Prepared by the North Dakota Legislative Council
staff for the Taxation Committee
July 2007

PROPERTY TAX REFORM AND RELIEF STUDY - BACKGROUND MEMORANDUM

Section 13 of 2007 Senate Bill No. 2032 provides:

> The legislative council shall study in each interim through 2012 the feasibility and desirability of property tax reform and providing property tax relief to taxpayers of the state, with the goal of reduction of each taxpayer's annual property tax bill to an amount that is not more than one and one-half percent of the true and full value of property, and including examination of the proper measure of education funding from local taxation and state resources and the variability of funding resources among taxing districts and examination of improved collection and reporting of property tax information to identify residency of property owners with minimized administrative difficulty.

This study directive contains specific references to several property tax issues that received a substantial amount of consideration and discussion during the 2007 Legislative Assembly.

2007 SENATE BILL NO. 2032

Senate Bill No. 2032 was introduced by the Legislative Council upon the recommendation of the 2005-06 interim Finance and Taxation Committee. As introduced, the bill provided a general fund appropriation of approximately $74 million for property tax relief and provided for allocation of the appropriated amount among school districts. The bill provided adjustments to reduce school district property tax levy authority by the amount of property tax relief to be received by each school district. The bill established an allocation process based on the number of mills levied by each school district above 111 mills.

Senate Bill No. 2032 was the subject of extensive discussion and amendments. On the final day of the legislative session, the bill was passed in a form substantially different from the bill as introduced. The bill as enacted contained the following provisions regarding property taxes, income taxes, and funding:

Property Tax

1. Homestead property tax maximum income eligibility for persons 65 years of age or older or permanently and totally disabled is increased from $14,500 to $17,500. The maximum value of property exempt under the homestead property tax credit is increased from $67,511 to $75,000.
2. The amount of an assessment increase for property which triggers the requirement for written notice to a property owner is reduced from a 15 percent increase to a 10 percent increase. The time the notice of assessment increases must be delivered to property owners is increased from 10 days to 15 days before the meeting date of the local board of equalization.
3. After June 30, 2007, in any school district election for approval by electors of unlimited or increased general fund levy authority, the ballot must specify the number of mills, percentage increase in dollars levied, or that unlimited levy authority is proposed for approval and the number of taxable years for which the approval is requested. Approval by electors of unlimited or increased school district general fund levy authority may not be effective for more than 10 taxable years. The number of petition signatures required to place the question of discontinuing increased or unlimited school district general fund levy authority on the ballot is reduced from 20 percent of the persons in the school census to 10 percent of the number of electors who cast votes in the most recent school district election.
4. Real estate and mobile home tax statements must include, or be accompanied by a separate sheet with, three columns showing for the year of the tax statement and the two preceding tax years the property tax levy in dollars against the property by the county and school district and any city or township that levied taxes against the property.

Income Tax

1. An income tax marriage penalty credit of up to $300 per couple is provided to offset any marriage penalty incurred for couples with incomes up to $154,200. The credit is determined by comparing the tax on the couples' joint North Dakota taxable income and the tax that would apply if the couples' income were separated and taxed at the single filer rate.
2. A homestead income tax credit is provided for individuals for taxable years 2007 and 2008 in the amount of 10 percent of property taxes or mobile home taxes that became due during the tax year and have been paid on the individual's homestead. Property taxes eligible for the credit do not include special assessments. For purposes of the credit, "homestead" means the dwelling occupied as a primary residence in this state and any residential or agricultural property owned by the individual in this state. The amount of the

homestead income tax credit for a year may not exceed $1,000 for married persons filing a joint return or $500 for a single individual or married individuals filing separate returns.

The amount of the homestead income tax credit exceeding the taxpayer's income tax liability may be carried forward for up to five years or the taxpayer may request that the Tax Commissioner issue the taxpayer a certificate in the amount of the excess. A certificate issued to a taxpayer may be used by the taxpayer against property or mobile home tax liability during the ensuing taxable year by delivering the certificate to the county treasurer of the county in which the taxable property or mobile home is subject to taxes. The county treasurer is to forward certificates redeemed in payment of tax obligations to the Tax Commissioner, who will issue payment to the county in the amount of the certificates.

Persons owning property together are entitled to only one credit for that parcel of property, so the credit may be shared between or among them. Persons owning property together are each entitled to a percentage of the credit for a single individual equal to their ownership interests in the property. There is no limit on the number of parcels of taxable property for which an individual may claim the credit.

If the total amount of homestead income tax credits claimed by November 15, 2008, exceeds $47 million, the rate of the credit is subject to adjustment to limit the amount of revenue impact in the second year of the biennium.

3. A commercial property income tax credit is provided for an individual or corporation for taxable years 2007 and 2008 in the amount of 10 percent of commercial property taxes or commercial mobile home taxes that became due during the income tax year and have been paid. Property taxes eligible for the credit do not include any special assessments. The amount of the credit for commercial property for a year may not exceed $1,000 for any taxpayer and is limited for individuals to $1,000 for married persons filing a joint return or $500 for a single individual or married individual filing separate returns.

   The amount of the commercial property income tax credit exceeding the taxpayer's tax liability may be carried forward for up to five years.

   Persons owning property together are entitled to only one credit for that property, so the credit may be shared between or among them. Persons owning property together are each entitled to a percentage of the credit equal to their ownership interests in the property. There is no limit on the number of parcels of taxable property for which a corporation or individual may apply.

   A passthrough entity entitled to the commercial property income tax credit will allocate the amount of the credit to the partners, shareholders, or members in proportion to their respective interests in the passthrough entity.

   If the total amount of credits claimed for commercial property exceeds $7 million on November 15, 2008, the Tax Commissioner may adjust the maximum amount of the credit to control the revenue impact from the credit for the second year of the biennium.

Funding

1. An appropriation of $3,604,000 is provided to the Tax Commissioner for enhanced funding for the expansion of the homestead tax credit for the 2007-09 biennium.
2. An appropriation of $1,100,000 is provided to the Tax Commissioner for the administrative costs related to the property tax and income tax changes made by the bill.
3. A transfer of $115 million is made from the permanent oil tax trust fund to the state general fund to offset the anticipated revenue loss to the state general fund from the income tax credits provided by the bill for the 2007-09 biennium.

The committee may wish to obtain periodic updates from the Tax Commissioner during this interim on the administration and fiscal effect of the property tax, income tax, and funding provisions of Senate Bill No. 2032.

PROPERTY TAX DETERMINATION

The property tax liability of a property owner is determined by multiplying combined mill rates for all taxing districts in which the property is located times the taxable value of the property. Although this formula is relatively simple, complexities are involved in determining the mill rate, taxable value, and tax status for the property.

All locally assessed property taxes are collected by the county and distributed among appropriate taxing districts. Property taxes are due January 1 following the year of assessment and are payable without penalty until March 1 of the year they are due. If property taxes are paid in full by February 15, the taxpayer is entitled to a 5 percent discount. Penalties begin to accrue if property taxes are not paid by March 1. Taxpayers have the option of paying property taxes in installments.

Determination of Mill Rate

The mill rate for a taxing district is established through the budget process. Each taxing district prepares a proposed budget based on anticipated expenditures for the upcoming fiscal year. Hearings are held on the proposed budget and adjustments are made as needed. The deadline for amendments to budgets and for sending copies of the levy and budget to the county auditor is October 10. From October 10 to December 10, the county auditor prepares tax lists, which must be delivered to the county treasurer by December 10 and mailed to property owners by December 26.

The amount budgeted by a taxing district may not result in a tax levy exceeding levy limitations established by statute. Levy limitations for political subdivisions are summarized in the schedule of levy limitations prepared biennially by the Tax Commissioner's office. Since 1981 the Legislative Assembly has provided optional authority to levy taxes with a maximum amount determined by comparison with a base year levy amount in dollars. This method is an alternative to the use of statutorily established mill levy limitations. Most taxing districts in the state use this optional method of determining the maximum levy to which they are entitled. From 1981 through 1996, percentage increases were allowed by law over the base year levy in dollars. The compounding of these increases allowed taxing districts to increase levies well beyond the amount they would be able to levy under mill levy limitations. For taxable years after 1996, taxing districts may use the optional method to levy up to the amount levied in dollars in the base year without a percentage increase.

To determine the mill rate for a taxing district, the county auditor determines whether the amount levied is within statutory levy limitations and, if it is, the county auditor divides the total property taxes to be collected for the taxing district by the taxing district's total taxable valuation. This generates a percentage that is the mill rate for the district.

Assessment of Locally Assessed Property

All property in this state is subject to taxation unless expressly exempted by law (North Dakota Century Code (NDCC) Section 57-02-03). Real property must be assessed with reference to its value on February 1 of each year (Section 57-02-11). All property must be valued at the "true and full value" of the property (Section 57-02-27.1). True and full value is defined as the value determined by considering the earning or productive capacity, if any, the market value, if any, and all other matters that affect the actual value of the property to be assessed. For purposes of agricultural property, this includes farm rentals, soil capability, soil productivity, and soils analysis (Section 57-02-01). The assessed value of property is equal to 50 percent of the true and full value of the property (Section 57-02-01). Taxable valuation of property is determined as a percentage of assessed valuation, which is 9 percent for residential and 10 percent for agricultural, commercial, and centrally assessed property. The taxable valuation is the amount against which the mill rate for the taxing district is applied to determine the tax liability for individual parcels of property.

Residential and commercial property true and full value is established by local assessors. True and full value of railroad, public utility, and airline property is centrally determined by the State Board of Equalization.

True and full value of agricultural property is based on productivity as established through computations made by the North Dakota State University Department of Agricultural Economics based on the capitalized average annual gross return of the land. Annual gross return is determined from crop share rent, cash rent, annual gross income, or annual gross income potential. Average annual gross return for each county is determined by taking annual gross returns for the county for the most recent 10 years, discarding the highest and lowest annual gross return years, and averaging the remaining 8 years. Statistics from the most recent 10 years for prices paid by farmers are used to adjust annual gross return. Annual gross return is then capitalized using a 10-year average of the most recent 12-year period for the gross agribank mortgage rate of interest. However, the minimum capitalization rate under the formula is set at 9.5 percent for tax year 2004, 8.9 percent for tax year 2005, and 8.3 percent for tax year 2006 and later. Personnel from North Dakota State University determine an average agricultural value per acre for cropland and noncropland on a statewide and countywide basis. This information is provided to the Tax Commissioner by December 1 of each year and then provided by the Tax Commissioner to each county director of tax equalization. The county director of tax equalization provides each assessor within the county an estimate of the average agricultural value of agricultural lands within the assessor's assessment district. The local assessor must determine the relative value of each assessment parcel within that assessor's jurisdiction. In determining relative values, local assessment officials are to use the following considerations, in descending order of significance--soil type and soil classification data, a schedule of modifiers approved by the state supervisor of assessments, and actual use of the property by the owner.

Assessment of Centrally Assessed Property

Property of railroads, public utilities, and airlines is assessed by the State Board of Equalization as required by Article X, Section 4, of the Constitution of North Dakota. Under NDCC Section 57-13-01, the State Board of Equalization consists of the Governor, State Treasurer, State Auditor, Agriculture Commissioner, and Tax Commissioner. The assessment process for centrally assessed property differs from the procedure for locally assessed property. The owner of centrally assessed property must file an annual report with the Tax Commissioner by May 1. The Tax Commissioner prepares a tentative assessment for the property by July 15. Notice of the tentative assessment is sent to the property owner at least 10 days before the State Board of Equalization meeting. On the first Tuesday in August, the State Board of Equalization meets to receive testimony on the value of centrally assessed property and to finalize assessments. The Tax Commissioner certifies the finalized assessments to the counties to reflect the portion of centrally assessed property for each property owner which is taxable in that county.

Airlines serving North Dakota cities pay a property tax computed by averaging mill levies in all the cities served by an airline and applying the average levy against the taxable valuation of property of the airline in North Dakota. Taxes imposed on an airline are collected by the State Treasurer and distributed to the cities in which the airline operates, to be used exclusively for airport purposes.

Payments In Lieu of Taxes

State law provides that some enterprises make payments in lieu of taxes rather than paying property taxes. Mutual or cooperative telephone companies and investor-owned telephone companies pay a tax of 2.5 percent of adjusted gross receipts. This tax is paid to the Tax Commissioner and allocated among counties.

Rural electric cooperatives pay a gross receipts tax in lieu of property taxes for all property except land. Rural electric cooperatives with generating facilities are subject to a transmission line tax of $225 to $300 per mile in lieu of property taxes on transmission lines of 230 kilovolts or more.

Coal conversion facility taxes are paid in lieu of property taxes. These taxes are allocated by state law and provide revenues to affected taxing districts.

Property owned by certain state agencies and certain agencies and instrumentalities of the federal government is subject to payments in lieu of property taxes.

PROPERTY TAX STATISTICS AND POLITICAL SUBDIVISION REVENUES

In taxable year 2006, political subdivisions levied over $715 million in property taxes and special taxes. The constitutional one-mill levy for the State Medical Center was imposed in the amount of $1.8 million, bringing the total property and special taxes imposed to more than $717 million. The following table shows the percentage of this amount levied by each type of political subdivision and the percentage increase in property taxes and special taxes levied by each type of political subdivision from 1993 through 2006. Because the State Medical Center levy is always imposed at a rate of one mill, the 81.1 percent increase shown in the table for the State Medical Center can be assumed to be approximately equal to the increase in taxable valuation in property statewide.

	Percentage of Statewide Property Taxes and Special Taxes[1] Levied in 2006	Percentage Increase in Property Taxes and Special Taxes[1] Levied 1993 Through 2006
School districts	55.57	94.3
Counties	23.71	78.2
Cities	13.08	78.6
City park districts	4.56	116.3
Townships	1.74	33.4
Rural fire protection	0.60	78.0
Garrison Diversion	0.20	108.3
Soil conservation districts	0.19	142.0
State Medical Center	0.25	81.1
Other[2]	0.10	50.0

[1]"Special taxes" include mobile home taxes, rural electric cooperative taxes, woodland taxes, and payments in lieu of taxes.

[2]"Other" includes West River/Southwest Water Authority, hospital districts, rural ambulance districts, and recreation service districts.

Attached as Appendices A and B are copies of schedules showing major state appropriations and revenue allocations for direct assistance to political subdivisions covering biennial assistance from 1991-93 through 2007-09. Comparison of appropriations and revenue allocations for the 1993-95 and 2007-09 bienniums shows an increase of 66.2 percent in state appropriations and revenue allocations to political subdivisions over that time period. This can be compared with an increase of 88.1 percent in political subdivisions' property taxes and special taxes levied from 1993 to 2006.

HOME RULE SALES TAXES

Another significant source of revenue for 113 cities and three counties is revenue from home rule sales taxes. Grand Forks imposed the first city home rule sales tax in 1985. In 1990, six cites imposed home rule sales taxes. By 2006 home rule sales taxes have become a significant revenue source. The following table illustrates the growth in home rule sales tax collections:

Fiscal Year	Local Sales and Use
1996	$36,534,413
1997	$45,184,127
1998	$48,929,646
1999	$54,058,001
2000	$58,711,263
2001	$66,961,363
2002	$65,368,838
2003	$73,666,551
2004	$68,644,864
2005	$78,761,154
2006	$87,563,544

SPECIAL ASSESSMENTS

A growing source of revenue to cities is from special assessments imposed. From 1998 to 2006, special assessments imposed statewide have increased by 76.8 percent and it appears there are varying levels of reliance on special assessments revenue among cities. For example, on a statewide basis more than $10 in property taxes is collected for every $1 collected in special assessments. In almost one-fourth of counties, the ratio is more than $50 in property tax collections for each $1 in special assessments collections. In Stark County, the ratio is 85-to-1. In Ward County, the ratio is 42-to-1. In Morton County, the ratio is almost 7-to-1. In Cass County, the ratio is almost 5-to-1.

RESOURCES

The statistical information in this memorandum was drawn from the *2006 Property Tax Statistical Report* and *State and Local Taxes 2006* (Red Book) prepared by the Tax Commissioner's office. These publications contain a wealth of information about property taxes and other tax types in North Dakota. The Tax Department staff will review the publications to point out the information available in these resources.

SUGGESTED STUDY APPROACH

This study resolution specifically refers to property taxes but could incorporate consideration of any tax type because the resolution calls for consideration of providing property tax relief and the proper measure of education funding from state resources. This makes it difficult to lay out a suggested study approach because it will be necessary for the committee to determine the extent to which it wishes to explore state tax types. The committee must also identify aspects of property tax reform and relief on which to focus its attention.

In addition to considering property tax reform and property tax relief issues, the study directive requires the committee to consider these issues:

1. The goal of reduction of each taxpayer's annual property tax bill to an amount that is not more than 1.5 percent of the true and full value of property.
2. The proper measure of education funding from local taxation and state resources.
3. The variability of funding resources among taxing districts.
4. Improved collection and reporting of property tax information to identify residency of property owners with minimized administrative difficulty.

ATTACH:2