. He said estimated costs and fees are added to special assessment projects and the method has worked well for Wahpeton. He said Wahpeton city officials believe that determination of special assessment costs and fees is a local issue and should be left to local decisionmakers.

Chairman Wardner called on Mr. Ward Koeser, President, Board of City Commissioners, Williston, for comments on the special assessment study. A copy of prepared testimony distributed by Mr. Koeser is attached as Appendix G.

Mr. Koeser said the proposed changes in the bill drafts under consideration will impede the process used for special assessment projects.

Chairman Wardner called on Mr. Jim Neubauer, City Administrator, Mandan, for comments on the special assessments study. Mr. Neubauer said the City of Mandan estimates 20 to 25 percent as added costs on special assessment projects. He said as actual costs become available, those amounts are substituted for estimates. He said sometimes actual costs for services associated with special assessment projects are not known until one or two years after the project is completed.

Senator Cook said he believes the bill draft requiring assessment of only actual costs and expenses requires exactly what Mandan does on assessing these costs. Mr. Neubauer said that is correct.

Chairman Wardner called on Mr. Vogelwohl for comments on the bill draft requiring assessment of only actual costs of construction and fees. Mr. Vogelwohl said he works with a lot of small cities on bond issues for special assessment projects. He said his concern is that requiring actual expenses and fees on projects might cause problems with conducting projects in small cities. He said smaller cities particularly must operate on estimates, including estimated costs of borrowing money. He said marketability of bonds requires that the city have authority to levy a sufficient amount to support the payment of bond costs. He said the bill draft limiting assessments to actual costs could affect marketability of bonds for small cities. He said NDCC Section 40-24-11 provides that when the bond sinking fund is adequate

to pay off bonds, the certification of levies must end. He said it is also important to remember that federal tax laws overlay the entire special assessment process. He said a city issuing bonds must fit the requirements of federal law to gain tax-exempt status. He said excessive estimates of added costs on special assessment projects are discouraged under federal law.

Chairman Wardner called on Mr. Greg Sund, City Administrator, Dickinson, for comments on the special assessment study. Mr. Sund said he is concerned the bill draft that would require actual costs to be assessed on projects could affect project timing. He said Dickinson has a current project that could be delayed by a year if it is necessary to determine actual costs before assessment. He said a delay of a year on a project would add significant amounts to the cost of the project.

It was moved by Senator Cook that the bill draft requiring assessment of actual costs and fees for special assessment projects be approved and recommended to the Legislative Council. The motion died for lack of a second.

It was moved by Representative Herbel, seconded by Representative Rennerfeldt, and carried on a voice vote that the bill draft requiring assessment of actual costs and fees on special assessment projects not be approved and recommended to the Legislative Council.

Chairman Wardner called on Ms. Sprynczynatyk for comments on the bill draft to require inclusion of estimated assessments in the published resolution of necessity for a special assessment project. Ms. Sprynczynatyk said city officials believe this requirement would add substantial costs on special assessment projects. She said the North Dakota League of Cities recommends the bill draft not be approved.

Chairman Wardner called on Mr. Vogelpohl for comments on the bill draft to require inclusion of estimated assessments in the published resolution of necessity for a special assessment project. Mr. Vogelpohl said this requirement would preempt the authority of the Special Assessment Commission to determine assessment allocations for each benefited parcel of property. He said even though the required amounts are estimates, the existence of the estimates would make it difficult for the Special Assessment Commission to change the amounts. He said if the list of parcels affected does not include all benefited property, a question would exist of whether the Special Assessment Commission would lose jurisdiction over unnamed properties.

Chairman Wardner called on Mr. Bittner for comments on the bill draft to require inclusion of estimated assessments in the published resolution of necessity for a special assessment project. Mr. Bittner said he would suggest more flexibility in the requirement. He said Fargo does a direct mailing

to affected property owners with notice of the estimated assessment. He said he believes this provides a better form of notice for property owners and requiring publication of the amounts would add another requirement and additional project costs.

Senator Cook said he commends the City of Fargo for providing mailed notice to affected property owners. He said he would prefer that state law require mailed notice of estimated assessments to each affected property owner. He asked whether Fargo requires estimates of cost of assessments to property owners. Mr. Bittner said Fargo does require estimates to be included based on either a per square foot basis or a linear foot of frontage basis. He said Fargo is seeking ways to enhance the system and provide even better estimates for property owners. Senator Cook said what Fargo does is what this bill draft was intended to accomplish.

Chairman Wardner called on Mr. Swanson for comments on the bill draft relating to the requirement of estimated assessments in the published resolution of necessity for a special assessment project. Mr. Swanson said NDCC Section 40-23-05 prohibits the Special Assessment Commission from meeting at the time that would be necessary to provide cost estimates before adoption of the resolution of necessity. He said the bill draft also does not address projects that do not require a resolution of necessity.

Chairman Wardner called on Mr. Jerry Lein, City Engineer, Wahpeton, for comments on the bill draft to require inclusion of estimated assessments in the published resolution of necessity for a special assessment project. Mr. Lein said Wahpeton provides estimated assessments per parcel upfront on special assessment projects because the city believes citizens want that service. He believes the bill draft requirement of inclusion of the estimates in the resolution of necessity could create jurisdiction problems for special assessment projects.

Senator Cook said property owners in some cities have no knowledge of the amount of their special assessments at the time they have an opportunity to protest the project. He said that is the problem this bill draft was intended to remedy. He said the committee has received testimony that some cities already follow practices to provide these estimated assessments for property owners.

It was moved by Senator Cook, seconded by Representative Schmidt, and failed on a roll call vote that the bill draft requiring inclusion of estimated assessments in the published resolution of necessity for a special assessment project be approved and recommended to the Legislative Council. Senators Cook and Tollefson and Representatives Carlson, Drovdal, Grosz, Ruby, and Schmidt voted in favor of the motion. Senators Wardner, Kroeplin, Nichols, and Urlacher and Representatives Herbel, Klein, Kroeber, Rennerfeldt, and Wikenheiser voted "nay."

It was moved by Representative Herbel, seconded by Representative Kroeber, and carried on a voice vote that the bill draft requiring inclusion of estimated assessments in the published resolution of necessity for a special assessment project not be approved and recommended to the Legislative Council.

AGRICULTURAL PROPERTY ASSESSMENT STUDY

Chairman Wardner called on Mr. Aakre for analysis of potential changes to the capitalization rate in the agricultural property valuation formula. A copy of Mr. Aakre's prepared testimony is attached as Appendix H.

Mr. Aakre said he prepared six tables showing agricultural land assessments for 2002 if the capitalization rate is adjusted. He said the capitalization rate used for the 2002 assessments was 8.91 percent and this amount was used to prepare the first table. He said the remaining five tables show capitalization rates ranging from 8.5 to 9.5 percent in one-quarter percentage point increments. He said increasing the capitalization rate used from 8.5 to 9.5 percent yields a decrease in agricultural property valuation statewide of 10.5 percent.

Mr. Aakre said he was also asked to analyze what would happen to the capitalization rate if the calculation excluded loans of less than 15 years duration from Agribank. He said he contacted Agribank regarding this potential change and the calculated effect is negligible, showing only an increase of .04 percentage points for 2002 and 2003 calculations.

Mr. Aakre said the reason for so little change in the capitalization rate of excluding shorter-term Agribank loans is that the longer-term rates do not differ much from shorter-term rates because Agribank makes variable rate loans available for short-term borrowers and these variable rates do not differ much from longer-term rates.

Senator Kroeplin said some of the loan vehicles now offered by Agribank are different from what was available 20 years ago. He said long-term loans were much more common when the formula was established. He said the changes in lending practices have affected the capitalization rate used in the formula. Mr. Aakre said that is correct. He said current conditions are such that there are not many 15-year or longer loans being taken by agricultural producers.

Senator Kroeplin asked whether there is a more appropriate rate that could be used for the capitalization rate in the formula. Mr. Aakre said he is unable to suggest a more appropriate rate.

Chairman Wardner called on Mr. Berdette Howe, Farm Credit Services, Mandan, for comments on Farm Credit Services loan products. Mr. Howe said Farm Credit Services still offers 15- or 20-year loans, but these are not being used much by producers because producers can get shorter-term loans with

variable interest rates that are now around 5 percent as compared to loan rates of approximately 8 percent for the longer-term loans.

Senator Kroeplin said another problem that appears to exist is that Agribank rates vary from region to region. He said he obtained information on Agribank 15-year adjustable rate loans from the Hillsboro office and those rates are substantially higher than the rates from the St. Paul office that are used in the formula. He distributed copies of the information he obtained on average loan rates from the Hillsboro Agribank office. A copy is attached as Appendix I.

Representative Renner said it appears that determination of the rate used in the valuation formula is based on the rates of loans being used by producers rather than the rates of all available loans through Agribank. Mr. Aakre said that is probably correct.

Chairman Wardner called on Mr. Larry Osborn, Richland County Supervisor of Tax and Property, for testimony relating to the agricultural property assessment study. A copy of Mr. Osborn's prepared testimony is attached as Appendix J.

Mr. Osborn said the weakness in the capitalization rate used in the formula is that it does not reflect property tax payments by farmers and ranchers. He said there are two ways the formula could be adjusted to reflect property tax impact. He said one method would be to subtract taxes paid from gross income, which would lower net income. He said the second option would be to combine the capitalization rate, based on mortgage rates, with an effective tax rate calculation. He said effective tax rate is determined by dividing actual annual tax payments by true and full value for property. He said he calculates the effective tax rate for rural communities in North Dakota to be approximately 1.5 percent.

In response to a question from Senator Tollefson, Mr. Osborn said he is familiar with South Dakota agricultural property valuation methods because he has served as an instructor for farmland appraisers in South Dakota. He said South Dakota currently uses market value for agricultural property assessment. He said this creates problems and South Dakota has frozen agricultural property valuations at approximately 90 percent of market value. He said consideration is being given to introducing legislation in South Dakota to go back to a productivity method of valuation because of dissatisfaction with the high level of valuations under the current method.

Representative Carlson said he appreciates the concerns of agricultural producers about increasing property valuations. He said the problem his constituents perceive is that lowering property valuations for agricultural property results in a transfer of tax responsibility to residential, commercial, and utility property. He said the problem he faces in representing his constituents is how to explain to them that it is appropriate to transfer tax burden from

agricultural property to residential, commercial, and utility property.

Senator Kroeplin said it was not the duty of the Taxation Committee to seek to shift tax burden away from agricultural property. He said the objective of the committee study is to make the agricultural property valuation formula as accurate as possible.

Chairman Wardner asked whether committee members had comments on the bill draft previously considered by the committee that would alter the agricultural property valuation formula by shifting to a basis of using entirely cash rent data to determine annual gross return. **It was moved by Senator Urlacher, seconded by Representative Carlson, and carried on a voice vote that the bill draft relating to determination of annual gross return based on cash rent data not be approved and recommended to the Legislative Council.** Senator Nichols said if there was a good way to measure cash rents, this would be a dependable method. He said the problem is that methods available to gather cash rent information are not reliable. Senator Urlacher said he does not believe shifting to an entirely cash rent basis in the formula would improve fairness.

Chairman Wardner asked whether committee members had comments regarding the bill draft previously considered by the committee to freeze agricultural property valuations for certain counties in 2003 and 2004. **It was moved by Senator Cook, seconded by Representative Carlson, and carried on a voice vote that the bill draft providing for a freeze in certain agricultural property valuations not be approved and recommended to the Legislative Council.** Representative Herbel said much discussion has centered on the potential shifting of tax burdens from agricultural property. He said he believes that issue is debatable. He said there have been comments that residential property taxes have risen faster than agricultural property taxes. He said it should also be recognized that market values of residential property have risen much faster than market values of agricultural property.

Chairman Wardner asked whether committee members had comments relating to the bill draft to exclude consideration of Agribank loans for a term of less than 15 years in determining the capitalization rate for agricultural property valuation. Senator Kroeplin said this bill draft is estimated to have very little impact. He said he would be interested in amending the bill draft to change the approach to incorporate an effective tax rate as suggested by Mr. Osborn. He asked how that could be accomplished. Committee counsel said the underscored language after page 1, line 18, could be deleted. He said a change could be made on page 1, line 8, to provide that the capitalization rate would be the sum of the effective tax rate and a 10-year average of the gross Agribank mortgage rate of interest for North Dakota.

Mr. Osborn said including the effective tax rate in the capitalization rate would result in a reduction of approximately 14 percent in agricultural property values. He said it may be necessary to phase in this change over a period of time to avoid an impact of this magnitude. Chairman Wardner said he believes it would be appropriate to provide for phasing in such a change.

Representative Renner said the bill draft should be further amended to phase in the use of the effective tax rate in equal amounts over a period of four years.

Representative Carlson said the proposed amendments are an interesting discussion topic but the committee does not have any analysis of the effect of such a change. He said he does not believe the committee should recommend this approach.

It was moved by Representative Schmidt, seconded by Representative Herbel, and carried on a voice vote that the bill draft relating to the capitalization rate used in the agricultural property tax valuation formula be amended to provide that the capitalization rate will be the sum of the effective tax rate and a 10-year average of the gross Agribank mortgage rate of interest and that the use of the effective tax rate be phased in over a period of four years in equal installments.

It was moved by Representative Schmidt, seconded by Representative Herbel, and carried on a roll call vote that the bill draft, as amended, relating to incorporating an effective tax rate in the capitalization rate used in the agricultural property tax valuation formula be approved and recommended to the Legislative Council. Senators Kroeplin, Nichols, Schobinger, and Urlacher and Representatives Drovdal, Herbel, Klein, Renner, Schmidt, and Wikenheiser voted in favor of the motion. Senators Wardner, Cook, and Tollefson and Representatives Carlson, Grosz, Kroeber, Rennerfeldt, and Ruby voted "nay."

Chairman Wardner asked for committee comments relating to the bill draft to establish a minimum amount of 9 percent for the capitalization rate in the agricultural property valuation formula. **It was moved by Senator Urlacher, seconded by Representative Drovdal, and carried on a voice vote that the bill draft relating to establishing a floor amount of 9 percent for the capitalization rate in the agricultural property valuation formula not be approved and recommended to the Legislative Council.**

CORPORATE INCOME TAX STUDY

Chairman Wardner called on committee counsel to review three bill drafts under committee consideration relating to corporate income taxes.

Committee counsel said the bill draft [30038.0300] that is marked as a third draft would eliminate the corporate income tax deduction for federal income taxes paid and would reduce corporate income tax

rates. He said the elimination of the federal income tax deduction would offset the rate reductions and the bill draft would be approximately revenue neutral. He said the highest corporate income tax rate in the bill draft is 7.6 percent. He said for corporations electing to file on a water's edge basis, current law requires them to give up the federal income tax deduction as part of electing water's edge treatment. He said the bill draft provides that current corporate income tax rates would be applied to water's edge filers because reducing corporate income tax rates for water's edge filers would have a negative fiscal effect because it would encourage more water's edge filings.

Committee counsel said the second corporate income tax bill draft [30142.0100] would eliminate corporate income taxes.

Committee counsel said the third corporate income tax bill draft [30143.0100] would eliminate the corporate income tax reduction for federal income taxes paid, eliminate graduated corporate income tax rates and substitute a flat-rate tax on all corporate income, and would use a flat-rate tax calculated to result in a reduction of approximately 5 percent in corporate income tax revenues. He said the bill draft imposes a flat-rate corporate income tax of 6.84 percent except that the rate for water's edge filers is 9.9 percent. He said the higher rate for water's edge filers is a reduction of approximately 5 percent in liability for water's edge filers, but the rate is higher than for other corporations to retain approximately the same incentive for filing on a water's edge basis. He said the federal income tax deduction for bank taxes is transferred to NDCC Chapter 57-35.3 on page 3, lines 3 through 6. He said language was inadvertently omitted from this draft that should be included in the transfer of language from Chapter 57-38. **It was moved by Representative Carlson, seconded by Senator Schobinger, and carried on a voice vote that the bill draft be amended to incorporate the remaining language regarding the federal income tax deduction to the financial institutions tax provisions of Section 57-35.3-02.**

Chairman Wardner called on Ms. Kathryn Strombeck, Research Analyst, Tax Department, for a fiscal impact analysis on the three corporation income tax bill drafts. A copy of Ms. Strombeck's prepared testimony is attached as Appendix K.

Senator Schobinger asked whether the fiscal analysis of any of the bill drafts includes any consideration of potential economic growth. Ms. Strombeck said economic growth is not factored into the analysis of fiscal impact of the bill drafts.

It was moved by Senator Schobinger, seconded by Senator Cook, and carried on a voice vote that the bill draft providing for revenue neutral corporate income tax rate reductions and elimination of the deduction for federal income taxes paid not be approved and recommended to the Legislative Council.

Senator Schobinger said with regard to the bill draft for repeal of the corporate income tax, he believes this is the right thing to do, but it probably should have been done five years ago or perhaps at some point in the future but not under the current budget situation. **It was moved by Senator Schobinger, seconded by Senator Tollefson, and carried on a voice vote that the bill draft providing for repeal of the corporate income tax not be approved and recommended to the Legislative Council.**

Senator Schobinger said he believes the bill draft providing for a flat-rate corporate income tax and a 5 percent reduction in corporate income tax revenues is an appropriate vehicle for legislative debate and would send a message to out-of-state businesses that North Dakota encourages them to locate here. **It was moved by Senator Schobinger, seconded by Representative Carlson, and carried on a roll call vote that the bill draft providing for a flat-rate corporate income tax and elimination of the corporate income tax deduction with a reduction of approximately 5 percent in corporate income tax revenues be approved and recommended to the Legislative Council.** Senators Wardner, Cook, Nichols, Schobinger, Tollefson, and Urlacher and Representatives Carlson, Drovdal, Grosz, Herbel, Klein, Kroeber, Nicholas, Renner, Rennerfeldt, Ruby, Schmidt, and Wikenheiser voted in favor of the motion. Senator Kroeplin voted "nay."

SUBSIDIZED HOUSING VALUATION STUDY

Chairman Wardner called on committee counsel to review a bill draft [30036.0100] previously considered by the committee which would provide a partial property tax exemption for certain subsidized housing properties. Committee counsel said the bill draft creates a partial property tax exemption, which was suggested to be an easier approach than changing the method of valuation of these properties. He said these properties would be valued under normal procedures and then an amount would be subtracted from the value as determined under this exemption. He said two components of the exemption include the value of a leasehold rent limitation under Section 42 of the Internal Revenue Code and the amount of or value received for the income tax credit under Section 42 of the Internal Revenue Code. He said the final sentence of the exemption provides that the exemption ceases when rent restrictions no longer apply to the property. He said the bill draft is to become effective for the 2004 taxable year and it could be speeded up by one year if the committee believes it appropriate.

Chairman Wardner called on Ms. Clarice Liechty, Jamestown, for comments on the bill draft. Ms. Liechty said she is a private property owner and recommends that the committee not recommend the

subsidized housing valuation bill draft. She said there are fewer than 1,300 rental units in Jamestown, but about 700 received some form of rent assistance. She said she believes over 200 of these units are under direct government contracts. She said the Jamestown city assessor is unable to identify which rental properties are subject to rent restrictions under Section 42 of the Internal Revenue Code. She said because it is not known how much property would be affected, the impact of the bill draft is unknown. She said she develops rental properties at her own expense. She said developers of Section 42 properties receive a subsidy upfront and providing a property tax break would provide an additional competitive advantage.

Chairman Wardner called on Mr. Jim Knutson, Valley City, for comments on the subsidized housing valuation study. Mr. Knutson said he would like to remind the committee that the concept of statutory clarification of assessment of Section 42 properties was brought forward because developers of properties received differing treatment in different parts of the state. He said another reason for this approach is that treatment of these properties in some cities discourages development of higher-quality properties. He said the benefit of the treatment under the bill draft would not be directly to developers but would be passed to tenants and the community.

Senator Cook said rents on Section 42 properties are restricted. Mr. Knutson said that is correct. Senator Cook asked how the developer can pass the benefit of a partial tax exemption to tenants when the rents are set by federal law. Mr. Knutson said in 99 percent of cases, the actual rent on units in North Dakota is less than the maximum amount allowed under federal law.

In response to a question from Senator Cook, Mr. Knutson said rent limits for Section 42 properties differ by county. Senator Cook said this means that the feasibility of a housing development project differs depending on what county the project would be located in. Mr. Knutson said that is correct. He said in Burleigh County there is a limit of \$495 per month rent for a unit for an eligible tenant. Senator Cook asked whether Mr. Knutson's rentals are less than that in Burleigh County. Mr. Knutson said his rentals are below the Burleigh County limit.

Senator Cook said the problem as he views it is that lower taxes on Section 42 properties would allow lower rent for tenants which in turn would force Ms. Liechty to lower rentals on her property and this seems unfair to her as a private developer. Mr. Knutson said there may be overlapping competition with private developers, but subsidized housing requires tenants to qualify on an income basis so potential renters are limited for Section 42 properties,

while private property is not subject to these limitations.

Representative Carlson asked whether Mr. Knutson would lower the rent on Section 42 rental units if this bill draft became law. Mr. Knutson said he would lower rentals.

Senator Kroeplin said committee members should recall the testimony presented by Ms. Dickerson at the previous committee meeting that if this exemption is allowed for Section 42 housing, other property owners with other forms of subsidy or income tax treatment could press for similar property tax exemption treatment. He said Ms. Dickerson also pointed out that current law allows the kind of assessment provided under the bill draft but does not require it.

It was moved by Senator Cook, seconded by Representative Klein, and carried on a voice vote that the bill draft providing a partial property tax exemption for certain kinds of subsidized housing not be approved and recommended to the Legislative Council.

STREAMLINED SALES TAX PROJECT

Chairman Wardner called on Mr. Gary Anderson, Sales Tax Division Director, Tax Department, to report on the streamlined sales tax project. Mr. Anderson said he has participated in several meetings of the streamlined sales tax project and he reviewed the current status of project consideration and recommendations. Senator Wardner said the streamlined sales tax project is not a study responsibility of the Taxation Committee, but committee members should be informed of the activities and recommendations as background for potential 2003 legislation.

COMMITTEE ACTION

It was moved by Representative Klein, seconded by Senator Tollefson, and carried on a voice vote that the chairman and the staff of the Legislative Council prepare a final report and recommended bill drafts and present the report and recommended bill drafts to the Legislative Council.

It was moved by Representative Renner, seconded by Representative Rennerfeldt, and carried on a voice vote that the committee be adjourned sine die.

The meeting was adjourned sine die at 4:15 p.m.

John Walstad
Code Revisor

ATTACH:11