TAXATION COMMITTEE

The Taxation Committee was assigned six studies. House Concurrent Resolution No. 3044 directed a study of the impact of tax-exempt property on school districts. Senate Concurrent Resolution No. 4050 directed a study of taxation and regulatory incentives for the lignite industry to improve its competitive position in the energy marketplace. House Concurrent Resolution No. 3052 directed a study of the property tax exemption for charitable organizations. House Concurrent Resolution No. 3037 directed a study of the feasibility and desirability of providing property tax relief through alternative state and local revenue sources. The chairman of the Legislative Council directed the committee to study the assessment of agricultural property and inundated lands and directed a study of the application of the farm building property tax exemption.

Committee members were Representatives Wesley R. Belter (Chairman), Grant C. Brown, Chris Christopherson, William E. Gorder, Mick Grosz, Ralph L. Kilzer, Kenneth Kroeplin, Edward H. Lloyd, Ronald Nichols, Alice Olson, Dennis J. Renner, Earl Rennerfeldt, Arlo E. Schmidt, and Ben Tollefson and Senators Randel Christmann, Layton Freborg, Meyer Kinnoin, Ed Kringstad, Randy A. Schobinger, Vern Thompson, and Herb Urlacher.

The committee submitted this report to the Legislative Council at the biennial meeting of the Council in November 1998. The Council accepted the report for submission to the 56th Legislative Assembly.

TAX-EXEMPT PROPERTY IMPACT ON SCHOOL DISTRICTS STUDY

Background

The existence of tax-exempt property within a school district affects the school district in two ways by limiting the amount of property tax revenue the maximum school district levy will generate (but not in all cases) and by excluding the value of exempt property from the equalization factor under the foundation aid allocation formula.

School districts with unlimited levying authority are not restricted in property tax dollars by the existence of tax-exempt property. The Fargo School District has statutory authority for unlimited levies under North Dakota Century Code (NDCC) Chapter 15-51. Under NDCC Section 57-15-14, any school district with a population of more than 4,000 may be granted unlimited levying authority upon approval by a majority vote of electors, and a school district with fewer than 4,000 population may be granted authority to levy any specific number of mills approved by a vote of 55 percent or more of electors.

School districts that have not been granted unlimited levying authority or authority to levy an excess levy are subject to a general fund levy limitation of 185 mills on the dollar of taxable valuation of property in the district under NDCC Section 57-15-14. A school district subject to this limitation which levied fewer than 185 mills for the prior school year may increase its levy by up to 18 percent in dollars from the prior school year, up to the 185-mill limitation. If a school district has an increase of 20 percent or more in total assessed valuation of property over the prior year, and as a result of the increase the district is to receive less in state foundation aid payments, that school district may levy any specific number of mills more in dollars than was levied in the prior year to make up for the loss of foundation aid revenue but may not exceed the 185-mill limitation.

School districts at or near the general fund 185-mill limitation have been eligible for optional percentage levy increases in dollars in the years since 1981. From 1981 through 1996, taxing districts were allowed a percentage increase in dollars over the base year levy in dollars. Under NDCC Section 57-15-01.1, as amended in 1997, during taxable years 1997 and 1998, a county, city, township, or school district eligible for federal funds on a matching basis as a result of a disaster declared by the President of the United States may levy an amount in dollars equal to the amount required to match federal funds up to an increase of two percent more than the amount levied in dollars by the district in the base year. Except for this authority to match federal disaster funding, taxing districts that are levying at levels in excess of statutory mill levy limits are authorized to maintain the amount levied in dollars in the base year but have no authority to increase levies without voter approval.

Many school districts in the state are levying an amount exceeding 185 mills for general fund purposes as a result of the compounding of percentage increase allowances during taxable years 1981 through 1996. However, the levy under NDCC Section 57-15-01.1 is not a levy in mills but is a levy of a specific amount in dollars which is converted to mills by the county auditor. The significance of this distinction is that when a levy limit is based on dollars levied in a prior year, that amount is unaffected by increases or decreases in the taxable valuation of property within the district. If a district is levying under this authority, an increase in valuation in the district with the same number of dollars levied will result in a lower mill rate but no change in the amount of property taxes collected, and a decrease in valuation will result in a higher mill rate but no change in taxes collected.

When a school district levy is limited to the statutory number of mills, the maximum amount a district can levy rises and falls with the taxable valuation of property within the district. It is within these districts that exemptions from property taxes have the most significant direct effect on property taxes.

An alternative to an unlimited levy is an excess levy under NDCC Chapter 57-16. If the governing board of the school declares that funds available at the maximum levy otherwise allowed by law are insufficient, the question may be placed on the ballot of increasing the legal limitation by a specified percentage of up to 75 percent. An excess levy may be authorized for up to five years and may be extended indefinitely in five-year increments by unanimous approval of the governing board of the school district.

School districts have authority to levy for various special fund purposes. School districts may levy without limitation for board and lodging or transportation allowance for high school students sent to another high school district, high school tuition, judgments, compromise of a judgment for injury, asbestos removal, special assessments, and bond sinking and interest funds. Upon approval by a vote of 60 percent or more of qualified electors, a school district may levy up to 20 mills for a building fund. A school district may levy up to three mills for a special reserve fund. School districts may levy for support of a junior college or off-campus educational center, municipal or regional airport authority, plant pest control, railroad purposes, asbestos abatement, and long-distance learning technology.

School districts levy more property taxes than all other taxing districts combined. For taxable year 1995, school district property taxes exceeded $230 million and comprised 54.5 percent of all property taxes collected in the state.

The effect of the existence of tax-exempt property on school district tax revenues depends upon how the maximum levy for the district is determined. However, all taxing districts' taxpayers are affected by the existence of tax-exempt property. In districts with a limitation of a number of mills, reduced taxable valuation due to tax-exempt property means a higher number of mills must be imposed against each parcel of property. In districts in which the levy is unlimited or limited based on dollars levied in a previous year, the number of tax dollars raised could be spread against a greater amount of property if tax-exempt property were added to the tax rolls.

Foundation aid allocations are determined under NDCC Chapter 15-40.1 and the appropriation made for that purpose by the most recent Legislative Assembly. The foundation aid allocation formula for school districts includes a variety of factors. The formula includes an equalization factor, applied to reduce the payment to the school district. For the 1996-97 school year and thereafter, 32 mills is multiplied times the latest available net assessed and equalized valuation of property in the school district and the resulting amount is subtracted from the payment to be made to the school district. For years after 1996-97, the number of mills in the factor must be adjusted by determining a percentage by dividing the number of mills used in the computation in the previous year by the state average school district general fund mill levy plus 40 percent of the percentage increase in foundation aid distributions and multiplying the amount times the state average school district general fund mill levy.

Because the equalization factor is multiplied times the assessed valuation of property in the taxing district, the more taxable property that exists in the district the greater the amount deducted from foundation aid payments for the district. Property that is not on the tax rolls generates no revenue for a school district, unless payments in lieu of taxes are received, and does not decrease foundation aid to the district.

Property tax exemptions exist for numerous kinds of property under many kinds of ownership. Thirty-nine subsections of NDCC Section 57-02-08 provide specific exemptions for different classifications of property. Several other provisions of law exempt property from taxation. However, it is exemptions granted at the discretion of city or county governing bodies that are of greatest concern to school district officials, who provided the impetus for 1997 legislation that was defeated and for introduction of the study resolution leading to this study. Discretionary exemptions allowable by cities and counties include exemptions for new residential property, day care property, pollution abatement improvements, residential and commercial property improvements, and exemptions or payments in lieu of taxes for new and expanding business.

House Bill No. 1318 (1997), introduced on behalf of the North Dakota School Boards Association, would have allowed school districts the opportunity to decide whether property tax exemptions or payments in lieu of taxes for new business would be granted to the extent of the school district property tax levy. The bill failed to pass and the decision on whether to grant exemptions or payments in lieu of taxes for new business remains in the discretion of the governing body of the city or county.

Senate Bill No. 2322 (1995) was enacted to provide that during deliberation on a property tax exemption or option to make payments in lieu of taxes for new business, a city or county must include, as nonvoting ex officio members of its governing body, a representative appointed by the school board of each affected school district and a representative appointed by the Board of Township Supervisors of each affected township. This law was adopted with an expiration date of July 31, 1997, and no attempt was made during the 1997 legislative session to extend the expiration date.

Committee Consideration

The North Dakota School Boards Association supported 1997 House Bill No. 1318 to allow school districts to opt out of property tax exemptions or payments in lieu of taxes granted by cities and counties. The association supports introduction of similar legislation in 1999. Association representatives stressed that it is not the intention of the association to obstruct economic development efforts, but rather to allow school districts to make their own decisions on exemptions to the extent of their property tax levies. The association does not seek authority to veto tax exemption decisions of cities or counties. They said that school districts are the appropriate body to decide whether to grant exemptions from school levies, and that school districts may experience greater immediate impact from economic development than other political subdivisions. They said school districts levy the majority of property taxes in dollars because school districts have greater need for revenues. They said a city or county may be able to forego property tax revenue for several years, and may base property tax exemption decisions on that fact. They said a city or county granting an exemption may not consider that economic development may cause an increase in students, which immediately impacts the school district budget.

School board representatives believe that some type of property tax incentive is necessary to successfully compete for new and expanding business opportunities. They are concerned that the school board is left out of the decisionmaking process and another entity may grant an exemption or payments in lieu of taxes that could last for up to 20 years with no real participation in the decision by the school board.

The North Dakota Industrial Development Association opposed allowing school districts to opt out of property tax exemptions for new businesses. A representative of the association said that North Dakota has a great need for economic development and the concept of providing tax incentives is that the community invests now to receive benefits later. An association representative said economic development professionals do not consider it a property tax revenue loss when a new project is established with a property tax exemption because if the project did not exist there would be no additional tax base. Eventually property will become taxable, so the association views new businesses established with property tax exemptions as a net gain.

An Industrial Development Association representative said there was concern in early stages of economic development efforts that businesses would take advantage of exemptions and, after the exemptions expired, would leave the state or community. It has not been proven that businesses have taken advantage of exemptions in that fashion. Businesses that have been granted exemptions were carefully evaluated by local officials and have proven to be solid corporate citizens of their communities. The association surveyed city economic development officials and found no example of a business that had taken advantage of an exemption and then moved elsewhere. In the survey, local economic development officials supported the economic development tools that have been provided by state law, particularly emphasizing the importance of property tax exemptions. Economic development officials suggested that allowing school districts to opt out of property tax exemptions would dilute the incentives that could be offered to new business. They suggested that the city or county is the appropriate decisionmaking authority for property tax exemptions because economic development professionals are involved at those levels of government.

The Greater North Dakota Association opposed allowing school districts to opt out of property tax exemptions granted by cities or counties. The association supports allowing a school district representative as a nonvoting member of a city or county governing body in considering property exemption decisions.

The North Dakota League of Cities opposed granting school districts authority to opt out of property tax exemption decisions made by cities or counties. A league representative said the Legislative Assembly gave authority to grant property tax exemptions in recognition of the importance of economic development to the state. He said the Legislative Assembly chose to have cities and counties make the decisions about granting exemptions because cities and counties are in the best position to weigh the benefits and assess the costs of a project and the needs of the community.

The North Dakota Association of Builders, the North Dakota Home Builders Association, and the Bismarck-Mandan Development Association expressed support for preserving the existing status of property tax exemption decision authority.

Bill Draft Consideration

The committee considered a bill draft to provide school districts authority over whether school district property tax levies would apply to property for which the city or county has granted a property tax exemption or payments in lieu of taxes as a new or expanding business under NDCC Chapter 40-57.1.

Some committee members said school districts should have decisionmaking authority over property tax exemption decisions to the extent of the school district property tax levy. However, the majority of committee members did not support recommending the bill draft and expressed the opinion that North Dakota's economy seems to be growing, and there is evidence that much of the growth is attributable to local economic development efforts. Committee members said diluting authority over exemption decisions would diminish the tools available to local economic development officials and would make it difficult for a taxpayer to know to whom complaints should be made about exemption decisions. Committee members said extending this authority to school districts would also serve as an argument that the authority should be extended to all political subdivisions having taxing authority.

Recommendation

The committee recommends Senate Bill No. 2051 to give school districts and townships the right to each have a member participate as a nonvoting, ex officio member of the governing body of the city or county when the governing body is considering granting of an exemption or the right to make payments in lieu of taxes for a new or expanding business under NDCC Chapter 40-57.1. The bill is identical to 1995 Senate Bill No. 2322, which was in effect through July 31, 1997, except that the bill creates permanent law. The bill is intended to allow school districts and townships to participate in discussions about property tax exemption decisions, to make city or county officials aware of any special concerns of the school district or township.

LIGNITE INDUSTRY STUDY

Background Coal Severance Tax

The coal severance tax was enacted as a temporary law in 1975 and was essentially reenacted in 1977, again as a temporary law. In 1979 the coal severance tax became permanent law. Under the 1975 law, the coal severance tax rate was set at 50 cents per ton plus an amount determined by an escalator clause that provided for an increase in the tax of one cent per ton for every three-point increase in the index of wholesale prices for all commodities as prepared by the United States Department of Labor, Bureau of Labor Statistics. The 1977 Legislative Assembly increased the base rate of the tax to 65 cents per ton plus the amount determined under an escalator clause, equal to one cent per ton for each one-point increase in the index of wholesale prices for all commodities. In 1979 the coal severance tax base rate was increased to 85 cents per ton with an escalator of one cent per ton for every four-point increase in the index of wholesale prices for all commodities. It was provided that, even though the wholesale price index may decline, the rate of severance tax would not be reduced. The coal severance tax rate formula remained in place and the rate reached a high of $1.04 per ton until passage of 1987 House Bill No. 1065, which reduced the general coal severance tax rate to 75 cents per ton, eliminated the escalator provision, and imposed an additional separate tax of two cents per ton, with the proceeds of the separate tax allocated to the lignite research fund. The 77 cents per ton rate of tax has been unchanged since 1987.

The coal severance tax is in lieu of sales or use taxes. Any coal that is exempt from the severance tax is subject to sales and use taxes unless a sales or use tax exemption exists. Severance tax exemptions are provided for coal used primarily for heating buildings and coal used by the state or any political subdivision. Coal used for heating privately owned buildings is not exempt from the sales tax. A severance tax exemption was created in 1985 for coal used in agricultural processing or sugar beet refining plants located in North Dakota or adjacent states. Other 1985 legislation provided that the severance tax rate is reduced by 50 percent if the coal is to be burned in a cogeneration facility. Coal mined for out-of-state shipment is subject to a reduced tax rate from July 1, 1995, through June 30, 2000.

Coal shipped into North Dakota for use in a coal conversion facility would not be subject to North Dakota's severance tax. Passage of 1997 House Bill No. 1467 provided that such coal would be subject to a special sales tax of six cents per million BTUs, and that revenue from the special sales tax would be allocated in the same manner as coal severance tax revenues. This tax has been challenged in a lawsuit filed by Montana coal producers, and the lawsuit was pending at the time of this report.

An exemption from the state's share of coal severance or sales taxes was created under 1997 House Bill No. 1467 for coal burned in smaller generating stations in this state or an adjacent state. This exemption does not apply to the coal development trust fund share of revenue, but the bill allows political subdivisions to individually give up their share of tax revenues on such coal.

All severance taxes, penalties, and interest collected by the Tax Commissioner are transferred to the State Treasurer within 15 days of receipt and are credited to a special fund called the coal development fund. The revenue in the coal development fund is allocated 50 percent to the state general fund, 35 percent to producing counties, and 15 percent to the coal development trust fund. The coal development trust fund is held in trust and administered by the Board of University and School Lands for loans to coal-impacted counties, cities, and school districts. Seventy percent of deposits in the trust fund are to be transferred to the lignite research fund.

Thirty-five percent of the revenue in the coal development fund is allocated to coal-producing counties in the proportion that the number of tons of coal severed in each county bears to the total number of tons of coal severed in the state. Of the 35 percent portion of the coal development fund which is distributed to coal-producing counties, 30 percent is paid by the county treasurer to incorporated cities of the county based upon population, 40 percent is deposited in the county general fund, and 30 percent goes to school districts within the county in proportion to average daily membership. The distribution formula within counties also provides for recognition of impact on surrounding areas not within the county. If the tipple of a currently active coal mining operation in a county is within 15 miles of another county in which no coal is mined, revenue apportioned from that coal mining operation is apportioned according to the same formula as county revenues with inclusion of cities, school districts, and the general fund of the non-coal-producing county within certain geographical limits.

Coal severance tax revenues for the 1997-99 biennium are estimated to be $45,846,000. Of this amount, the state general fund is estimated to receive $22,310,000, allocations to political subdivisions are estimated to be $15,640,000, and the coal development trust fund is estimated to receive $6,703,000. The remaining $1,192,000 will go to the lignite research fund.

Privilege Tax on Coal Conversion Facilities

The privilege tax on coal conversion facilities was enacted as a companion to the severance tax and is imposed by NDCC Section 57-60-02. A coal conversion facility is defined as an electrical generating plant that converts coal into electrical power and has a capacity of 120,000 kilowatts or more or a facility that uses over 500,000 tons of coal per year to be converted into other products. Differing tax rates are imposed on different types of coal conversion facilities.

As enacted in 1975, the coal conversion facilities privilege tax on electrical generating plants was at a rate of one-fourth of one mill per kilowatt hour of electricity produced, and the tax on coal gasification plants was the greater of 2.5 percent of gross receipts or 10 cents per 1,000 cubic feet of synthetic natural gas. In 1983 an additional one-fourth of one mill per kilowatt hour tax was imposed on electrical generating plants. In 1985 the floor on the tax for coal gasification plants was increased from 10 cents to 15 cents per 1,000 cubic feet of synthetic natural gas. In 1987 the basis of the tax for electrical generating plants was changed from kilowatt hours of electricity produced to 60 percent of the installed capacity of each generating unit times the number of hours in the taxable period, and for damaged units a reduced tax rate based on cost of repairs was established to be in effect until the unit is capable of generating electricity. Other 1987 legislation reduced the alternative tax for coal gasification plants from 15 cents to seven cents for each 1,000 cubic feet of synthetic natural gas and provided an exemption for any synthetic natural gas production in excess of 110 million cubic feet per day. In 1989 separate tax treatment was provided for coal beneficiation plants, providing an alternative tax of 20 cents per ton of beneficiated coal or one and one-quarter percent of gross receipts, whichever is greater. In 1991 legislation was enacted to provide a five-year exemption for new electrical generating plants from all but 35 percent of the one-fourth of one mill tax based upon production capacity of the generating unit, and the 35 percent remaining tax is allocated entirely to the county and may be eliminated by approval of the board of county commissioners.

For electrical generating plants, the present conversion tax is at a rate of one-half of one mill on each kilowatt hour of electricity produced for the purpose of sale. For coal gasification plants, the rate of tax is either 2.5 percent of gross receipts or seven cents per 1,000 cubic feet of synthetic natural gas, whichever is greater. A provision enacted in 1985 provides that gross receipts from the sale of a capital asset are not included in gross receipts for purposes of the coal conversion tax. Provisions added in 1985 exempted from gross receipts any financial assistance provided by the federal government. A 1987 amendment exempted byproducts of the gasification process to a maximum of 20 percent of all gross receipts of the facility. Passage of 1997 Senate Bill No. 2196 increased the maximum gross receipts from 20 to 35 percent to be eligible for the exemption until December 31, 2000, when the limit will revert to 20 percent. Senate Bill No. 2196 also exempted sales of carbon dioxide for oil and gas recovery from the gross receipts tax. Passage of 1997 Senate Bill No. 2339 extended the property tax exemption for a pipeline to transport carbon dioxide to 10 years after initial operation, rather than commencement of construction, and allowed the exemption to apply to a pipeline carrying carbon dioxide outside the state.

Under the coal conversion tax, each coal conversion facility is classified as personal property and is exempt from property taxes except taxes on the land upon which the facility is located. The coal conversion tax is in lieu of property taxes on the facility. The coal conversion tax is also in lieu of taxes on rural electric cooperatives and cooperative electrical generating plants that qualify as coal conversion facilities.

Allocation of coal conversion tax revenues is made annually on or before July 15 of each year. Revenue from one-fourth of one mill of the tax on electrical generating plants is deposited entirely in the state general fund. Revenue from all remaining coal conversion taxes is allocated 35 percent to the producing county and 65 percent to the state general fund.

Revenue allocated to counties from the coal conversion tax is allocated within the county with 40 percent to the county general fund, 30 percent to cities in the county according to population, and 30 percent to school districts in the county on an average daily membership basis.

Total revenue from coal conversion taxes for the 1997-99 biennium is estimated to be about $30,847,000. That amount would be allocated approximately $6,133,000 to political subdivisions and $24,714,000 to the state general fund.

Lignite Research, Development, and Marketing

North Dakota Century Code Section 54-17.5-02 requires the Industrial Commission to consult with the Lignite Research Council in matters of policy affecting the administration of the lignite research fund. In evaluating applications for funding from the lignite research fund for North Dakota's lignite research, development, and marketing program, the Industrial Commission and the Lignite Research Council are required to give priority to those projects, processes, or activities that will preserve existing jobs and production, create the greatest number of new jobs and most additional lignite production and economic growth potential in coal-producing counties or those counties with recoverable coal reserves, attract matching private industry investment equal to at least 50 percent or more of the total cost, and result in development and demonstration of a marketable lignite product or products with a high level of probability of rapid commercialization.

Under Section 54-17.5-05, the Industrial Commission may issue evidences of indebtedness payable solely from appropriations by the Legislative Assembly from the lignite research fund; revenues or income that may be received by the commission from lignite projects, processes, or activities funded with the proceeds of the commission's evidences of indebtedness; and revenues or income received by the commission from any other source under Chapter 54-17.5. The evidences of indebtedness may be issued to fund research, development, and marketing projects, processes, or activities directly related to lignite and products derived from lignite.

For the 1997-99 biennium, the estimated receipts for the lignite research fund are approximately $6,245,000. That amount includes about $1,192,000 from the separate and additional two-cent coal severance tax, about $4,693,000 from the coal severance tax deposited in the permanent coal development trust fund, and about $360,000 from interest income. The estimated balance at the beginning of the 1997-99 biennium was approximately $7,877,000.

Estimated expenditures from the lignite research fund for the 1997-99 biennium are about $13,430,000. Estimated expenditures included about $400,000 for a lignite marketing feasibility study and $13,030,000 for administration and development of the lignite research, development, and marketing program. The Industrial Commission authorized an investment of $4,200,000 from the fund in the Dakota Gasification Company lignite to anhydrous ammonia project and issuance of tax-exempt bonds to provide $8,100,000 to the Dakota Gasification Company. The bonds are for 10-year financing with annual principal and interest payments of approximately $1,085,000 from lignite research fund revenues. The total bond cost to the fund is estimated to be $11 million.

Regulation of Coal Mining - Coal Exploration

North Dakota Century Code Section 38-12.1-04 provides that the Industrial Commission has jurisdiction over all persons and property necessary to regulate the exploration for coal on state and private lands within the state. The State Geologist is required to act as a supervisor responsible for enforcing the regulations and orders of the commission. The commission may require the furnishing of a reasonable bond conditioned upon the full compliance with state law and rules of the commission prescribed to govern the exploration for coal. In addition, the commission may require the delivery to the State Geologist of basic data collected during the exploration for coal; may require plugging, covering, or reburial to protect environmental quality, general health, and safety and economic values of all holes, pits, or trenches excavated during the course of coal exploration; and may inspect all drilling or exploration sites. The commission must require reclamation of any lands substantially disturbed in coal exploration, including excavations, roads, drill holes, and the removal of facilities and equipment.

Section 38-12.1-05 prohibits the commencement of operations for drilling for the exploration for coal without first obtaining a permit from the State Geologist. That section also prohibits the removal of more than 250 tons of coal without a permit from the Public Service Commission.

Regulation of Coal Mining - Surface Mining and Reclamation Operations

North Dakota Century Code Chapter 38-14.1 addresses surface mining and reclamation operations. Under that chapter, the Public Service Commission is designated the state regulatory authority for all purposes relating to the federal Surface Mining Control and Reclamation Act of 1977. The commission may issue permits for surface coal mining operations and adopt regulations necessary to carry out Chapter 38-14.1 and the federal Surface Mining Control and Reclamation Act of 1977.

Section 38-14.1-06 allows any person having an interest that is or may be adversely affected, including state agencies other than the Public Service Commission, to petition the commission to hold a hearing for the purpose of having an area designated as unsuitable for surface coal mining operations or to have such designation terminated. The section requires the Public Service Commission to hold public hearings in the locality of the affected area for each petition filed. The commission may designate an area as unsuitable for surface coal mining operations after a hearing if the commission determines that the operations will be incompatible with existing state or local land use plans or programs; affect fragile or historic lands in which the operations could result in significant damage to important historic, cultural, scientific, and aesthetic values and natural systems; affect renewable resource lands in which the operations could result in a substantial loss or reduction of productivity of long-range water supply or food or fiber products, and the lands include aquifers and aquifer recharge areas; or affect natural hazard lands in which the operations could substantially endanger life and property, and the lands include areas subject to frequent flooding and areas of unstable geology.

Section 38-14.1-14 provides the requirements for permit applications for surface coal mining and reclamation operations. Among other things, the permit application requires the applicant to provide cultural resource information and submit a reclamation plan for the land. In addition, the permit applicant is required to file a performance bond in an amount sufficient to complete the reclamation plan.

Chapter 38-14.3 establishes a surface mining and reclamation bond fund to be maintained at the Bank of North Dakota to provide bonds for the faithful performance of all surface coal mining laws, rules, and permit conditions and terms. The bond fund is to be administered by the Industrial Commission.

Surface Owner Protection

North Dakota Century Code Chapter 38-18 was enacted in 1975 to provide the maximum amount of constitutionally permissible protection to surface owners from the undesirable effects of development of minerals underlying the surface of their property. A mineral developer is required to give the surface owner written notice of the type of land disturbance or mining operation contemplated by the mineral owner before the Public Service Commission may issue a permit to surface mine the land. The Public Service Commission may not issue a permit to surface mine land unless the permit application is accompanied by statements of consent executed by each surface owner whose land is included within the permit area. The chapter also provides for the payment of surface damage and disruption payments to surface owners and requires a mineral developer to pay the entire cost of the surface reclamation necessitated by that developer's mining operation.

Administrative Rules

More than 300 sections of the North Dakota Administrative Code have been adopted by the Industrial Commission and Public Service Commission regarding coal exploration and surface mining and reclamation. Administrative rules of the State Department of Health and Tax Commissioner also affect coal mining operators. As a result of the passage of 1997 House Bill No. 1410, the State Department of Health cannot adopt administrative rules on air quality affecting coal conversion facilities which are more strict than federal rules or standards under the Clean Air Act (42 U.S.C. 7401 et seq.). As a result of the passage of 1997 Senate Bill No. 2356, the State Department of Health is prohibited from adopting administrative rules on sulfur dioxide air quality which are stricter than federal rules or standards under the Clean Air Act.

Consultant Study of the Lignite Industry

The North Dakota Lignite Energy Council suggested, and the Taxation Committee agreed, that independent consultant analysis was necessary to assess the competitive position of lignite coal in the electric energy industry. A consultant study, funded in equal amounts by the North Dakota Lignite Energy Council and the Legislative Council, was conducted by Dr. David Ramsett, Director, Division of Economics and Public Affairs, University of North Dakota. Dr. Ramsett's report *Competition in North Dakota's Coal-Electric Utility Industry: Lignite vs. Subbituminous Coal*, reached the following major conclusions:

1. Coal is more important than ever to national energy production.
2. Open market competition is here at the wholesale level in electric energy production, and open market competition will soon become the norm at the retail level.
3. The driving force in the nation's coal industry is low sulfur western subbituminous coal produced in Wyoming and Montana.
4. Users of subbituminous coal have enjoyed continuous price reductions due to rising productivity in mining and reduced

costs of transportation.
5. Electric power producers must choose the most cost-efficient energy source. Continuing price decreases in the delivered price of subbituminous coal to electric power plants in the region are threatening the economic viability of North Dakota's mine-mouth coal-electric power industry.
6. Coal taxation has become a bigger issue for the North Dakota coal-electric utility industry as the delivered price of subbituminous coal has dropped.
7. North Dakota must evaluate the economic effects of taxing lignite coal because of the economic impact and the state revenue impact of the coal-electric utility industry and the increasing potential that subbituminous coal could be burned in North Dakota power plants.

Dr. Ramsett said significant changes are occurring in the national electric utility industry and industry competition. He said the industry is moving from exclusive regional operation to open market sales. The industry was segregated and is moving to a national sales market, was regulated and is moving to free market competition, and is in transition to a character that cannot be determined at this time but will clearly be significantly different.

States in this region of the country are net exporters of electric power. States in the region are in competition with each other for markets. It is necessary to closely examine competitive factors in surrounding states to assess the continued economic viability of lignite coal. North Dakota is the only state in the region using lignite coal to produce electric power. North Dakota power plants have been located at the mine site to reduce transportation costs. In contrast, all other states in the region use imported subbituminous coal to generate electric power production. The vast majority of this coal is shipped by rail from Wyoming.

Dr. Ramsett said the best means of measuring competitiveness in the coal industry is comparing coal costs per megawatt hour (CCMH). The resulting statistic depends on several variables, including the price of coal delivered to the producing plant, the energy-producing quality of the coal, and the efficiency of the plant burning the coal. Comparing the CCMH for 1991 and 1996 shows that significant changes occurred in regional competition. The CCMH for North Dakota was relatively stable at $8.29 in 1991 and $8.32 in 1996. Other states in the region have experienced declines in CCMH because of importation of subbituminous coal from Wyoming at a greatly decreased cost. The CCMH in Nebraska has decreased from $8.72 in 1991 to $7.88 in 1996. Each state in this region has experienced a decrease in CCMH from 1991 to 1997 except North Dakota, which has experienced an increase of 5.7 percent. This compares with decreases of 34.9 percent for Nebraska, 33.1 percent for Missouri, 28.3 percent for South Dakota, and 19.5 percent in the national average CCMH.

Lignite productivity has remained stable from 1992 to 1996. During that time period productivity for subbituminous coal has increased 49.1 percent, leading to a cost reduction of 21.3 percent. Increased productivity in subbituminous coal is attributable to thicker seams of coal, less overburden to remove and replace, larger mines, and improved equipment for subbituminous mining operations.

Another very significant edge for subbituminous coal competitiveness has been deregulation of rail rates, which has substantially reduced shipping costs for coal. Unit trains increased the number of tons that may be shipped. Greater density of track and improved rail technology have also increased the ability to ship coal.

Dr. Ramsett said it is important to remember that North Dakota tax and regulatory policy for the coal industry is not what has created the current economic problems faced by the lignite industry. He said price reductions in subbituminous coal and transportation costs have been so significant that they are responsible for the competitive crisis faced by the industry. He said these events have focused attention on taxation policy because close competitive pricing of coal and electricity produced from coal depends on several variables and very small pricing differences spell success or failure in competition in the open market.

Dr. Ramsett said the continued reductions in the price of delivered subbituminous coal have made it feasible to burn subbituminous coal in North Dakota power plants. He said this fact must be remembered in North Dakota coal taxation and regulatory policymaking. He said North Dakota tax policy was established based on a coal industry that mines lignite coal at the generation plant and produces electric power for sale. He said continuation of current trends will result either in a gradual loss of market share for the electric utility industry or increased use of subbituminous coal in North Dakota power plants. He said either result would cause a reduction in mining of lignite coal in North Dakota. Dr. Ramsett said it might make sense to shift reliance from the coal severance tax to a tax on electric power production, which would generate tax revenues whether the source of generation is lignite or subbituminous coal.

Testimony

North Dakota Lignite Energy Council representatives said Dr. Ramsett's report underscores that the lignite industry is in a fiercely competitive war in the marketplace. Because Dr. Ramsett's report was received late in the interim, Lignite Energy Council representatives made no recommendation to the committee but stated their intention to work with the Governor, legislators, political subdivisions, and the industry to develop a legislative approach for consideration during the 1999 legislative session.

Lignite Energy Council representatives reviewed the economics of using Wyoming coal in North Dakota. The price of Wyoming coal is $3.12 per ton compared to $10.56 per ton for lignite at the plant. The Wyoming coal would be subject to transportation costs of $8.02 per ton plus the new North Dakota sales tax for imported coal of $1.02 per ton. This comparison indicates a total cost of Wyoming coal of $12.16 per ton versus a cost of $10.56 per ton for lignite. The fact that a ton of lignite is less expensive may be misleading. A more realistic measure of actual cost is converting the cost of coal to a price per million BTUs produced. On this basis, the cost of North Dakota lignite is 78 cents per million BTUs compared to 72 cents per million BTUs for Wyoming coal delivered to the Leland Olds Station in North Dakota. Given this comparison, subbituminous coal is not merely competitive but actually lower in price than lignite coal for burning in North Dakota power plants. Another significant consideration is that subbituminous coal burns with substantially lower levels of sulfur dioxide and nitrate oxide, which means that blending of subbituminous coal with lignite coal for burning in the future may become environmentally significant if air standards become more stringent.

Conclusion

The committee makes no recommendation regarding the lignite industry study.

CHARITABLE ORGANIZATIONS' PROPERTY TAX EXEMPTION STUDY

Background Constitutional and Statutory Provisions

The Constitution of North Dakota provides in Article X, Section 5 that ". . . property used exclusively for schools, religious, cemetery, charitable or other public purposes shall be exempt from taxation."

The study resolution focuses only on the charitable organization property tax exemption under NDCC Section 57-02-08(8). North Dakota Century Code Section 57-02-08(8) provides an exemption for:

1. All buildings belonging to institutions of public charity, including public hospitals and nursing homes licensed pursuant to section 23-16-01 under the control of religious or charitable institutions, used wholly or in part for public charity, together with the land actually occupied by such institutions not leased or otherwise used with a view to profit . . . .

Most property tax exemptions provided by the Legislative Assembly do not apply to land. The Constitution of North Dakota , Article X, Section 5 provides that ". . . The legislative assembly may by law exempt any or all classes of **personal property** from taxation and within the meaning of this section, fixtures, buildings and improvements of every character, whatsoever, upon land shall be deemed personal property. . . ." (emphasis added) This constitutional authority of the Legislative Assembly does not include providing an exemption for land upon which buildings are located. However, the same section of the constitution provides that the "property" used exclusively for charitable purposes shall be exempt from taxation. Because this provision is not limited to personal property, it appears both real and personal property of charities is intended to be exempted by the constitutional provision.

Unity of Ownership and Use

The statutory requirement that buildings and land, to be exempt, must be property "belonging to" institutions of public charity requires that the property must be owned by the institution of public charity to be eligible for the exemption and ownership by an individual renders property ineligible for the charitable property tax exemption. Vacant lots owned by institutions of public charity are not exempt because they are not "actually occupied" by the charitable institution.

In *Riverview Place, Inc. v. Cass County*, 448 N.W.2d 635 (N.D. 1989), the Supreme Court of North Dakota said:

[T]he determination of whether an institution falls within the exemption is, essentially, a two-step process in which it must be determined "whether the organization claiming the exemption is in fact a charitable one, and whether the property on which the exemption is claimed is being devoted to charitable purposes." . . . ownership of the property in question by an institution of public charity does not, by that fact alone, exempt the property from taxation . . . it is the **use** made of the property . . . which determines whether the property is exempt from taxation. [emphasis in text] The property's use must be devoted to charitable purposes and it must actually be used in carrying out the charitable purposes of the organization claiming the exemption.

Use With a View to Profit

In *Riverview Place*, the Supreme Court of North Dakota said:

. . . When a charitable organization charges a fee for its services and operates at a small net profit which is reinvested back into the organization's charitable operations, those facts do not automatically disqualify the entity's property from an exemption on the basis that it was operated "with a view to profit," as the concept of charity encompasses "something more than mere almsgiving" and therefore a "benevolent association is not required to use only red ink in keeping its books and ledgers."

The following conclusions have been reached in application of the exemption by the Attorney General and the Tax Commissioner:

1. Only the amount of land that is reasonably required for a site for the buildings and improvements used for charitable purposes is eligible for the exemption. Excess land used to pasture cattle is "used with a view to profit."
2. The meaning commonly given to "not used with a view to profit" is that no individual stockholder or investor will receive any kind of profit or gain or dividend from the operation of the charity. It does not mean that the charity cannot make some type of charge for certain services.
3. Occasional rental of property owned by a public charity and rented for nonexempt purposes does not destroy the tax-exempt status of the property.
4. If a charitable organization leases a building to another charitable organization at rent substantially below market rental rates so as to constitute financial assistance to the lessee charitable organization, then a charitable use by the lessor can be established.
5. A used clothing store operated by a public charity is not exempt because it is used for profit rather than the charitable uses of the charitable institution.

Valuation of Exempt Property of Charitable Organizations

For many years, state law has required valuation by assessment officials for all exempt property. However, assessment officials have generally not assessed that property. The reason given is that they believe it is more productive to devote limited time and resources to valuation of taxable property. For this reason, only a limited amount of information has been available from a few jurisdictions on values of exempt charitable property.

In 1995 Senate Bill No. 2081, the Legislative Assembly provided a statutory mechanism to allow the growth in tax-exempt property to be reflected in the amount that may be levied by political subdivisions beginning in 1999, under the reasoning that expanded amounts of exempt property require additional services from local governments and levying authority is required to meet the increased demand. After a 1997 amendment, local assessment officials will be required to establish valuations for property exempted from taxation as new or expanding businesses, improvements to property, property of institutions of public charity, new single-family residential or townhouse or condominium property, property used for early childhood services, or pollution abatement improvements. These valuations must be in place for taxable year 1999.

Acquisition of Agricultural Land by Nonprofit Organizations

The Governor vetoed 1997 Senate Bill No. 2385, which would have prohibited any nonprofit corporation from acquiring more than 16,000 acres of land in North Dakota. Proponents of this legislation pointed out the potential damage to tax bases of political subdivisions when large amounts of property are removed from the tax rolls and the loss of local economic activity when agricultural land is removed from production. The Governor stated in his veto message that these are valid public policy concerns. The Governor stated that he had initiated a process to carefully consider this issue, and one of the main objectives of this process is to develop agreement regarding "how much is enough" for entities, such as the Nature Conservancy, North Dakota Wetlands Trust, United States Fish and Wildlife Service, and other organizations.

Legal Basis for Limiting Land Acquisition

Attempts to limit alienation and acquisition of property require examination of legal authority regarding the power of states to limit the amount of property that may be acquired by nonprofit organizations.

The 14th Amendment to the United States Constitution provides in part that state law may not deprive any person of life, liberty or property, without due process of law.

It is necessary to balance the unfettered right to ownership and use of property against the public interest. There are situations in which the interest of the general welfare of the public will outweigh the objectives of an individual or corporation in ownership or use of property. Although there is no court decision on the precise issue of whether a state may limit the acreage of property that may be owned by a nonprofit organization, it appears from existing legal authority that:

1. The due process clause of the 14th Amendment of the United States Constitution protects the right to acquire, possess, and use property.
2. Corporations are entitled to protection of the due process clause in their property rights.
3. The constitutional right of property is not absolute and is subject to restraint under the exercise of the police power.
4. In reviewing exercise of the police power, courts will not substitute their judgment for that of the legislature unless it clearly appears that the actions of the legislature have no just foundation in reason or necessity.
5. The legislature may not, under the guise of the police power, arbitrarily interfere with private property or impose unusual or unnecessary regulations on it.

In a challenge to the North Dakota corporate farming law, the United States Supreme Court upheld the authority of North Dakota to exclude corporations from ownership of farm property. The United States Supreme Court said "the Fourteenth Amendment does not deny to the state power to exclude a foreign corporation from doing business or acquiring or holding property within it." *Asbury Hospital v. Cass County*, 326 U.S. 207, 66 S. Ct. 61, 90 L. Ed. 6, (1945).

Although no discussion of the due process clause was included, the United States Supreme Court upheld an Act of Congress prohibiting religious and charitable corporations from acquiring or holding real estate exceeding a specified value in *Church of Jesus Christ of Latter Day Saints v. United States*, 136 U.S. 1, 10 S. Ct. 792, 34 L. Ed. 478, (1890).

Questions may arise about the right of a landowner to freely choose the party to whom the owner wishes to convey property. It has been held that the owner of property does not have a fundamental right to freely alienate property. *Northwestern Life Insurance Company v. Commodore Cove Improvement District*, 678 F.2d 24 (5th Cir. 1982).

State Limits on Charitable Property Tax Exemptions

Property tax exemptions originated at a time when churches conducted most educational and charitable activities. Because these activities were operated by churches and relieved government of the cost of performing some services or obligations, there was little controversy when property tax exemptions were written into states' constitutions and laws. As other organizations began to offer these services, exemptions were extended to these new activities. However, modern operation of charitable organizations has changed so that they sometimes compete with businesses run on a for-profit basis. A 1990 United States Government Accounting Office report prepared for the House Select Committee on Aging noted these changes and observed that nonprofit hospital goals most often relate to increasing the share of patients within market areas, mirroring the goals of investor-owned institutions. Several observers have suggested that granting and retaining charitable exemptions in the modern political environment have more to do with political clout than benefits to the public and government. The changing nature of charitable organization operation is one of the factors that led assessment officials to more closely scrutinize application of exemptions. Another factor leading to increased scrutiny of claims for exemptions is the proliferation in tax-exempt real property and resulting tax burden shifted to other taxpayers, who voice growing displeasure with property tax levels.

1985 Court Decisions

The Supreme Courts of Utah and Pennsylvania decided cases in 1985 which gained national attention regarding property tax exemption application for hospitals. The Utah Supreme Court (*Utah County v. Intermountain Health Care, Inc.*, 709 P.2d 265 (1985)) concluded that two hospitals whose exempt status had been challenged by local assessors lacked sufficient charitable attributes to qualify for property tax exemption. The Pennsylvania Supreme Court (*Hospital Utilization Project v. Commonwealth*, 487 A.2d 1306 (1985)) concluded that a jointly owned hospital support facility was not an institution of purely public charity. The Pennsylvania decision involved application of a sales tax exemption, but the same standards apply to property tax exemptions in Pennsylvania so the decision meant the facility lost its exempt property tax status.

The Utah Supreme Court modified a six-factor standard from the Minnesota Supreme Court (*North Star Research Institute v. County of Hennepin*, 236 N.W.2d (1975)) and laid out the factors to be weighed in determining whether a particular institution is using its property exclusively for charitable purposes.

The Pennsylvania case did not involve a hospital. The Hospital Utilization Project was established by an association of hospitals to prepare a statistical abstract of patient information for all the hospitals in the area. The court found the project not to be charitable in nature. The court established criteria to determine that an entity is a purely public charity if it:

1. Advances a charitable purpose;
2. Donates or renders gratuitously a substantial portion of its services;
3. Benefits a substantial and indefinite class of persons who are legitimate subjects of charity;
4. Relieves the government of some of its burden; and
5. Operates entirely free from private profit motive.

Developments in Utah

After *Intermountain Health Care*, the Utah hospital industry prevailed upon the legislature to propose a constitutional amendment specifically granting a property tax exemption for nonprofit hospitals and nursing homes. Despite an extensive campaign by nonprofits, the measure was defeated by the voters in 1986.

A 1986 decision of the Supreme Court of Utah supplemented the guidelines from *Intermountain Health Care*. The Utah Tax Commission found that the guidelines after the court decisions did not produce objective standards to apply to particular fact situations. The Tax Commission conferred with county assessors, other county representatives, representatives of nonprofit hospitals and nursing homes, and representatives of for-profit hospitals and conducted a series of public hearings. The Tax Commission adopted standards for determining applicability of property tax exemptions for hospitals and nursing homes and the standards were reviewed and approved by the Utah Supreme Court. The six standards adopted are as follows:

1. The institution must be organized on a nonprofit basis and the property in question must be dedicated to its charitable purpose.
2. The institution must demonstrate that net earnings and donations do not inure to the benefit of any private shareholder or individual.
3. The institution must provide open access to medical services regardless of race, religion, gender, or ability to pay and must provide evidence of its efforts to inform the public of its open access policy and of the availability of services for the indigent.
4. The institution must maintain a "charity plan" and must have a governing board consisting of a broad-based membership, operate in an open atmosphere, and meet at least annually to address the needs of the community.
5. The institution must enumerate and total various ways in which it provides unreimbursed service to the community according to specified measurement criteria. The value of unreimbursed care to indigent patients must be measured by the hospital's normal billing rate, reduced by the average of reductions provided to all patients who are not covered by government entitlement programs, plus expenses directly associated with special indigent clinics. The total of unreimbursed service must exceed for each year what would otherwise be the institution's property tax liability for the year.
6. Satellite facilities of an institution are entitled to an exemption if it is shown that these facilities enhance the institution's charitable mission.

Developments in Pennsylvania

Pennsylvania experienced 12 years of litigation in the wake of *Hospital Utilization Project*. Assessment officials and representatives of charitable organizations have been involved in frequent disputes over application of the five-point standards announced by the Pennsylvania Supreme Court in the *Hospital Utilization Project*. The Commonwealth Court of Pennsylvania has issued a series of decisions denying exemptions for hospitals, nursing homes, private schools, a religious publishing company, a residential program for troubled youth, and a Head Start program. In an effort to end the cycle of litigation and uncertainty, Pennsylvania charities sought a legislative solution that would provide clear, objective standards for determining what is an institution of purely public charity.

Pennsylvania 1997 House Bill No. 55 was passed and was signed by the Governor on November 26, 1997. The bill established five detailed criteria to determine what qualifies as a purely public charity:

1. The institution must advance a charitable purpose. This criterion is satisfied if the institution is organized and operated primarily to fulfill any of six listed purposes.
2. The institution must operate entirely free from private profit motive. Without regard to whether the institution's revenues exceed expenses, this criterion is satisfied if four listed criteria are met.
3. The institution must provide a community service by donating or rendering gratuitously a substantial portion of its services. This criterion is satisfied if the institution benefits the community by meeting one of seven detailed standards.
4. The institution must benefit a substantial and indefinite class of persons who are legitimate subjects of charity. "Legitimate subjects of charity" is defined as individuals unable to provide themselves with what the institution provides

for them. The bill specifically disqualifies any organization not recognized as exempt under Section 501(c)(3) of the Internal Revenue Code and certain institutions otherwise qualified under Section 501(c)(3) of the Internal Revenue Code.

5. The institution must relieve the government of some of its burden. This criterion is satisfied if the institution meets any one of six criteria.

The bill provides a rebuttable presumption of exemption for institutions that were exempt under prior law but, for institutions having annual program service revenue of $10 million or more, the presumption applies only if the institution has a voluntary agreement with a political subdivision. A voluntary agreement consists of making voluntary contributions to a political subdivision in the nature of payments in lieu of taxes.

The bill states that it is the policy of the State of Pennsylvania that institutions of purely public charity may not use their tax-exempt status to compete unfairly with small business. The bill prohibits an institution of public charity from funding, capitalizing, guaranteeing indebtedness for, leasing obligations of, or subsidizing a commercial business unrelated to the institution's charitable purpose. A broad range of exceptions are provided for a commercial business intended only for use of employees, staff, alumni, facility, members, students, clients, volunteers, patients, or residents or if the commercial business results in incidental or periodic sales rather than permanent and ongoing sales.

Committee Considerations

A North Dakota Long Term Care Association representative said 90 percent of the 88 long-term care facilities in the state are operated on a nonprofit basis. The representative said the association recognizes the benefits of services provided by political subdivisions. The association representative said it should be remembered that payment of property taxes, if required by law, might not be allowed from some funds received by nursing homes, and if property taxes are to be paid, state reimbursement to nursing homes may have to be increased accordingly.

Assessment officials expressed concerns about the charitable organizations exemption. One difficulty is determining whether property qualifies and another is dealing with public concerns about possible unfair advantages exempt property provides in competing with taxable property. Assessment officials described the statutory exemption as requiring a great deal of legal interpretation, which can result in differences in administration within and across jurisdictions. Another growing problem is how to approach assessment for hospitals, YMCAs, and other organizations providing an expanded range of services in recent years. These expanded activities generate complaints from private businesses about unfair competition being fostered by a property tax exemption. Assessment issues can become extremely complicated when a property is used for charitable purposes and nonexempt activities. This requires a partial assessment against the property, which becomes difficult when there is mixed usage of certain areas.

A representative of the North Dakota Healthcare Association said nonprofit entities are required by Internal Revenue Code standards to not use earnings or donations to benefit private shareholders or others similarly situated; to not pay compensation to directors, officers, and employees based solely upon financial performance of the organization; and to use any excess revenues to further the organization's nonprofit purposes or fund other nonprofit organizations. The association representative suggested that adding criteria to define charitable activities can become extremely complex and lead to an unworkable, narrow test that becomes an accounting exercise and does not adequately address the range of activities engaged in by nonprofit organizations.

A representative of the Nature Conservancy stated opposition to limiting ownership of property in North Dakota by nonprofit organizations. The Nature Conservancy pays property taxes on all of its property in the state, although the property is exempt by law. The organization is very selective in the property it acquires in the state and seeks to acquire property only having rare, threatened, or endangered species or natural communities. Nearly all of the grasslands owned by the Nature Conservancy are under active grazing.

The committee considered a bill draft patterned after 1997 Pennsylvania law which established specific criteria to determine what constitutes charitable use of property for property tax exemption purposes. Committee members said it would be useful to establish a workable standard for assessors to fairly distinguish charitable activities from those that should not be eligible for property tax exemptions. Committee members were critical of the approach in the Pennsylvania law as being too complicated and placing too much emphasis on tracking revenues and expenses. Committee members said the Pennsylvania law was obviously directed toward hospitals and does not adequately address other charitable organizations.

The committee considered a bill draft that limited the property tax exemption for property of hospitals to those areas of a building essential to providing inpatient services. Committee members said hospital activities have changed substantially in recent years, hospitals now have enormous budgets, and health care customers are now paying for services that did not exist several years ago like sports medicine, women's health centers, screening services, and other efforts. These activities were described as intended to expand operations and the client base for the hospitals and as encroaching in areas that should be left to private enterprise. Committee members did not support the bill draft approach because of concern about its effect on small town medical facilities and the difficulty assessment officials would have to determine which portions of a facility would be exempt as being essential for inpatient services.

The committee considered a bill draft that limited a nonprofit organization to ownership of no more than 16,000 acres of land in this state. Committee members expressed concern that farm property is being removed from production by acquisition by nonprofit organizations, which hurts the local economy and diminishes the tax base. Committee members said the approach in the bill draft did not address legislative concerns about protecting the tax base and would probably depress land prices. Committee members said legislation should not deprive the owner of property of the opportunity to sell property to whom the owner chooses.

Recommendation

The committee recommends House Bill No. 1051 to allow imposition of special assessments by cities against exempt property of charitable organizations. The bill allows a city to establish a special assessment district composed only of property of charitable organizations. The bill allows imposition of special assessments by the governing body of a city for the proportionate share of costs of police and fire protection and infrastructure expenditures paid from the budget of the city. The bill limits the amounts that may be levied against subject properties based on comparison of the value of those properties to the value of taxable property in the city. Committee members said the bill would provide local flexibility in determining whether and at what level special assessments would be imposed. The bill gives cities an option to require charitable organizations to pay for the value of certain city services in the same manner they pay special assessments for property improvements under existing law, because the services contribute to the value of the property.

PROPERTY TAX RELIEF STUDY

Background Property Tax Liability Determination

Property tax liability is determined by multiplying applicable taxing district mill rates times the taxable value of the property. Property taxes are collected by the county and distributed among taxing districts according to their interests in the revenues.

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 budget and adjustments may be made. 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 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 the levy limitations established by law. Since 1981, state law has allowed political subdivisions to levy a percentage increase in dollars over the amount levied in the base year, as an alternative to the use of statutory mill levy limitations. Most taxing districts in the state use this optional method of determining the maximum levy. From 1981 through 1996, taxing districts were allowed a percentage increase in dollars over the base year levy amount in dollars. After 1996 NDCC Section 57-15-01.1 allows taxing districts using the optional method of determining levy limits to maintain the amount levied in dollars in the base year, but levies subject to this limit may not be increased without voter approval. During taxable years 1997 and 1998, an exception is provided for a county, city, township, or school district eligible for federal funds on a matching basis as a result of a disaster declared by the President of the United States to allow an increased levy in dollars equal to the amount required to match federal funds, up to an increase of two percent more than the amount levied in the base year.

The county auditor determines whether the amount levied by a taxing district is within the statutory limitations that apply to the district levy and divides the total property taxes to be collected for the taxing district by the taxing district's total taxable valuation. The result is a percentage that is the mill rate for the district.

Real property must be assessed with reference to its value on February 1 of each year. All property must be valued at its true and full value. True and full value is defined as the value determined by considering any earning or productive capacity, the market value, and all other factors that affect the actual value of the property. For agricultural property, valuation is determined by a productivity formula. The assessed valuation of property is 50 percent of true and full value. Taxable valuation of property is nine percent of assessed valuation for residential property and 10 percent of assessed valuation for agricultural, commercial, and centrally assessed property. Taxable valuation is the amount against which the mill rate for the taxing district is applied to determine tax liability for individual parcels of property.

Committee Considerations

In 1960 property taxes accounted for 55 percent of all taxes collected in North Dakota. In 1992 property taxes accounted for less than 34 percent of all taxes collected in North Dakota. From 1960 to 1984, property taxes as a percentage of all taxes steadily decreased. Taxes collected by the state were about equal to property tax collections in 1970. By 1984 the state share of total tax collections was at 73 percent, a maximum for the period from 1960 through 1992. Since 1984 the trend has reversed and property taxes as a share of total tax collections are increasing.

The relative share of collections among tax types shifted since 1960. The most notable change is that property taxes decreased as a percentage of total tax collections since 1960. The greatest reduction in property tax collections occurred after 1969 when personal property was exempted and eliminated from the local property tax base. Increases in the sales tax rate and a business privilege tax were used to offset the loss of tax revenue resulting from exemption of personal property. Energy tax collections peaked in 1982 due to high prices but declined substantially after 1982. The loss in energy tax revenues after 1982 was replaced by increasing sales tax and individual income tax revenues. State sales and use taxes are the dominant force in state and local tax collections in North Dakota, exceeding property tax collections. Reliance on sales and property taxes is heavy, accounting for almost three-fourths of all taxes collected in North Dakota.

Shares of the total property tax burden for residential and commercial properties have increased. Agricultural property owners paid 38.2 percent of statewide property taxes in 1984 and that percentage declined to 31.7 percent in 1998 while residential property owners' share of statewide property taxes increased from 33.2 percent to 38.1 percent in the same period. Centrally assessed and commercial properties retained approximately equal shares of the tax burden during that time period. It appears there has been a shifting of tax burden from agricultural to residential property, but examination of county data shows this has not been uniform in all counties. Only eight counties collect more property taxes from residential than agricultural property but because these are the eight highest population counties, their effect skews statewide comparisons. Lower population counties still place an extremely high reliance on property tax revenue from agricultural property.

During the years 1981 through 1997, statewide agricultural property valuation declined by 1.5 percent while residential property valuation increased 57.6 percent and commercial property valuation increased 52.3 percent. In the years from 1993 through 1997, agricultural property had valuation increases of 3.3 percent or less per year, except for a 9.3 percent valuation increase in 1996. In the same time period residential property valuations statewide increased by almost seven percent per year and commercial property increased approximately 3.5 percent per year. The fact that valuations increase does not mean that property taxes will increase, because property tax liability is a function of valuation, rate of tax, and the mix of property types in the jurisdiction. If property taxes in a jurisdiction remain the same, a property's valuation could increase, but the property tax bill for the property would go down if the valuation of other property in the jurisdiction has a greater percentage increase in value.

The committee reviewed information on major state and local tax collections to try to determine whether an abnormal increase has occurred in property taxes in North Dakota over a period of 20 years. Reliance on property taxes as a percentage of total tax collections declined slightly from 1992 through 1997. Property taxes have shown a steady rate of growth in recent years, but the increase is slightly less than the increase for other tax types.

School district property taxes are responsible for most of the increase in property taxes from 1983 through 1997. In 1983 school districts levied 43 percent of all property taxes, and in 1997 they accounted for 51 percent of the total. Increases in property tax reliance across the state have not been uniform, and there is evidence that tax increases for agricultural property in certain areas of the state have been more severe than in other areas.

The committee reviewed information comparing effective tax rates for various property classifications. Effective tax rate is calculated by dividing the amount of property tax by the market value of the property. The purpose of the comparison is to determine whether property taxes are increasing or decreasing more than the market value of property. A higher effective tax rate means a higher property tax compared to market value. The 1996 effective tax rate for agricultural property was 1.04 percent compared to 1.86 percent for residential property, 2.24 percent for commercial property, and 1.74 percent for utility property. Although agricultural property has the lowest effective tax rate, the effective tax rate for agricultural property doubled from 1983 to 1991 and has remained approximately stable since then.

The committee reviewed information comparing average income among regions of the state on a per capita basis. In 1986 per capita income among regions was in a relatively narrow range from $11,157 to $13,461. By 1996 per capita income had stratified to show greater income differences from $15,905 to $23,117 among the regions. Areas with lower per capita income generally coincide with areas where heavy reliance for property tax revenues is placed on agricultural property. This creates concern that the impact of property taxes is felt more keenly in some areas of the state, particularly where agricultural income has been below par.

Most concerns expressed to the committee about the need for property tax relief related to agricultural property. Because these issues led the committee into examination of the agricultural property valuation formula and classification and assessment of inundated agricultural property, the committee requested and received authority from the Legislative Council chairman to conduct a separate study of assessment and taxation of agricultural property and inundated lands. The results and recommendation of that study are described under **Agricultural Property Assessment Study** in this report.

As property valuations and property taxes continue to increase, concerns were raised about the impact on persons 65 years of age or older with limited income. Such people are eligible for the homestead credit to relieve some of the impact of property taxes. The homestead credit is limited based on income, and committee members were concerned that these income limitations must keep pace with inflation so the benefit of the credit is not lost to those it was intended to help.

Recommendation

The committee recommends House Bill No. 1052 to increase income limits for eligibility for the homestead credit by $500 in each income category. The credit is based on five income categories, with the maximum benefit available to a person whose annual income is $7,500 or less and no benefit to a person whose income exceeds $13,500. The bill would raise the maximum annual income to qualify for the exemption from $13,500 to $14,000. Committee members said state law must preserve the benefit of the homestead property tax credit for persons 65 years of age or older with fixed or limited income. If those individuals receive a modest cost of living increase in income but lose the homestead credit as a result, the net effect would impose a hardship. Because the state reimburses political subdivisions for the cost of the homestead credit, the bill is anticipated to have a fiscal impact to the state, and it is estimated that the increased cost will be less than $200,000 per biennium.

AGRICULTURAL PROPERTY ASSESSMENT STUDY

Background

True and full value of agricultural property for property tax purposes is based on productivity, as established through computation of the capitalized average annual gross return of the land made by the North Dakota State University Department of Agricultural Economics. Annual gross return for rented land is determined from crop share or cash rent information and for other land is 30 percent of annual gross income for cropland used for growing crops other than sugar beets or potatoes, 20 percent of annual gross income for cropland used for growing sugar beets or potatoes, and 25 percent of gross income potential based on animal unit carrying capacity of the land for land used for grazing animals. Average annual gross return for each county is determined by using annual gross returns for the county for recent years, discarding the highest and lowest annual gross returns from those years, and averaging the returns for the remaining years. Passage of House Bill No. 1069 (1997) extended the number of years of production data used in the agricultural property valuation formula from six years to 10 years. The bill makes this change in increments by use of seven years' data in 1997, eight years' data in 1998, nine years' data in 1999, and 10 years' data after 1999. Average annual gross return is then capitalized using a 10-year average of the most recent 12-year period for the gross Farm Credit Services mortgage rate of interest. An average agricultural value per acre is established 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 with an estimate of the average agricultural value of agricultural lands within the assessor's district. The assessor determines the value of each assessment parcel within that district. Within each county and assessment district, the average of values assigned must approximate the averages determined under the formula for the county or assigned to the district by the county director of tax equalization. In determining relative values, local assessment officials are to use soil type and soil classification data whenever possible.

Committee Considerations

Recent increases in agricultural property valuations in the state generated many complaints to legislators. Many farmers in the state are frustrated because a time of poor production and low commodity prices has been accompanied by increased agricultural property valuations and property tax burdens.

In 1996 average assessed value of agricultural land increased more than nine percent statewide. This substantial jump in values resulted because of the years used in the formula. For 1996 assessments, the 1988 drought year was replaced by 1994 good production year statistics. In addition, the capitalization rate has been declining steadily, which produces higher valuations. Passage of 1997 House Bill No. 1069 eased the effect of these factors by including an additional year of production data to computation of agricultural property valuations, resulting in a decrease of almost 3.5 percent in 1997 average agricultural values per acre statewide compared to what would have been determined under the formula before the 1997 amendment. As additional years of data are added to the formula, the formula should generate more stable property valuations.

The committee reviewed detailed data on calculation of county average agricultural values per acre for several individual counties, including counties in the Devils Lake Basin experiencing difficulties because of inundation of agricultural property. The formula reflects the fact that land has been flooded because reported cropland acreage under the formula has diminished. However, nonproducing cropland is ignored in the formula and the average agricultural value per acre for the county is determined only on the basis of statistics for producing acreage. This artificially inflates the average agricultural value per acre for the county because the valuations for all agricultural property in the county must approximate the county average valuation as determined under the formula, and inundated land must be assessed as agricultural property. If the county assigns lower values to inundated lands, values of other agricultural property must be inflated to allow the average for all agricultural property to approximate the county average. The county is faced with the choice of keeping an unnaturally high valuation for inundated land or placing an unnaturally high valuation on property that remains in production. Representatives of counties in the Devils Lake Basin told the committee that they are having enormous difficulties with requests for abatement of inundated property, and that this in turn causes substantial problems for valuation of agricultural property that remains in production. It was suggested that the formula be adjusted to allow inundated lands to be excluded from consideration in agricultural property valuations. It was suggested that in addition to existing agricultural property classifications of cropland or noncropland, a third category should be created for inundated agricultural property.

The committee received a resolution signed by county commissioners from 10 counties stating that an increase in valuation for agricultural property is unacceptable in view of the current farm economy. The resolution requested assistance from the Legislative Assembly in restraining agricultural property valuations, particularly in counties in the Devils Lake Basin, where the lake has inundated vast amounts of farmland. The State Board of Equalization has recently granted several counties authority to reduce agricultural property valuations below the statewide average agricultural value per acre as determined under the valuation formula. The board concluded that following the law precisely would impose a hardship within these counties. This action was cited as evidence that the agricultural property valuation formula does not adequately address problems that arise in agricultural property valuation when a substantial amount of agricultural property is inundated.

The capitalization rate used in the agricultural property valuation formula was criticized as being too influential on valuations because a minor reduction in interest rates results in significant increases in valuation as established by the formula. The formula was also criticized for failing to account for costs of production because if farmers' costs of production increase while all other factors remain stable, farmers' net income will decrease but land valuation will remain the same. This was described as a deficiency in the formula because the formula is supposed to measure productivity, which should include consideration of all factors affecting farm income. The committee received information that farm production costs have increased approximately 67 percent in 10 years while yields have increased by 7.5 to 8 percent over that time period and prices received for products have declined.

The committee reviewed an analysis of the effect of restricting changes in the capitalization rate used in the agricultural property valuation formula. Based upon assumptions about what will happen to interest rates, it was estimated that limiting the capitalization rate to no less than 10 percent would result in land valuation reductions of approximately 2.5 percent per year, with a total reduction of approximately 14 percent by the year 2007. The committee obtained an analysis of the effect on agricultural property valuation of including a component in the valuation formula based on the National Agricultural Statistics Service annual index of prices paid by farmers. It was estimated that use of this component would decrease agricultural property valuations statewide by approximately two percent per year. The cumulative effect of this change would be a reduction of approximately 25 percent in agricultural property assessed valuation by the year 2010 as compared to values determined under the formula without use of the cost index.

The committee recognized that including a production cost index in the agricultural property valuation formula would decrease agricultural property values, and that this change would have differing effects in different counties. Whenever agricultural property valuations are decreased, there will be a resulting shift of tax burden to other types of property unless valuations of those properties decrease even more. Because the mix of agricultural, residential, commercial, and utility property within counties is different, the effect of reduction of agricultural property valuations and resulting shift of property tax burden is different for each county. This effect will be minimal in counties in which substantial amounts of residential, commercial, and utility property exist to absorb the shifting tax burden but will have a more pronounced effect in counties in which agricultural property makes up a high proportion of the property tax base. The committee requested an analysis of this change, which was completed after the committee's final meeting and which bears out the committee's concern. The analysis shows that effects on agricultural property valuations are variable for different counties. Over a period of 10 years, including a production cost index in the agricultural property valuation formula, and assuming all other factors remain the same, could result in an agricultural property tax decrease of 5.3 percent and a residential property tax increase of 17.1 percent in Benson County, an agricultural property tax decrease of 5.7 percent and a residential property tax increase of 15.1 percent in Nelson County, and an agricultural property tax decrease of 8.5 percent and a residential property tax increase of 10.6 percent in Walsh County. For the same time period, an agricultural property tax decrease of 21.4 percent would be accompanied by a residential property tax increase of 1.4 percent in Grand Forks County, an agricultural property tax decrease of 11.6 percent would be accompanied by a 1.1 percent residential property tax increase in Cass County, and a 12.9 percent agricultural property tax decrease would be accompanied by a 2.9 residential property tax increase in Williams County.

Recommendations

The committee recommends Senate Bill No. 2052 to create a separate category for inundated agricultural land for valuation purposes. The bill limits the county average valuation for inundated lands to 10 percent of the valuation of noncropland for the county. Establishing a separate classification category for inundated land will allow these lands to be assigned reduced valuations without affecting the valuation of other agricultural property in the county. This will address a significant problem that has arisen for counties in the Devils Lake Basin, where it has been necessary to transfer valuation from inundated agricultural lands to agricultural lands that remain in production. This will not solve the problem of loss of property tax revenue from inundated lands but will give counties a way to avoid the need to receive requests for abatements for inundated lands and the need to artificially inflate valuations of productive agricultural property. The bill defines inundated agricultural land as property that is unsuitable for growing crops or grazing farm animals for a full growing season or more due to the presence of water. The bill requires that classification of a parcel of property as inundated agricultural property must be approved by the county board of equalization for each taxable year. This will avoid the need for granting abatements but still allow the county to have decisionmaking authority to review the productive status of the property. The bill provides that valuation of individual parcels of inundated agricultural property may recognize the probability of whether or not the property will be suitable for production in the future.

The committee recommends Senate Bill No. 2053 to limit the capitalization rate in the agricultural property valuation formula to no less than 10 percent and no more than 11 percent. Under current law, the capitalization rate is one-half of the determinant of agricultural property valuations. Limiting the capitalization rate fluctuation will avoid extreme effects on agricultural property values when interest rates are abnormally high or low.

The committee recommends Senate Bill No. 2054 to incorporate use of an index of prices paid by farmers in the agricultural property valuation formula. The bill requires establishing a base year index of prices paid by farmers which would be compared with an average of those costs over the most recent 10 years. Changes in prices paid by farmers would be factored into the valuation formula to increase valuations if costs decline or decrease valuations if costs increase. The index would be based on annual statistics prepared by the National Agricultural Statistics Service.

FARM BUILDINGS PROPERTY TAX EXEMPTION STUDY

Background

Farm residences and farm buildings other than residences are exempt from property taxes under NDCC Section 57-02-08(15). The provision relating to farm residences is much more detailed than the provision relating to other farm buildings. The exemption for residences provides criteria to determine what qualifies as a farm and who qualifies as a farmer and imposes income limitations. The exemption for farm buildings other than residences does not apply to any structure or improvement used in connection with a retail or wholesale business other than farming, any structure on platted land within the corporate limits of a city, or any structure located on railroad-operating property.

The North Dakota Supreme Court decision in *Butts Feed Lots v. Board of County Commissioners*, 261 N.W.2d 667 (1977) concluded that a feedlot operation was an industrial activity and the property did not qualify for the farm buildings exemption. The Supreme Court found that contract feeding of cattle not owned by the owner of the facility is an industrial activity and that raising cattle owned by the owner of the facility is an industrial activity if the feed for the cattle is not grown onsite. The Supreme Court also said an operation may be industrial if replacement animals are not raised onsite. The Tax Commissioner adopted guidelines that are intended to follow the Supreme Court decision. The guideline for animals raised and owned by the operator provides that the feed must be primarily grown by the person raising the animals and the enterprise must be operated in connection with or incidental to an ordinary farming operation.

1995-96 Interim Committee Considerations

The 1995-96 interim Taxation Committee study of the farm buildings exemption arose because of events that transpired in

Richland County, although the topic is of relevance in each county in the state. In 1995 a large turkey-raising operation was established in Richland County. Richland County officials assumed that the property would not qualify for the farm buildings exemption under the *Butts* analysis. During consideration of this issue, however, Richland County officials recognized that several existing operations raising turkeys, cattle, or hogs would also become taxable under the Tax Commissioner's guidelines adopted to implement *Butts*. Several issues arose regarding application of these guidelines in specific instances and Richland County officials decided to seek a legislative solution to clarify when the farm buildings exemption applies.

Richland County officials said the impact to Richland County's road budget for maintenance of the road to the new turkey facility exceeds normal costs of maintenance for a county road by approximately $28,000 per year. The road in question is subjected to high-volume truck traffic due to the existence of the turkey-raising operation. Committee members asked whether granting county authority to levy special assessments for road damages would alleviate the problem. Richland County officials said levying special assessments in the situation at hand would not resolve the problem because several properties under different ownership abut the road, but traffic attributable to only one property is responsible for most of the road deterioration.

The committee considered several factors to distinguish industrial or commercial operations from agricultural operations, but none of the factors provided a solution without problems. Basing the exemption on whether the farmowner owns the animals that are being fed would require monitoring ownership of animals. Basing qualification for the exemption on the source of feed, as was done by the Supreme Court in *Butts*, requires monitoring feed and may force operators to grow their own feed when it could be a better management decision to purchase feed from off the farm. Basing the exemption on whether the owner lives on the site might unduly restrict a person's freedom to choose where to live. Limiting the number of paid employees could result in loss of jobs for employees above the limit. Limiting the value of farm buildings eligible for exemption would require assessment of all farm buildings. Causing excessive road repairs for the county or township could involve arbitrary decisions on who is responsible for road damage. Limiting the number of animals raised would require establishment of an accurate count of animals at any time of year and different limitations would be required for different kinds of animals. Basing the exemption on whether replacement animals are raised on the farm, as was discussed by the Supreme Court in *Butts,* was described as inappropriate for some kinds of animals and an interference with management decisions. The committee discussed eliminating the farm buildings exemption and offsetting the property tax increase by a corresponding reduction in taxes against agricultural land. This would eliminate the need to determine who qualifies for the farm buildings exemption. However, this would reduce the tax burden for persons who own agricultural land but have few or no buildings or do not actively farm the land, including nonresident landowners.

The 1995-96 interim Taxation Committee made no recommendation on the farm buildings exemption study. The committee did not agree with the criteria established under the Supreme Court's *Butts* decision but could not find a workable, fair method to distinguish farming operations. Committee members expressed preference for flexibility to allow common sense decisions by local governing bodies, over establishing statutory criteria that might be excessively rigid and unfair in some situations. Recent events in other counties indicate there is likely to be continued growth in the number and impact of livestock and poultry feeding operations, and the chairman of the Legislative Council assigned this subject to the interim Taxation Committee to continue the study.

Committee Considerations

The income limitations for the farm residence exemption were examined. Net income from farming or ranching as interpreted by the Tax Commissioner includes income from producing unmanufactured products of the soil, poultry, or livestock, or from dairy farming. This includes taxable farm income for income tax purposes and excludes income from custom work. Interest expense is deducted from income if it was incurred in the farm or ranch operation and was deducted in computing taxable income. Net income from farming or ranching does not include cash rent, mineral leases or royalties, wages or salaries, interest income from contract for deed payments on sale of farmland, or any other income not specifically included in farm income for federal income tax purposes. Depreciation of farm equipment is treated like other farming expenses and is deducted from gross revenues to determine net income from farming activities. A Tax Commissioner representative said obtaining and verifying net farm income information can be difficult.

Ward County officials informed the committee that it recently came to their attention that a beginning farmer cannot qualify for the farm residence exemption because the statutory provision defines a farmer as one who has not received more than 50 percent of annual net income from nonfarm sources during any one of the three preceding calendar years. The problem with this provision is that any individual who is just starting farming will be disqualified from the exemption because the person would have no farm income history to qualify under the statutory provision. Committee members were surprised that this statutory provision has existed for many years and has not been interpreted to cause problems for beginning farmers. Committee members said it would be appropriate to change the statutory provision to encourage efforts of individuals to begin farming.

The North Dakota Ag Coalition, Stockmen's Association, Turkey Growers Association, and Farm Bureau suggested that the criteria established by the North Dakota Supreme Court in *Butts* are inappropriate in the current farm economy. These criteria were described as management decisions that are based on economics and efficiency. The Ag Coalition recommended limiting the definition of farm activities to raising or growing unprocessed agricultural products, regardless of feed source. An Ag Coalition representative said determining what constitutes processing of agricultural products should be the key to whether the exemption applies and suggested that anything involved with final preparation of the product for human consumption would be considered processing.

Another issue that was brought to the committee's attention involves establishing assessed valuations for tax-exempt farm buildings and residences. The state supervisor of assessments said farm buildings and residences are not required to be assessed or valued under 1997 legislation but a preexisting law originally enacted in 1897 requires assessors to establish values for all property except governmental property. It was suggested that the law be amended to exclude farm buildings and residences from the properties for which values must be established.

Recommendations

The committee recommends House Bill No. 1053 to allow beginning farmers to qualify for the farm buildings property tax exemption. The bill defines a beginning farmer as one who has begun occupancy of a farm within the three preceding calendar years, who normally devotes the majority of time to farming activities, and who does not have a history of farm income for each of the three preceding calendar years.

The committee recommends House Bill No. 1054 to eliminate consideration in farm buildings tax exemption decisions of the criteria established by the North Dakota Supreme Court in *Butts*, based on whether the farmer grows or purchases feed for animals, whether the farmer owns the animals, whether replacement animals are produced on the farm, and whether the farmer is engaged in contract feeding of animals. The bill provides that buildings are not eligible for the exemption if they are primarily used for processing to produce a value-added physical or chemical change in an agricultural commodity beyond the ordinary handling of that commodity by a farmer prior to sale. The language is intended to allow flexibility of interpretation by assessment officials to recognize ordinary farm practices but exclude processing that goes beyond ordinary handling.

The committee recommends House Bill No. 1055 to provide that farm buildings and residences are not among the properties for which assessors must establish a valuation.