NORTH DAKOTA LEGISLATIVE COUNCIL

Minutes of the

TAXATION COMMITTEE

Friday, July 16, 2004
Roughrider Room, State Capitol
Bismarck, North Dakota

Senator Dwight Cook, Chairman, called the meeting to order at 9:00 a.m.

Members present: Senators Dwight Cook, Randy A. Schobinger, John O. Syverson, Thomas L. Trenbeath, Herb Urlacher, Rich Wardner; Representatives Wesley R. Belter, David Drovdal, C. B. Haas, Craig Headland, Ron Iverson, Frank Klein, Phillip Mueller, Kenton Onstad, Arlo E. Schmidt, Elwood Thorpe, Dwight Wrangham, Steven L. Zaiser

Members absent: Senators Ronald Nichols, Harvey Tallackson, Ben Tollefson; Representatives Larry Bellew, Mike Grosz, Dave Weiler, Ray H. Wikenheiser

Others present: See Appendix A

It was moved by Senator Schobinger, seconded by Senator Wardner, and carried on a voice vote that the minutes of the April 1, 2004, meeting be approved as distributed.

INCOME TAX STUDY

Chairman Cook called on committee counsel for review of a bill draft [50077.0100] to impose North Dakota income taxes on earnings from out-of-state bonds. Committee counsel said the bill draft would make a change to require an adjustment to North Dakota taxable income on Form ND-1, formerly called the short-form return. He said earnings from out-of-state bonds are required by current law to be added to North Dakota taxable income on Form ND-2, formerly called the long-form return.

Committee counsel said earnings from state and local bonds are not included in federal taxable income, which is used as the starting point for both North Dakota state income tax returns. He said interest from out-of-state bonds is required to be added to the Form ND-2 return but enjoy the same tax-free status on the Form ND-1 return as is provided for North Dakota state and local bond earnings. He said most states that impose income taxes do not grant favorable tax status except for earnings from bonds issued within their state.

Senator Syverson asked whether imposing income taxes on out-of-state bonds would increase demand for North Dakota municipal bonds and lower interest rates on North Dakota bonds as a result. Tax Commissioner Rick Clayburgh said he is not sure whether this change would affect interest rates on North Dakota municipal bonds. He said this would tend to increase demand for North Dakota bonds but he believes there is already more demand for North Dakota bonds than there are bonds available for investment.

Mr. Clayburgh said current North Dakota law provides an incentive for North Dakota taxpayers to invest in out-of-state municipal bonds. He said very few states provide incentive of any kind to invest in other states. He said there is a limited supply of North Dakota bonds for investment and there would be some opposition to this bill draft among investors who now own out-of-state bonds and enjoy tax-free status on the Form ND-1 return. He said the Tax Department estimates the fiscal effect of this bill draft to increase general fund revenue by approximately $1.5 million per biennium. Representative Schmidt asked whether the bill draft would apply to existing investments. Mr. Clayburgh said the bill draft is effective for the 2005 tax year and would apply to bonds already purchased.

Representative Drovdal said this situation is similar to other circumstances under the income tax in which North Dakota is the only state allowing this kind of benefit to taxpayers.

It was moved by Representative Drovdal and seconded by Senator Syverson that the bill draft requiring addition of earnings from out-of-state bonds to taxable income on income tax Form ND-1 be approved and recommended to the Legislative Council.

Representative Mueller asked whether the positive fiscal effect of the bill draft would be eliminated if existing investments are allowed to continue tax-exempt status. Mr. Clayburgh said the fiscal effect would be substantially reduced and would be approximately revenue-neutral.

Representative Thorpe asked whether investment in municipal bonds would become less attractive if this bill draft is enacted. Mr. Clayburgh said the primary attraction of municipal bonds is federal income tax-exempt status so this change should not have much impact on demand for bonds as an investment.

In response to a question from Senator Wardner, Mr. Clayburgh said the concern of opponents of this change during consideration of 2001 legislation was that there are not enough North Dakota bonds to serve the demand for tax-free bonds as investments.

Representative Belter asked whether, if the bill were amended to grandfather tax-exempt status for existing bond investments, an administrative problem would be created for the Tax Department. Mr. Clayburgh said the department would have to live with that approach but it should not create too great an administrative problem. Representative Belter said he believes it would be appropriate to allow continued tax-free status because he does not believe it would be fair to change the tax status of bonds already purchased.

It was moved by Representative Belter and seconded by Representative Haas that the bill draft be amended by providing that it applies only to bonds purchased after December 31, 2005.

Senator Wardner said he believes adding this amendment would diminish opposition to the bill.

Senator Urlacher said he agrees that this would diminish opposition to the bill and believes this would be best for North Dakota in the long run.

Mr. Clayburgh said mutual funds should also be addressed in the grandfather clause for preexisting investments.

Representative Wrangham said he would support the amendment because it allows investors to be aware of the change in tax status.

The question was called and **the amendment carried on a voice vote**.

Senator Wardner said he would like to move the bill forward so that discussions can be had during the legislative session to find out how investors feel about this change.

Representative Belter said he agrees with Senator Wardner that the bill should move forward. He said he believes the discussion of this issue would be useful during the legislative session.

The question was called on approval and recommendation of the bill draft and **the motion carried on a roll call vote**. Voting in favor of the motion were Senators Cook, Schobinger, Syverson, Trenbeath, Urlacher, and Wardner and Representatives Belter, Drovdal, Haas, Headland, Mueller, Onstad, Schmidt, and Zaiser. Voting in opposition to the motion were Representatives Iverson, Klein, Thorpe, and Wrangham.

Chairman Cook called on committee counsel for review of a bill draft [50076.0100] relating to income tax treatment of passthrough entities. Committee counsel said passthrough entities include organizations, such as subchapter S corporations, partnerships, limited liability companies, and limited liability partnerships. These entities do not pay taxes at the entity level, as is the case with corporations other than subchapter S corporations. Income or loss of passthrough entities is passed through to the various owners based on their ownership interests in the entity. Those owners are required to report the passthrough income on their own individual income tax returns or, if those owners are corporations, on their corporate returns. He said there is a compliance problem associated with collection of income taxes due from nonresident owners of interests in passthrough entities. He said the Multistate Tax Commission has a uniformity committee that has developed the proposed reporting option for nonresident members of passthrough entities on which the bill draft is based. The bill draft requires a passthrough entity to withhold and remit income tax on behalf of nonresident members. He said the bill draft provides exceptions that would not require passthrough entity income tax withholding for a nonresident member if the member has an income share of less than $1,000 per annual accounting period, the Tax Commissioner determines by rule that certain income is not subject to withholding, the member elects to have tax due paid as part of a composite return filed by the passthrough entity, or the entity is a publicly traded partnership.

Mr. Clayburgh said North Dakota has supported the Multistate Tax Commission in its efforts to create uniformity among states. He said this legislation puts passthrough entities in the position of withholding on income of owners who reside in other states. He said individuals who own interests in passthrough entities would be under an obligation to pay the tax anyway. He said this bill draft would be a compliance tool for income tax administration. He said the Tax Department estimates the fiscal effect of this bill draft to increase general fund revenue by approximately $500,000 per biennium.

It was moved by Senator Wardner, seconded by Representative Klein, and carried on a roll call vote that the bill draft to require withholding by passthrough entities for income tax purposes in specified circumstances be approved and recommended to the Legislative Council. Voting in favor of the motion were Senators Cook, Schobinger, Syverson, Urlacher, and Wardner and Representatives Drovdal, Haas, Klein, Mueller, Onstad, Schmidt, and Zaiser. Voting in opposition to the motion were Senator Trenbeath and Representatives Belter, Headland, Iverson, Thorpe, and Wrangham.

In discussion of the motion, Senator Trenbeath said S corporations are often family farms and he is concerned that this bill would add a burden of withholding for some of those farms.

Chairman Cook called on committee counsel for presentation of a bill draft [50075.0100] relating to inclusion of corporations in a unitary relationship and incorporated in a tax haven as part of a water's edge corporate income tax filing election. Committee counsel said Mr. Dan Bucks, Executive Director, Multistate Tax Commission, discussed tax avoidance issues at the April committee meeting. He said Mr. Bucks suggested one improvement for combined reporting for unitary filings would be to require information on tax havens. He said Mr. Bucks pointed out that Montana enacted 2003 legislation on this topic and the committee requested preparation of a bill draft patterned after the Montana law. He said the bill draft defines tax haven and requires that an entity filing a water's edge group income tax return must include in that group any corporation that is in a unitary relationship with the taxpayer and is incorporated in a tax haven. The bill allows the Tax Commissioner to require a taxpayer to include in a domestic disclosure spreadsheet any corporation in a unitary relationship with the taxpayer and incorporated in a tax haven. The bill draft also provides that income shifted to a tax haven, to the extent it is taxable, is considered income subject to apportionment for income tax purposes.

Mr. Clayburgh said national groups dealing with tax policy have sought ways to address tax havens for state income tax purposes. He said the Multistate Tax Commission approach is the basis for the bill draft. He said the water's edge filing election is not used by many North Dakota taxpayers. He said the focus of the bill draft is to address abuses by corporations using offshore holding companies to shelter income.

Senator Cook asked how many states follow this approach. Mr. Clayburgh said it is relatively new and Montana has enacted this approach and perhaps three other states are considering it.

Senator Wardner said he believes this issue needs full exploration during the legislative session and this bill draft is important to initiate this discussion. **It was moved by Senator Wardner, seconded by Representative Zaiser, and carried on a roll call vote that the bill draft to include corporations in a unitary relationship and incorporated in a tax haven as part of a water's edge corporate income tax filing election be approved and recommended to the Legislative Council.** Voting in favor of the motion were Senators Cook, Schobinger, Syverson, Trenbeath, Urlacher, and Wardner and Representatives Belter, Drovdal, Haas, Headland, Iverson, Klein, Mueller, Onstad, Schmidt, Thorpe, Wrangham, and Zaiser. No negative votes were cast.

In response to a question from Senator Cook, Mr. Clayburgh said the estimated fiscal effect of the bill draft is to increase general fund revenue by approximately $150,000 per biennium.

Chairman Cook called on committee counsel for presentation of a bill draft [50072.0100] relating to income tax credit or refund claims by nonresident members of the armed services. He said at the April committee meeting a Tax Department representative described a 2003 amendment to the federal Servicemembers Civil Relief Act that provides that a servicemember's state of legal residence does not change because military orders move the individual from state to state and only the servicemember's state of legal residence may tax the individual's active duty military pay. An additional provision of the federal legislation prohibits a state from using the active duty military pay of a nonresident servicemember in calculating the income tax on other income that is taxable by the state. The Tax Department representative said the most likely case affected by this federal legislation arises in situations in which a nonresident civilian spouse of a servicemember earns income in the state. North Dakota follows the "California method" for taxing nonresident individuals, which means that the income of the servicemember from military duty is included in calculating income taxes for a nonresident civilian spouse, which means that the income of the spouse may be taxed at a higher rate than should be applied. To comply with the 2003 federal legislation, an adjustment must be made on Form ND-1 to remove the nonresident servicemember's military pay from calculation of initial tax for married taxpayers.

Committee counsel said that because the 2003 federal legislation was signed into law in 2003, the Tax Department has determined that the new provision in the 2003 federal legislation applies for North Dakota income tax purposes to 2003 and subsequent tax years. However, it is the Tax Commissioner's opinion that state legislation is needed to recognize the 2003 federal legislation for tax years before 2003 to allow refund claims for prior tax years. Committee counsel said the bill draft allows a claim for credit or refund of an overpayment if the overpayment is attributable to application to the taxpayer of Section 511 of the Servicemembers Civil Relief Act. He said the bill provides an effective date and expiration date that make it effective for the 2001 and 2002 tax years. He said the bill draft opens "a window" for refund claims, which must be filed by April 15, 2006, to claim the credit or refund.

Mr. Clayburgh said the Tax Department would support approval of the bill draft. He said he believes it is a legislative prerogative whether to allow retroactive credits or refunds under the federal legislation. He said the Tax Department should be able to administer the claims for retroactive credits or refunds. He said the Tax Department estimates the fiscal effect of the bill draft to decrease general fund revenue by approximately $30,000 to $60,000 for the 2005-07 biennium.

Senator Urlacher asked whether this legislation would affect only active duty military personnel. Mr. Clayburgh said that is correct. Senator Urlacher asked how eligible individuals will be notified of the opportunity for a credit or refund. Mr. Clayburgh said notification will be provided by the Tax Department through military pay personnel.

Senator Trenbeath asked whether the Tax Commissioner believes the federal government would find this legislation would comply with the 2003 federal law. Mr. Clayburgh said the United States Department of Defense is aware of this legislation and would recognize that it would bring North Dakota into compliance with the federal legislation.

It was moved by Senator Trenbeath, seconded by Senator Urlacher, and carried on a roll call vote that the bill draft to allow a limited filing period to claim a retroactive income tax credit or refund attributable to the Servicemembers Civil Relief Act by a nonresident member of the United States armed services be approved and recommended to the Legislative Council. Voting in favor of the motion were Senators Cook, Schobinger, Syverson, Trenbeath, Urlacher, and Wardner and Representatives Belter, Drovdal, Haas, Headland, Iverson, Klein, Mueller, Onstad, Schmidt, Thorpe, Wrangham, and Zaiser. No negative votes were cast.

Chairman Cook called on committee counsel for presentation of two bill drafts relating to streamlined sales tax compliance issues. Committee counsel said one bill draft [50073.0200] incorporates amendments suggested by the Tax Department at the April committee meeting. He said the bill draft also incorporates a change recommended at the April committee meeting by the North Dakota League of Cities relating to a change from sales taxes to gross receipts taxes for local sales taxes on farm machinery, farm irrigation equipment, and farm machinery repair parts effective after December 31, 2005. He said the change suggested by the League of Cities would conform local sales taxes to the changes made to state sales taxes to convert sales taxes on alcohol and farm machinery to gross receipts taxes to comply with the streamlined sales tax agreement without the necessity of an election in each affected city. He said the bill draft provides for allocation of delivery charges for shipments, including exempt property and taxable property, elimination of the sales tax exemption for sales of water in containers of one gallon or more, use tax amendments to conform with previous sales tax amendments relating to streamlined sales tax agreement compliance, and conversion of the 1 percent sales tax on lodging for promotion of the Lewis and Clark Bicentennial into an equivalent tax on gross receipts on lodging.

Committee counsel said the other bill draft [50100.0100] relating to the Streamlined Sales Tax Project would allow North Dakota to have representation on the Streamlined Sales Tax Governing Board. He said the provision is identical to the provision previously enacted that allowed North Dakota representation on the Streamlined Sales Tax Working Group. He said two members of the House of Representatives and two members of the Senate would be appointed by the chairman of the Legislative Council to represent North Dakota. He said the bill draft also would allow the Tax Commissioner to designate a member of the Tax Commissioner's staff to accompany and advise the members appointed regarding streamlined sales tax issues.

Representative Belter asked why the sales tax exemption for water is repealed by the first bill draft. Mr. Gary Anderson, Tax Department, said water is exempt from sales taxes except the exemption does not apply to water in containers of less than one gallon. He said this conflicts with the general exemption for water and this change would make clear that all water is exempt from sales taxes.

Mr. Clayburgh said the streamlined sales tax agreement efforts have been successful. He said the importance of the project is emphasized by an additional 40 percent increase in online sales for 2002 and 2003. He said sales by remote sellers represent a huge revenue loss to states and create an unfair competitive advantage for remote sellers over local retailers. He said the goal of the streamlined sales tax effort is to create a level playing field among retailers by promoting uniform application of sales taxes to sales at retail without regard to the location of the retailer.

Senator Urlacher said participation in the Streamlined Sales Tax Project has impressed him with the detailed coverage and discussion of each sales tax issue that has arisen for consideration.

Representative Schmidt said he believes there were some states that were not going along with the Streamlined Sales Tax Project. Mr. Anderson said only Colorado has not participated in the project among those states that impose sales taxes.

Senator Syverson said a goal of the Streamlined Sales Tax Project is to gain approval from Congress for imposition of sales taxes on remote sellers. He asked whether there is any pending federal legislation in that regard. Mr. Clayburgh said there are various bills pending in Congress. He said an item of interest is the proposed extension of the Internet Tax Freedom Act. He said there are also bills pending related to the goals of the Streamlined Sales Tax Project. He said there is interplay between these kinds of legislation and possibly some confusion on how the Internet Tax Freedom Act would affect the Streamlined Sales Tax Project.

Chairman Cook called on Mr. Jerry Hjelmstad, North Dakota League of Cities, for comments on the streamlined sales tax bill drafts. Mr. Hjelmstad distributed copies of a proposed amendment to the bill draft containing amendments to bring North Dakota law into compliance with the streamlined sales tax agreement. He said the purpose of the amendments is to address existing caps and thresholds allowed by cities under city home rule sales taxes. He said some cities have a limit on the maximum city sales tax on single purchases and these limitations would not comply with the streamlined sales tax agreement. He said he believes it would be permissible to provide that retailers must collect the full amount of tax on taxable sales and allow purchasers to seek a refund of the difference between the full amount of tax and the city limitation. He said the purpose of the amendment is to allow refunds in those situations. A copy of the proposed amendment is attached as Appendix B.

In response to a question from Representative Belter, Mr. Clayburgh said the proposed amendment could result in refunds in situations in which a city has a cap on sales taxes for a single transaction. He said the Tax Department could administer refunds in this fashion. He said if the committee approves the amendment, a companion amendment should also apply under county home rule in Section 1 of the bill draft.

Representative Wrangham asked how many refunds would have to be administered by the Tax Department if the amendment is approved. Mr. Anderson said the Tax Department has discussed that issue but has not determined an estimated total of refunds. He said refunds would be available only on large purchases so it should be manageable. He said the program would be similar to administration for Canadian sales tax refunds that the department has been administering for several years.

Representative Mueller asked how refund eligibility would be made known to purchasers and asked whether retailers would have refund claim forms. Mr. Anderson said he believes the Tax Department would make claim forms available to retailers. Representative Mueller asked what would happen to unclaimed refunds. Mr. Clayburgh said unclaimed refunds would be returned to the city in which the sale was made.

Senator Wardner asked how long Canadians have to seek refunds under current law. Mr. Clayburgh said one year is allowed for refund claims for Canadian residents.

Senator Trenbeath said he is concerned with the language of the proposed amendment. He said the language provides that a cap or threshold on a sales tax is invalid. He said he does not believe a cap or threshold would be invalid if a refund would be allowed.

Representative Belter suggested that the committee hold off action on the bill draft and proposed that amendments be prepared to refine the language of the proposed amendment.

It was moved by Senator Wardner, seconded by Senator Trenbeath, and carried on a roll call vote that the bill draft providing for North Dakota representation on the Streamlined Sales Tax Governing Board be approved and recommended to the Legislative Council. Voting in favor of the motion were Senators Cook, Schobinger, Syverson, Trenbeath, Urlacher, and Wardner and Representatives Belter, Drovdal, Haas, Headland, Iverson, Klein, Schmidt, Thorpe, and Wrangham. Voting in opposition to the motion were Representatives Mueller, Onstad, and Zaiser.

PROPERTY TAX INFORMATION

Chairman Cook called on Mr. Dwight Aakre, Department of Agribusiness and Applied Economics, North Dakota State University, for comments on agricultural land valuation for property tax purposes. A copy of Mr. Aakre's prepared testimony is attached as Appendix C.

Mr. Aakre said 2003 North Dakota legislation established a minimum capitalization rate for the land valuation model of 9.5 percent. He said the capitalization rate used in the formula for 2002 was 8.91 percent. He said the increase in the capitalization rate from 2002 to 2003 accounted for an average decrease in agricultural land values statewide of 6.2 percent. He said the increase in the cost of production index resulted in an additional 2.43 percent decrease and the two decrease factors were partially offset by increased productivity, resulting in an overall statewide agricultural property valuation decrease of 5.4 percent from 2002 to 2003.

Mr. Aakre said he expects the calculated capitalization rate to remain below the 9.5 percent minimum for several years, which means agricultural land valuation will not change due to the capitalization rate for that length of time and any changes that do occur in value will be due to changes in productivity, cost of production, or shifting of acres between cropland and noncropland.

Mr. Aakre said he estimates that it will take at least five years for the capitalization rate to climb above the minimum value of 9.5 percent. He said until that happens, he expects cropland values to remain steady to down 1 percent per year, noncropland values to decline 2 to 2.5 percent per year, and total agricultural land value to decline one-half of 1 percent to 1 percent per year. He said when the capitalization rate rises above the minimum set by statute, the decline in agricultural land values will accelerate.

Mr. Aakre distributed copies of results of the North Dakota land valuation model for the 2003 and 2004 agricultural real estate assessments.

Senator Cook asked how a shift in use from cropland to noncropland becomes known for purposes of the formula. Mr. Aakre said he is not certain how that shift is recognized. He said it is done within the county and North Dakota State University gets statistics from county directors of tax equalization.

Senator Cook asked what relationship exists between agricultural property valuation under the formula and market value of agricultural property. Mr. Aakre said the handout of the results of the 2004 assessment contain information on market value on pages 8 and 9. He said comparison of market value and valuation under the formula varies across the state. He said in some counties market value is very close to the value determined by the formula and in some counties market value is approximately double the value determined under formula.

Senator Cook asked whether the 2003 decrease of 5.4 percent in statewide agricultural values resulted in a shift in tax burden from agricultural property to commercial and residential property. Mr. Aakre said he believes that is the case but he is not an expert in that area.

Representative Haas said it appears that limiting the minimum for the capitalization rate artificially manipulated the valuation formula. Mr. Aakre said imposing the minimum on the capitalization rate certainly had an effect on the operation of the formula but the question is where the correct capitalization rate should be. Representative Haas asked if the formula is valid, how can you fix a variable and still have a valid formula. Mr. Aakre said he is not sure how to answer that question.

Senator Urlacher said in his part of the state a lot of property is sold for hunting and recreation purposes at more than agricultural market value. He asked how those sales impact valuation under the formula. Mr. Aakre said sales are not directly reflected in the formula. He said the formula values property on the basis of agricultural productivity. He said agricultural property is not sold on the basis of its productivity and there are many reasons to own agricultural land other than its ability to produce enough to pay for itself. He said these other factors may increase market value but not valuation under the productivity formula.

In response to a question from Senator Cook, Mr. Aakre said 50 percent of income from conservation reserve program land goes into the agricultural property valuation formula and that has been the case for many years.

Chairman Cook called on Ms. Marcy Dickerson, State Supervisor of Assessments, Tax Department, for testimony relating to the property tax exemption for farm structures and determination of taxable valuation for school districts. A copy of her prepared testimony is attached as Appendix D.

Ms. Dickerson said the State Board of Equalization has been told by several county directors of tax equalization that the farm buildings exemption is difficult to administer equitably. She reviewed examples of circumstances in which application of the exemption is difficult for assessment officials. She made suggestions in how the exemption could be changed to make it easier to fairly administer.

Ms. Dickerson's testimony also addresses the question of how data on taxable valuation is provided to the Department of Public Instruction. She said North Dakota Century Code Section 15.1-27-02 requires that on or before December 15, each school district shall file with the Superintendent of Public Instruction the taxable valuation and mill levy certification for the district. She said she has determined that county auditors actually provide the information to the Department of Public Instruction. She said a spot check of valuation used by the Department of Public Instruction matches values reported to the Property Tax Division by county auditors. She said there was a school district for which valuations did not agree and the reason for the discrepancy is being investigated.

Ms. Dickerson said taxable valuation of a school district includes values determined for all taxable property within the boundaries of the district and does not include values for any exempt property. She said property exempt by local discretion or charitable status may be used in mill levy calculations under North Dakota Century Code Section 57-15-01.1 but none of that property is included in the taxable valuation to which the school district's mill levy is applied or to which the mill deduct for foundation aid purposes is applied.

Ms. Dickerson said whether a school district is considered a "rich" or "poor" school district is based on its taxable valuation per pupil. She said if a school district's taxable valuation per pupil is substantially greater than the statewide average, it would be considered a "rich" school district. She said the concept of a rich or poor school district is a function of the amount of taxable property and the number of pupils. She said the mill levy deduct for foundation aid purposes under North Dakota Century Code Section 15.1-27-05 serves to some extent to equalize funding between rich and poor districts. She presented and reviewed a table showing the effect on four hypothetical school districts of the equalization formula.

In response to a question from Representative Drovdal, Ms. Dickerson said county directors of tax equalization must complete 190 hours of assessment instruction. She said county directors in turn train assessors in their counties. She said for purposes of agricultural property assessments, there is training in using detailed soil surveys. She distributed copies of a survey conducted among county officials regarding use of detailed soil surveys and agricultural assessments. She said the survey shows variable application among counties.

Senator Cook said it is provided in North Dakota Century Code Section 57-02-27.2 that whenever possible, assessment officials shall use soil surveys. He asked who determines whether counties comply with this requirement. Ms. Dickerson said the Tax Department cannot force usage of soil survey information by counties. Senator Cook said the language of the statute seems compulsory. Representative Zaiser said the state needs to enforce the requirement in the law regarding use of soil surveys. Ms. Dickerson said she does not know how the state could enforce this requirement other than hiring assessors to redo assessments for counties.

Ms. Dickerson said that according to her calculations, using the capitalization rate that would have been in place versus the capitalization rate minimum established by 2003 legislation, she has determined that a 14.67 percent reduction has resulted through 2004 for agricultural property statewide. Senator

Cook asked whether this change has shifted tax burden from agricultural property to commercial and residential property. Ms. Dickerson said this change has shifted a significant tax burden from agricultural property to other property types.

Senator Cook asked how many states provide a farm buildings property tax exemption. Ms. Dickerson said there are no other states that provide an exemption for farm residences but some states do provide an exemption for farm buildings.

Senator Cook asked how other states assess farm buildings. Ms. Dickerson said she is not familiar with methods used in all states but in Montana, state assessors do all of those assessments for farm buildings.

Senator Cook said it appears Ms. Dickerson has made good suggestions for adjustments to the property tax exemption for farm buildings. He asked whether she could help to prepare a bill draft to follow the example of the homestead tax credit for purposes of the farm buildings exemption. Ms. Dickerson said she could assist committee counsel with that project.

Chairman Cook called on Mr. Terry Traynor, North Dakota Association of Counties, for comments on use of soil surveys in agricultural assessments. Senator Cook asked why some counties have not implemented use of detailed soil surveys. Mr. Traynor said the county average agricultural valuation is delivered to the county after computations under the statutory valuation formula. He said at the county level, the function is to allocate valuation among agricultural parcels based on the average determined by the formula. He said going to use of soil surveys requires expenditure of time and money and it is a contentious thing to make these changes. He said some counties are being cautious in implementation.

INCOME TAX STUDY

Chairman Cook called on committee counsel to review a bill draft to reduce corporate income tax rates by 10 percent per year. Committee counsel said the bill draft [50071.0100] provides a 10 percent reduction in the corporate income tax rate beginning for the 2005 taxable year and an additional 10 percent reduction in rates each year until the corporate income tax is eliminated for the 2014 tax year.

Chairman Cook called on Ms. Kathy Strombeck, Tax Department, for information on the fiscal effect of the bill draft. Ms. Strombeck said the estimated effect of the bill draft would be a loss of $1.3 million in general fund revenue in the 2003-05 biennium, a loss of $14.91 million in state general fund revenue in the 2005-07 biennium, and a loss of state general fund revenue of $31.66 million in the 2007-09 biennium.

In response to a question from Senator Cook, Ms. Strombeck said these fiscal estimates are based only on corporate income tax revenues and this change may also cause future losses in individual income taxes as passthrough entities such as limited liability companies, partnerships, and similar organizations convert into corporations as corporation income taxes are reduced.

Representative Schmidt said the proponents of eliminating corporate income taxes believe this would bring businesses into North Dakota. He said eliminating corporate income taxes is not what brings businesses into the state.

Representative Thorpe said he does not believe eliminating the corporate income tax is even a consideration. He said North Dakota has a relatively low burden for corporate and individual income taxes and has a fair tax balance. He said a well-rounded and balanced tax system serves the people well.

Chairman Cook called on committee counsel to review a bill draft [50074.0100] to eliminate individual and corporate income taxes and broaden the state sales tax to mirror the South Dakota sales tax structure. Committee counsel said the bill draft eliminates corporate and individual income taxes beginning with the 2005 tax year and revises the state sales and use tax provisions and motor vehicle excise tax rate effective July 1, 2005. He said the sales tax allocation to the state aid distribution fund is altered in the bill draft to be approximately revenue-neutral for political subdivisions. He said the sales tax rate in the bill draft is 5.65 percent, including the tax rate for farm machinery and irrigation equipment. He said the most substantial difference in sales tax application in South Dakota is taxation of businesses and services. He said the bill draft does not duplicate South Dakota provisions for a contractors 2 percent sales tax or a 1 percent tourism tax. He distributed copies of a listing of sales and use tax exemptions under South Dakota law from the South Dakota Department of Revenue.

Committee counsel distributed copies of articles from the National Conference of State Legislatures on state sales tax issues and a *State Tax Notes* article entitled "Sales Taxation of Services: An Economic Perspective." He said Chairman Cook requested distribution of these articles to committee members as background for issues relating to expanded sales tax bases.

Representative Zaiser said it appears this bill draft would make North Dakota's tax structure much more regressive than the current structure.

Mr. Clayburgh said Mr. Anderson and Ms. Strombeck spent a great deal of time on this project. He said they traveled to Pierre, South Dakota, to meet with South Dakota tax officials to develop a good understanding of the South Dakota sales tax structure. He said there are some factors that make North Dakota substantially different from South Dakota which cannot be overcome by the bill draft. He said videogaming in South Dakota generates approximately $100 million per year in sales tax revenue and South Dakota also imposes a special tax on credit card companies. He said the combined effect of these two taxes in South Dakota is approximately $145 million per year. He said this revenue cannot be duplicated in North Dakota and that is a significant reason why the North Dakota sales tax rate under the bill draft cannot be reduced to a 4 percent sales tax rate as exists in South Dakota.

Mr. Clayburgh said the committee should also be aware that South Dakota is currently debating repealing the sales tax on food and adding a state income tax. He said the committee should also be aware that eliminating income taxes and placing a heavy reliance on a consumption tax, such as sales taxes, can impact state revenues severely during an economic downturn.

Representative Thorpe asked what sales tax rate North Dakota would have to impose under the existing sales tax structure to replace individual and corporate income taxes. Mr. Clayburgh said a rate of about 8.5 percent would be needed with the current sales tax structure to generate revenue to replace income taxes.

Senator Wardner said the North Dakota tax structure serves the state well so he would not support this change.

Representative Iverson said South Dakota is outpacing North Dakota in economic growth and the state can learn from South Dakota. He said he is not sure this bill draft is the answer but South Dakota is doing something right to attract new business.

COMMITTEE DISCUSSION

Chairman Cook asked whether Mr. Clayburgh could survey property tax relief efforts of nearby states to inform the committee on this issue at its next meeting. Mr. Clayburgh said he could obtain information on property tax relief.

Representative Mueller said the committee should bear in mind, for consideration of the bill draft to be prepared relating to the farm buildings property tax exemption, that farmers already face a substantial property tax burden on agricultural property.

Representative Belter said he does not believe the farm buildings property tax exemption is as big a problem as was described by Ms. Dickerson in his area. Senator Cook said perhaps that is correct but in some areas of the state it appears there is a substantial controversy regarding application of the exemption.

Senator Wardner said the committee should seek opinions from local assessors on the farm buildings property tax exemption for the next committee meeting.

No further business appearing, Chairman Cook adjourned the meeting at 3:00 p.m.

John Walstad
Code Revisor

ATTACH:4