Prepared by the North Dakota Legislative Council staff
November 2011

PROPERTY TAX ELIMINATION INITIATED MEASURE - ANALYSIS OF ISSUES RAISED BY THE PROPERTY TAX MEASURE REVIEW COMMITTEE

PRELIMINARY CONSIDERATIONS

The basic rules of statutory construction apply with equal force to legislation by the people through the initiative process. 42 Am. Jur. 2d *Initiative and Referendum* § 49. The fact that the measure being reviewed is an initiated constitutional amendment does not change the basis of judicial construction. The North Dakota Supreme Court has stated that principles of construction applicable to statutes are generally available to construction of the constitution. *McCarney v. Meier*, 286 N.W.2d 780 (N.D. 1979). In *Kelsh v. Jaeger*, 641 N.W.2d 100 (N.D. 2002), the North Dakota Supreme Court listed several principles for construing constitutional provisions, including:

- When interpreting the state constitution, our overriding objective is to give effect to the intent and purpose of the people adopting the constitutional statement.
- The intent and purpose of a constitutional provision is to be determined, if possible, from the language itself.
- We give words in a constitutional provision their plain, ordinary, and commonly understood meaning.
- When interpreting constitutional provisions, we apply general principles of statutory construction.
- We must give effect and meaning to every provision and reconcile, if possible, apparently inconsistent provisions.
- We presume the people do not intend absurd or ludicrous results in adopting constitutional provisions, and we therefore construe such provisions to avoid those results.

Rules of interpretation for statutory provisions are described at 73 Am. Jur. 2d *Statutes* § 171 as follows:

> It is generally regarded as permissible to consider the consequences of a proposed interpretation of a statute, where the act is ambiguous in terms and fairly susceptible of two constructions. Under such circumstances, it is presumed that undesirable consequences were not intended; instead, it is presumed that the statute was intended to have the most beneficial operation that the language permits. A construction of which the statute is fairly susceptible is favored which will avoid all objectionable, mischievous, indefensible, wrongful, evil, and injurious consequences. On the other hand, where a statute is so plain and unambiguous that it is not susceptible of more than one construction, courts construing the same should not be concerned with the consequences resulting therefrom. The undesirable consequences do not justify a departure from the terms of the act as written. In such case, the consequences, if objectionable, can only be avoided by a change of the law itself, to be effected by the legislature, and not by judicial action in the guise of interpretation.

The North Dakota Legislative Assembly has set out in statute rules of interpretation to be used in statutory construction. Most of these rules were drawn from court decisions and are codified in North Dakota Century Code Chapter 1-02, which, among other things, includes the following provisions:

> **1-02-02. Words to be understood in their ordinary sense.** Words used in any statute are to be understood in their ordinary sense, unless a contrary intention plainly appears, but any words explained in this code are to be understood as thus explained.
>
> **1-02-05. Construction of unambiguous statute.** When the wording of a statute is clear and free of all ambiguity, the letter of it is not to be disregarded under the pretext of pursuing its spirit.
>
> **1-02-06. Clerical and typographical errors.** Clerical and typographical errors shall be disregarded when the meaning of the legislative assembly is clear.
>
> **1-02-07. Particular controls general.** Whenever a general provision in a statute is in conflict with a special provision in the same or in another statute, the two must be construed, if possible, so that effect may be given to both provisions, but if the conflict between the two provisions is irreconcilable the special provision must prevail and must be construed as an exception to the general provision, unless the general provision is enacted later and it is the manifest legislative intent that such general provision shall prevail.
>
> **1-02-30. Vested rights protected.** No provision contained in this code may be so construed as to impair any vested right or valid obligation existing when it takes effect.
>
> **1-02-38. Intentions in the enactment of statutes.** In enacting a statute, it is presumed that:
>
> 1. Compliance with the constitutions of the state and of the United States is intended.
> 2. The entire statute is intended to be effective.
> 3. A just and reasonable result is intended.
> 4. A result feasible of execution is intended.
> 5. Public interest is favored over any private interest.

1-02-39. Aids in construction of ambiguous statutes. If a statute is ambiguous, the court, in determining the intention of the legislation, may consider among other matters:

1. The object sought to be attained.
2. The circumstances under which the statute was enacted.
3. The legislative history.
4. The common law or former statutory provisions, including laws upon the same or similar subjects.
5. The consequences of a particular construction.
6. The administrative construction of the statute.
7. The preamble.

CONSIDERATION OF ISSUES RAISED BY THE COMMITTEE

Effective Date Issues

Section 7 of initiated constitutional measure No. 2 (attached as an appendix) on the June 12, 2012, primary election ballot (measure No. 2) provides that the measure is effective January 1, 2012. Section 8, Article III, of the Constitution of North Dakota, provides that an initiated or referred measure which is approved shall become law 30 days after the election, which in the case of measure No. 2 would be July 12, 2012. It appears the drafters of the initiated measure recognized the absurdity and administrative and legal difficulties that would exist if the property tax were eliminated in the course of a property tax year. It appears the effective date provision, which would be more appropriately considered an application date provision, was included to make the property tax elimination effective beginning with the full 2012 property tax year. What is prohibited by Section 1 of measure No. 2 is "levying" of property tax. The levying of a tax occurs at a definite time by action of the governing body of a political subdivision, which cannot occur later than October 10 (Section 57-15-31.1). The 2011 levy occurred before and the 2012 levy will occur after any potential interpretation of the effective date of measure No. 2. It appears the measure should be interpreted to apply for 2012 and succeeding tax years.

It appears the effective date of the measure would not affect 2011 property tax year liability because the liability for property taxes attaches at the conclusion of the 2011 tax year, which occurs at the same instant, or perhaps the instant just before, the measure would become effective. To interpret the measure as eliminating 2011 tax year liabilities would contravene Section 18, Article X, of the Constitution of North Dakota, which prohibits gifts of state or political subdivision funds "in aid of any individual, association or corporation except for reasonable support of the poor," because the North Dakota Supreme Court has concluded that once a tax liability has attached, any forgiveness of that obligation is an unconstitutional gift in violation of the constitutional prohibition. In *Petters & Co. v. Nelson County,* 281 N.W. 61 (N.D. 1938), the North Dakota Supreme Court held that real estate taxes paid by the purchaser of a tax sale certificate could not be refunded if no provision of law in existence at the time of the purchase authorized any refund of those taxes. The court found a later enacted law invalid to the extent that it provided for refund of such taxes on the grounds that the law violated the constitutional gift prohibition (Section 185 of the Constitution of North Dakota at that time) because at the time the purchaser paid the taxes, the purchaser had no legal, equitable, or moral claim to a refund. The court found that the subsequent legislative enactment allowing such a refund was an unconstitutional gift.

The North Dakota Supreme Court has concluded that the repeal of a tax does not extinguish tax liabilities that existed at the time of repeal and administrative and penalty provisions that existed at the time of repeal continue to apply to unpaid tax liabilities. *Cuthbert v. Smutz*, 282 N.W. 494 (1938). In *Cuthbert*, a 1935 income tax law enacted as an emergency measure was repealed by referendum in the 1936 primary election. The appellant argued that the 1936 repeal canceled any right to collect the 1935 income tax. The court disagreed and stated that the date December 31, 1935, was the date that fixed the period of liability for the income tax year and that date occurred before the referendum election. In addition, Section 1-02-17 provides that the repeal of any statute by the Legislative Assembly, or by the people through an initiated law, does not have the effect of releasing or extinguishing any penalty, fine, liability, or forfeiture incurred under such statute.

Effect on Property Taxes

Property taxes would be eliminated by enactment of measure No. 2 because all property taxes are levied on the assessed value of property. This would apply to general fund and special fund levies of all political subdivisions, including property taxes levied and dedicated to retirement of political subdivision indebtedness or tax increment financing projects. However, elimination of property taxes dedicated for bonded debt may be delayed in becoming effective.

The language of Section 1 of measure No. 2 appears to clearly eliminate levying property taxes dedicated to retirement of political subdivision general obligation bond issues because the taxes levied for those purposes are a tax on assessed value of real property. However, bonded indebtedness is issued under a contractual agreement between the political subdivision and the bondholders in which the political subdivision pledges to levy dedicated property taxes until the bonded indebtedness is retired. This contractual agreement would certainly be "substantially impaired" if the measure is interpreted to take away the authority to levy the property taxes required to make payments to bondholders. Whether

this would constitute a violation of the contract clause of the United States Constitution (Article I, Section 10) is an issue that must be considered. The contract clause of the Constitution provides that "no state shall . . . pass any . . . law impairing the obligation of contracts . . . ." A similar prohibition is contained in Section 18, Article I, of the Constitution of North Dakota. A summary of court decisions on this issue is contained in 16B Am. Jur. 2d *Constitutional Law* § 787 where it is stated:

> The contract is substantially impaired when legislation detrimentally affects the financial framework that induced the bondholders to originally purchase the bonds, without providing alternative or additional security. This is true even if the market for the bonds remains strong following the law's enactment. The financial framework of a bond contract is detrimentally affected when a law put into effect after bonds were issued diminishes a tax source (that is, repeals a tax or reduces the tax base) that was pledged to support repayment of the bonds. However, as long as the bond-issuing entity is clearly able to repay its obligations within statutory and constitutional limitations, legislation reducing the entity's tax base does not impair the obligation of contracts in violation of the contract clause.

It appears that elimination of property taxes pledged to payment of bonded indebtedness would be a substantial impairment of contractual rights of bondholders, and a court could find measure No. 2 to be an unconstitutional violation of the United States Constitution's prohibition against impairment of contracts. However, the overriding objective of construing constitutional provisions is to give effect to the intent and purpose of the people adopting the constitutional provision. The North Dakota Supreme Court has ruled that if a statute is capable of two constructions--one that would render it of doubtful constitutionality and one that would not--the constitutional interpretation must be selected. *Peterson v. Peterson*, 559 N.W.2d 826 (1997). In addition, there is a statutory presumption (Section 1-02-38) that compliance with the federal and state constitutions is intended. The question would become whether there is an interpretation that would allow property taxes to continue to be levied after measure No. 2 becomes effective, to the extent of funds dedicated for payment for bonded indebtedness obligations. Political subdivision property taxes are generally thought to be levied annually. A plausible argument can be made that the property taxes for payment for bonded indebtedness obligations were actually "levied" before the effective date of the measure and that the obligation continues after the effective date of the measure. This argument would be supported by Section 21-03-15, which provides that the "governing body of every municipality issuing bonds . . ., before the delivery thereof, shall levy by recorded resolution or ordinance a direct, annual tax which, together with any other moneys provided by, or sources of revenue authorized by, the Legislative Assembly, shall be sufficient in amount to pay, and for the express purpose of paying, the interest on such bonds as it falls due, and also to pay and discharge the principal thereof at maturity." Additional support for this argument is found in Section 21-03-23, which requires certification to the county auditor at the time of a bond issue the amount to be levied each year to retire the debt.

The argument that the property taxes for payment of bonded indebtedness were levied before the effective date of measure No. 2 is further supported by Section 16, Article X, of the Constitution of North Dakota, which provides:

> Any city, county, township, town, school district or any other political subdivision incurring indebtedness shall, at or before the time of so doing, provide for the collection of an annual tax sufficient to pay the interest and also the principal thereof when due, and all laws or ordinances providing for the payment of the interest or principal of any debt shall be irrepealable until such debt be paid.

The argument is further supported by views that new law must be applied only looking forward in time, expressed in these two decisions of the North Dakota Supreme Court from the 1920s.

> *E.J. Lander & Co. v. Deemy*, 176 N.W. 922 (1920):
>
> The rule is that statutes are prospective, and will not be construed to have retroactive operation unless the language employed in the enactment is so clear it will admit of no other construction. . . . The rule is especially applicable where the statute, if given a retrospective operation, would be invalid, as impairing the obligation of contracts or interfering with vested rights. The principle that all statutes are to be so construed, if possible, as to be valid, requires that a statute shall never be given a retrospective operation, when to do so would render it unconstitutional, and the words of the statute admit of any other construction.
>
> *Patterson Land Co. v. Merchants' Bank*, 212 N.W. 512 (1927):
>
> . . . statute must be presumed as prospective only. In other words, it must be presumed that the legislature did not intend it to apply to contracts in existence at the time of its going into effect. Otherwise the statute would be unconstitutional as impairing the obligations of contracts.

If the argument that taxes for existing debt were levied before the measure's effective date is valid, property taxes could continue to be collected until payment of the bonded indebtedness obligation is completed. If this argument is valid, another question would be raised about bonds issued by political subdivisions from January 1, 2012, (the declared

effective date of measure No. 2) until July 12, 2012 (the effective date of measure No. 2 under the constitutional effective date provision). Because the law in effect during the time period in question would allow political subdivisions to pledge property tax revenues for payment of bonded indebtedness obligations, and because the outcome of the June 2012 election is not known until the election and canvass is completed, it appears an argument could be made that property tax levies pledged to bonded indebtedness obligations during that time period would be considered to be levied before the measure prohibits levying property taxes. However, caution must be advised on bond issues during that time period unless court decisions provide some certainty. It appears that if measure No. 2 is enacted, a political subdivision could not issue bonds after July 12, 2012, because the political subdivision could not make a valid levy of necessary property tax revenues.

If courts do not conclude that property taxes may continue to be levied for previously issued bonds and property tax authority is eliminated for payment of bonded indebtedness, another consideration is whether the state would be deemed to have assumed the bonded indebtedness obligation. If that is the case, it appears that would be a violation of the state's debt limit imposed by Section 13, Article X, of the Constitution of North Dakota, which limits state debt for bonds to $2 million, unless any additional amount is secured by first mortgage upon real estate. The North Dakota Supreme Court stated in *State ex rel. Lesmeister v. Olson*, 354 N.W.2d 690 (1984):

> We decline to extend the special-fund doctrine as requested by the respondents, and agree with those jurisdictions which hold that an obligation to be funded from general tax revenues, whether they be ad valorem or excise taxes, is a "debt" within the meaning of the debt limitation provision. Therefore, the special-fund doctrine does not exempt such obligations from the $2,000,000 debt limitation contained in our State Constitution.

The issue of whether state assumption of bonded indebtedness would violate the specific $2 million limit of Section 13, Article X, of the Constitution of North Dakota, could raise another issue of conflict resolution--whether measure No. 2 could be interpreted as a "general" provision allowing state assumption of debt in excess of the "specific" $2 million limit because measure No. 2 is later enacted.

Effect of Measure No. 2 on Existing Tax Types

Section 1 of measure No. 2 would prohibit the Legislative Assembly and political subdivisions "from raising revenue to defray the expenses of the state or political subdivisions through the levying of a tax on the assessed value of real or personal property." It appears the significant definitional issues are what constitutes a "tax" and what constitutes "assessed value." A tax is "an enforced contribution for public purposes." *Menz v. Coyle*, 117 N.W.2d 290 (N.D. 1962). The point is that it does not matter if a charge is called a tax, assessment, fee, or by any other name, the charge will be considered a tax. *Webster's Online Dictionary* defines assess as "to estimate the value of property for taxation." The word assess may also be used in the sense of "to impose a tax." However, as used in Section 1 of measure No. 2, in the phrase "levying of a tax on the assessed value . . .," it appears clear that "levying" is used in the sense of imposing a tax and "assessed" is used in the sense of estimating value of property for taxation. This is significant to resolving the question of whether the measure applies to some tax types. This is also consistent with the intention of the sponsors of measure No. 2, expressed in the petition title, that the measure would eliminate "property taxes . . . ."

There are several tax types under North Dakota law which contain a statutory statement that the tax is imposed "in lieu of property taxes." It has been suggested by some observers that these "in lieu of" taxes would be eliminated by measure No. 2 at the time property taxes are eliminated. However, it does not appear that the fact a tax is stated to be "in lieu of property taxes" means the tax would be eliminated. What the measure would eliminate is levying of a tax on the assessed value of real or personal property. Many of the "in lieu" taxes imposed by the state are based on assessed value of property, but many are not. In the case of certain state-owned property, the Legislative Assembly made a decision that acquisition of the property by the state and removal from the tax rolls would have an undesirable impact on the local tax base. Those taxes are assessed in the same manner as other property, and taxes are paid to maintain local tax revenue streams. Many of the "in lieu" taxes imposed by the state, i.e., coal and oil industry taxes, were based on the recognition that a large project or facility has a much broader impact than the township and school district in which it is located. In these instances, the Legislative Assembly determined that simply applying a property tax was inadequate to address the needs of the impacted area, and a tax structure was established to allocate revenues to address needs of the impacted area and also to recognize that depletion of a state resource is cause for the state to receive a share of revenue for the benefit of all citizens of the state. In these cases the Legislative Assembly has provided that the taxes are "in lieu" of property taxes, and one component of the tax is providing revenue to political subdivisions in place of what a property tax would have provided but that does not mean the tax is a property tax. What the constitutional measure prohibits is levying of a tax on the assessed value of real or personal property, and this is the standard that must be applied to "in lieu" taxes to determine if the measure would eliminate the tax.

Mobile Home Taxes

Mobile homes may be taxed as real property if they are affixed to land or as personal property if they are not affixed to land. In either case, taxes on mobile homes would be eliminated because the property tax and the mobile home tax are based on the assessed value of the mobile home.

Special Assessments

It appears special assessments would not be eliminated by enactment of measure No. 2. The amount of special assessments against a property are not allowed by law to be based on the assessed value of the property but are required to be based on the property's "just proportion of the total cost of such work" and "not exceeding the benefits" to the property (Section 40-23-07).

It has been suggested that if measure No. 2 is approved, political subdivisions will be able to use special assessments to pay general obligation bonded indebtedness or provide funds for certain services of the political subdivision. There is no basis for this assumption under existing law. Special assessments are allowed to be used for certain types of improvements, specifically listed in statute. Payment of indebtedness (other than the special assessment project) and costs of operations of political subdivisions are not included in the listed purposes for special assessments. It is questionable whether bonds would be marketable and debt limits would be violated if special assessment laws were modified to permit levies for indebtedness or operating funds. Even if that is possible, there would be a huge shift in relative shares of the "tax" burden among property owners if assessed values are not allowed as a basis for spreading the burden, and benefits to each property must be determined. An additional problem is that special assessment debt is not considered "debt" for constitutional purposes under the special fund doctrine if the obligation is payable from revenue from property acquired or assessments on benefited property. It is uncertain whether that doctrine would be interpreted to apply to the suggested uses of special assessments.

Crew Housing Permit Fees

A city or county is permitted to impose crew housing permit fees for property that is not taxable as real property or mobile homes under existing law. Measure No. 2 would not directly affect crew housing permit fees because the statutory provision allows the fees to be determined on the basis of the value of services and facilities provided to the crew housing facility. To the extent any city or county uses assessed valuation in determining fees, that practice would be prohibited and would have to be changed.

Oil and Gas Taxes

The oil and gas gross production tax is a tax "in lieu" of property taxes (Section 57-51-03). One issue that may cause some interpretive problems is the provision in Section 57-51-02.1, which provides that the gross production tax is a real property tax. However, the provision is limited by its own terms to interpretation of taxability of oil and gas from governmental lands if immunity from property taxes has been waived by Congress. The oil extraction tax does not contain the "in lieu" of property tax provision. It appears neither gross production nor extraction tax would be affected by measure No. 2 because neither tax is based on assessed value of property. The oil extraction tax and the gross production tax for oil are based on a percentage of the gross value at the well, which is generally the price of the oil under an arm's-length contract between the producer and purchaser or based on market value or posted price. Natural gas is taxed under the gross production tax based on a gas tax rate and gas base rate adjustment determined each year.

Coal Conversion Taxes

Coal conversion taxes would not be affected by enactment of measure No. 2 because the coal conversion tax is not based on assessed value of property. The coal conversion tax basis is the output capacity or gross receipts of the facility. The coal conversion tax is "in lieu of ad valorem taxes" on the facility, but the land on which a coal conversion facility is located is subject to property taxes (Section 57-60-06), which would be eliminated by enactment of measure No. 2.

Coal Severance Tax

The coal severance tax would not be affected by measure No. 2. The coal severance tax is stated by law to be "in lieu" of sales or use taxes, and there is no "in lieu" provision regarding property taxes. The coal severance tax is imposed at a specified number of cents per ton and is not based on assessed value of property.

Electric Generation, Distribution, and Transmission Taxes

Transmission line taxes for rural electric cooperatives are imposed in dollars per mile, with rates graduated as nominal operating voltage increases. It could be argued that increased voltage is a form of assessment of market value, but "assessment" of transmission lines is not required. Distribution lines of rural electric cooperatives are taxed at a rate of one dollar per megawatt-hour delivered to a consumer. Taxes on wind generators and gas generators of rural electric cooperatives are taxed based on generating capacity.

It appears none of these electric generation, distribution, and transmission taxes would be affected by measure No. 2. However, investor-owned utilities are subject to property taxes based on assessment and imposition by the State Board of Equalization under Chapter 57-06, and it appears clear that these property taxes would be eliminated by enactment of measure No. 2. A significant change in the

competitive position of rural electric cooperatives and investor-owned utilities would be created by enactment of measure No. 2.

Telecommunications Company Taxes

Telecommunications companies are subject to a gross receipts tax in lieu of property taxes. A gross receipts tax is not based on the assessed value of property. Telecommunications taxes would not be eliminated by enactment of measure No. 2. However, the tax is allocated among political subdivisions to replace property taxes that applied to the industry in 1997 so it is likely the industry might suggest to the Legislative Assembly that the tax should be reduced or eliminated if property taxes are eliminated.

Financial Institutions Taxes

Financial institutions taxes are income-based taxes, and financial institutions are also subject to property taxes. Property taxes would be eliminated, but the financial institutions tax would be unaffected by enactment of measure No. 2.

Payments in Lieu of Taxes for New or Expanding Businesses

A city or county may grant a new or expanding business the privilege of making payments in lieu of property taxes. No directive is provided by statute on how the payment is determined. These payments in lieu of taxes would not be eliminated by measure No. 2 except in the unlikely event they are based on assessed value.

Farmland or Ranchland Owned by Nonprofit Organizations for Conservation Purposes

Farmland or ranchland owned by nonprofit organizations for conservation purposes is subject to payments in lieu of taxes, and the nonprofit organization must make payments in lieu of property taxes on the property, calculated in the same manner as if the property was subject to full assessment and levy of property taxes. This tax would be eliminated by measure No. 2, because it is based on assessed value of property.

Game and Fish Department Lands

The director of the Game and Fish Department must make annual payments to counties in which property is located which is controlled by the Game and Fish Department, not including leased land already subject to property taxes. The property subject to in lieu of tax payments must be assessed and valued for tax purposes, excluding improvements to property, and the mill levies are applied which apply to other taxable property in the taxing districts in which the property is located. These in lieu of tax payments would be eliminated by measure No. 2 because they are based on the assessed value of property.

National Guard Land

For land acquired for the National Guard training area and facility development trust fund, the Adjutant General shall make payments in lieu of real estate taxes to the counties in which the property is located in the same manner and according to the same conditions and procedures as provided in Chapter 57-02.1 for payments in lieu of real estate taxes by the director of the Game and Fish Department, but no county may receive less in payments for any property than the county received in real estate taxes for the last year in which the land was taxable. These in lieu of tax payments would be eliminated by measure No. 2 because they are based on the assessed value of property.

Land Owned by Board of University and School Lands or State Treasurer

Certain property owned by the Board of University and School Lands or by the State Treasurer as trustee for the state of North Dakota is subject to payments in lieu of taxes. All such property must be assessed in the same manner as other real property in the state is assessed for tax purposes, excluding improvements to the property. Payments in lieu of taxes are computed by extending the mill levies that apply to taxable property in the taxing districts in which the property is located. These payments would be eliminated by enactment of measure No. 2 because the taxes are based on the assessed value of property.

Forest Stewardship Tax

The owner of property with a growth of trees may obtain approval from the board of county commissioners to pay a forest stewardship tax of 50 cents per acre in lieu of the property taxes that would otherwise apply. This tax was established to provide reduced taxes to encourage growth and preservation of forested areas. However, because the reduced tax is not based on assessed value, it appears this tax would not be eliminated by measure No. 2.

Carbon Dioxide Pipelines

Carbon dioxide pipeline property is exempt from property taxes for the first 10 years after construction. During that time, the state makes payments in lieu of property taxes based on assessment by the State Board of Equalization and application of mill rates of taxing districts in which the pipeline is located. The property tax and the state payments in lieu of property taxes would be eliminated by enactment of measure No. 2.

Leases for Tourism or Concession Purposes

Property leased from the State Historical Society or the Parks and Recreation Department is subject to payment of a license fee in lieu of property taxes. The license fee is set by the director of the State Historical Society or Parks and Recreation Department at an

annual amount not less than $1 and not more than 1 percent of the gross receipts of the tourism or concession enterprise. The license fee is paid to the treasurer of the county in which the enterprise is located. These license fees would not be affected by enactment of measure No. 2 because the fees are not based on assessed value of property.

Devils Lake Project Land

Land acquired by the State Water Commission for the Devils Lake project is subject to payments in lieu of real estate taxes to the counties in which the property is located. The property is assessed, and mill levies of local taxing districts are applied. These payments would be eliminated by enactment of measure No. 2.

Workforce Safety and Insurance Building

The building purchased by Workforce Safety and Insurance is subject to payments in lieu of property taxes in the manner and according to the conditions and procedures that would apply if the building and property were privately owned. These payments would be eliminated by enactment of measure No. 2.

Motor Vehicle Registration Fees

Motor vehicle registration fees are in lieu of personal property taxes. These fees would not be eliminated by enactment of measure No. 2 because motor vehicle registration fees are based on weight and age of vehicles and not assessed value.

REPLACEMENT OF REVENUES

Revenues to political subdivisions that would be required to be replaced by the state under measure No. 2 are addressed in Section 2 of measure No. 2. Section 2 contains three subsections, each of which is worded differently and apparently intended to address another aspect of revenue replacement.

Subsection 1 of Section 2 of measure No. 2 provides:

> Taxes upon real property which were used before 2012 to fund the operations of counties, cities, townships, school districts, park districts, water districts, irrigation districts, fire protection districts, soil conservation districts, and other political subdivisions with authority to levy property taxes must be replaced with revenues from the proceeds of state sales taxes, individual and corporate income taxes, oil and gas production and extraction taxes, tobacco taxes, lottery revenues, financial institutions taxes, and other state resources.

Several of the words and phrases in subsection 1 appear to be the key to determining how it would be applied.

"Taxes upon real property" limits the replacement funding to consideration of real property taxes imposed by the political subdivision. Whether intentional or not, this excludes mobile home taxes because they are not taxes upon "real property." It appears likely this interpretation would apply to replacement of "in lieu" taxes that would be eliminated by enacted of measure No. 2, as discussed previously in this memorandum.

"Used" is distinctive because this word was employed by the drafter rather than the word "levied." Because the word "levied" was not employed, it appears the intention was to focus the replacement requirement on the expenditures made from property tax revenues by the political subdivision. That this would be a reasonable interpretation is supported by the recognition that the drafter could well have intended not to replace property tax revenues that were set aside, such as in a building fund or interim fund, and focus attention on only expenditures that were made in the "operations of" political subdivisions.

"Before 2012" is a phrase that is somewhat puzzling. Taken literally, it could include any year from 1861 through 2011. It appears most likely this phrase must be interpreted to refer to calendar year 2011.

"Replaced" is a word of debatable meaning. Dictionary definitions indicate the word is used in several senses. In some senses it appears to mean "take the place of," which would not require "equivalency," and in some senses it means to "pay back" or "restore," which would require equivalent substitution. It appears the safest assumption until the issue is decided by a court is to assume the measure requires the state to provide dollar-for-dollar replacement.

Using these interpretations, it appears subsection 1 establishes a "baseline" of replacement revenue from the state to political subdivisions that would be the 2011 calendar year expenditures from real property tax revenues of the political subdivision and certain in lieu of tax revenues.

Subsection 2 of Section 2 of measure No. 2 provides:

> The legislative assembly shall direct as much oil and gas production and extraction tax, tobacco tax, lottery revenue, and financial institutions tax as necessary to fund the share of elementary and secondary education not funded through state revenue sources before 2012. The state cannot condition the expenditure of this portion of elementary and secondary education funding in any manner and school boards have sole discretion in how to allocate the expenditure of this portion of the elementary and secondary funding provided.

Subsection 2 is difficult to interpret because of the language employed. "The share of elementary and secondary education not funded through state revenue sources" could be interpreted to require the state to fund the share of education funded through federal sources, which presumably does not need to be replaced because it will continue to be supplied to school districts. In examining the *2011 School Finance Facts* publication of the Superintendent of Public Instruction, it appears that 2011 school district revenues in the state totaled $1,129,563,160. In very

rough percentages, state sources made up about 50 percent, local sources about 30 percent, and federal sources about 20 percent of statewide education funding. School district property tax revenues and in lieu of tax payments totaled slightly less than 25 percent of total revenues. Because the purpose of measure No. 2 is to eliminate and replace funding for property taxes, there is an attraction to simply interpreting subsection 2 as requiring replacement of property taxes levied by school districts. However, it is not clear that the language of the subsection is capable of that interpretation. If this subsection is interpreted to require replacement of school district property taxes, it would be very nearly a redundancy of the subsection 1 requirement for school districts.

Subsection 3 of Section 2 of measure No. 2 provides:

> The legislative assembly shall direct a share of sales taxes, individual and corporate income taxes, insurance premium taxes, alcoholic beverage taxes, mineral leasing fees, and gaming taxes and any oil and gas production and extraction taxes, tobacco taxes, lottery revenues, and financial institutions taxes not allocated to elementary and secondary schools to counties, cities, and other political subdivisions according to a formula devised by the legislative assembly to fully and properly fund the legally imposed obligations of the counties, cities, townships, and other political subdivisions. The allocation of the amount determined by the legislative assembly must be provided to the governing bodies of counties, cities, townships, and other political subdivisions. How counties, cities, townships, and other political subdivisions choose to allocate the expenditures of this revenue is at the sole direction of the governing bodies of counties, cities, townships and other political subdivisions.

Subsection 3 requires the Legislative Assembly to allocate a share of state taxes according to a "formula devised by the Legislative Assembly to fully and properly fund the legally imposed obligations" of political subdivisions. It appears there is little room for argument that this requirement places discretion in the Legislative Assembly to determine what level of funding is "proper."

Taken as a whole, Section 2 of measure No. 2 appears to:

1. Establish a "baseline" funding level equal to political subdivision expenditures from real property taxes equal to the amount expended by each political subdivision during 2011. No growth factor is included in the measure for this allocation.
2. Require allocation of approximately 25 percent of the cost of education among school districts in the state. Because this requirement is expressed as a "share," it will be subject to growth as the cost of education increases.
3. After the funding requirements of subsections 1 and 2 have been met, the Legislative Assembly will have to make the determination of what additional level of funding is proper.

It should be noted that the only funding to school districts required by measure No. 2 is to fund the share of education not funded through state revenue sources. This does not appear to mandate that the Legislative Assembly maintain the same levels of funding to school districts that it maintained in 2011.

ADDITIONAL COMMITTEE QUESTIONS

How Will "Market Value" of Property Be Determined for Purposes of Constitutional Debt Limits?

This is one of the questions that will have to be answered by the Legislative Assembly if measure No. 2 is enacted. Market value is not defined by the measure or by statute, except as one component of determining "true and full value," and even if it is interpreted as equivalent to "true and full" value, market value for agricultural property is clearly not the value determined by the productivity valuation formula.

Does "Market Value of All of the Property in the State" Make It Necessary to Determine Market Value for Personal Property?

This will have to be interpreted by the Legislative Assembly. It appears that the word "taxable" was removed by the drafters of measure No. 2 because upon enactment there will no longer be "taxable" property. However, removal of the word "taxable" leaves the word "property" standing alone, which includes all property. The plain language of the provision appears to require determination of market value of real and personal property, and the measure does not appear to allow any discretion for the Legislative Assembly to exclude any kind of personal property. Literal application of this language would result in an enormous expansion of assessment responsibilities, costs, and intrusion into what citizens have deemed to be outside the reach of governmental inquiries. This expansion of assessment would serve only the limited purpose of determining debt limits for the state and political subdivisions. Perhaps a means could be devised to "impute" value of personal property.

What Effect Does Changing True and Full Value to Market Value of All Property as the Basis for Limitation Have on the State Debt Limit?

The change increases the state's limitation of indebtedness, but Section 13, Article X, of the Constitution of North Dakota, would still limit state general obligation bonded debt to $2 million. For the

purpose of promoting generation and transmission enterprises, the state may issue a combination of bonds that, added to outstanding general obligation debts, will not exceed 5 percent of the market value of all of the property in the state, which would be an increased debt limit.

Does Political Subdivision Bonding Capacity Increase if the Basis of the Constitutional Limitation Is Changed From Assessed Value of Taxable Property to Market Value of Property?

The debt limitation for political subdivisions would be substantially increased by the initiated measure because market value is approximately twice the amount of assessed value and because valuation of personal property would become part of the limit. This question may be largely academic because the Legislative Assembly will be forced to rewrite statutory provisions on political subdivisions incurring indebtedness and would be free to establish lower limits than the constitutional provision would contain.

May Political Subdivisions Issue General Obligation Bonds if Property Taxes May Not Be Levied?

Political subdivisions would be without authority to issue general obligation bonds without legislative changes to statutory authority. Under Section 21-03-15, a political subdivision issuing general obligation bonds is required to levy an annual property tax to retire the indebtedness. Beginning on the effective date of measure No. 2, general obligation bonds could not be issued.

May the Legislative Assembly Require Special Assessment Debt to Be Included in Calculating Debt Limits of Political Subdivisions?

No, the North Dakota Supreme Court has adopted the "special fund doctrine" under which special assessment debt is not considered "debt" for purposes of the constitutional debt limit for political subdivisions.

Will Political Subdivisions Need Legislative Approval Before Issuing Debt?

It does not appear legislative approval would be required under current statutory provisions for issuing certificates of indebtedness or warrants, but legislative approval would be required for issuance of general obligation bonds. The form of legislative approval could range from enactment of statutory authority providing a standard procedure and funding mechanism or by requiring legislative approval of bond issues on a case-by-case basis.

Would a Home Rule City or County Be Prohibited From Using Home Rule Sales Taxes or Other Tax Revenues for Payment for Bonded Indebtedness?

No, if the bonds are marketable with that backing.

May Political Subdivisions Use Anticipated State Revenues to Pay for Retirement of Indebtedness?

Yes, if the debt is marketable with that backing. For general obligation bonds, existing statutory provisions would have to be revised by legislation to allow state revenues to be used as a funding source.

Will Property Tax and Budget Statutes of Political Subdivisions Become Void?

Statutory provisions governing property tax levies and levy limitations would be void. Statutory provisions governing political subdivisions' budgeting would undoubtedly be rewritten by the Legislative Assembly. However, unless a special legislative session is held in 2012, enactment of measure No. 2 would mean 2012 political subdivision budgets are unlimited.

May a County Obtain Property Through Tax Foreclosure if Property Taxes Were Due and Unpaid Before the Effective Date of Measure No. 2?

Yes, it appears the obligation to pay and the remedies for nonpayment for any property taxes for 2011 or earlier would remain effective.

What Effect Will Measure No. 2 Have on the Ability of Political Subdivisions to Consolidate?

It appears measure No. 2 would not discourage consolidation of political subdivisions.

Does Measure No. 2 Limit the Legislative Assembly's Ability to Consolidate Services Between Counties?

It appears measure No. 2 would not affect the Legislative Assembly's prerogative to require or allow consolidation of services between counties.

Does Measure No. 2 Limit the Legislative Assembly's Ability to Consolidate School Districts or Consolidate All School Districts Into One School District?

It appears measure No. 2 would have no impact on the Legislative Assembly's prerogative to require or allow consolidation of school districts.

What Effect Will Measure No. 2 Have on Tax Increment Financing?

Measure No. 2 will have an uncertain impact for tax increment financing. Measure No. 2 requires the

Legislative Assembly to "replace" or "fully and properly fund" property taxes that would be eliminated by the measure. The premise of tax increment financing is that there will be a growth in valuation which will generate a stream of increased property tax revenue that will pay for indebtedness incurred for the project. Measure No. 2 does not appear to require the Legislative Assembly to provide increased replacement revenue on the basis of increased property valuation. It is questionable whether tax increment financing will remain a viable property development option if property taxes are eliminated.

If Local Governments Can No Longer Levy for an Emergency Fund, May the Legislative Assembly Provide Revenues for Each Political Subdivision to Be Held in Reserve for Emergency Needs?

It would be within the prerogatives of the Legislative Assembly to provide funding to political subdivisions for an emergency fund, but it is not clear if those allocations would be required by the measure.

ATTACH:1