TAXATION COMMITTEE

The Taxation Committee was assigned four studies. Section 13 of Senate Bill No. 2032 (2007) directed a study of property tax reform and relief for taxpayers, with the goal of reduction of each taxpayer's annual property tax bill to an amount not more than 1.5 percent of the true and full value of property. Section 3 of Senate Bill No. 2178 (2007) directed a study of allocation of oil and gas tax revenues to or for the benefit of political subdivisions. Senate Concurrent Resolution No. 4021 (2007) directed a study of the income tax laws, with emphasis on adjustments necessary to minimize or negate the impact to any taxpayer of establishing a single, uniform income tax return for all individuals. Senate Concurrent Resolution No. 4031 (2007) directed a study of political subdivisions that receive property tax revenue and any changes that may increase the efficiencies of local governments and reduce property taxes.

In addition to the study assignments, the Legislative Council assigned to the committee the responsibility under Section 3 of House Bill No. 1303 (2007) to monitor county implementation of soil type and classification data from detailed and general soil surveys for property tax assessment purposes.

Committee members were Senators Bob Stenehjem (Chairman), Dwight Cook, Ben Tollefson, Constance Triplett, and Herbert Urlacher and Representatives Larry Bellew, Wesley R. Belter, David Drovdal, Glen Froseth, Craig Headland, Gil Herbel, Jim Kasper, Scot Kelsh, Mark S. Owens, Arlo Schmidt, Benjamin A. Vig, Dave Weiler, and Dwight Wrangham.

The committee submitted this report to the Legislative Council at the biennial meeting of the Council in November 2008. The Council accepted the report for submission to the 61st Legislative Assembly.

PROPERTY TAX REFORM AND RELIEF STUDY

Background

The directive for this study was included in the major property tax relief legislation of 2007--Senate Bill No. 2032. Senate Bill No. 2032 was introduced by the Legislative Council upon the recommendation of the 2005-06 interim Finance and Taxation Committee. As introduced, the bill provided a general fund appropriation of approximately $74 million for property tax relief and provided for allocation of the appropriated amount among school districts. The bill provided adjustments to reduce school district property tax levy authority by the amount of property tax relief to be received by each school district. The bill established an allocation process based on the number of mills levied by each school district above 111 mills.

Senate Bill No. 2032

Senate Bill No. 2032 was the subject of extensive discussion and amendments. The bill was passed in a form substantially different from the bill as introduced. The bill as enacted contained provisions regarding these three areas--property taxes, income taxes, and funding.

Property Taxes

1. Homestead credit property tax income eligibility was increased $17,500 and the maximum value of property exempt was increased $75,000.
2. The amount of an assessment increase for property which triggers the requirement for written notice to the property owner was reduced from 15 percent to 10 percent. The time the notice must be delivered to property owners was increased from 10 days to 15 days before the meeting of the local board of equalization.
3. In school district elections for unlimited or increased general fund levy authority, the ballot must specify the number of mills, percentage increase in dollars levied, or that unlimited levy authority is proposed for approval and the number of taxable years for which the approval is requested. Approval of unlimited or increased school district general fund levy authority was limited to 10 taxable years. The number of petition signatures required to place the question of discontinuing increased or unlimited school district general fund levy authority on the ballot was reduced from 20 percent of the persons in the school census to 10 percent of the number of electors who cast votes in the most recent school district election.
4. Real estate and mobile home tax statements must provide three columns showing for the current year and the two preceding years the property tax levy in dollars against the property by the county and school district and any city or township that levied taxes against the property.

Income Taxes

1. An income tax marriage penalty credit of up to $300 per couple was provided to offset any marriage penalty incurred for couples with incomes up to $154,200. The credit is determined by comparing the tax on the couple's joint North Dakota taxable income and the tax that would apply if the couple's income were separated and taxed at the single filer rate.
2. A homestead income tax credit was provided for individuals for taxable years 2007 and 2008 in the amount of 10 percent of property taxes or mobile home taxes that became due during the tax year and have been paid on the individual's homestead--i.e., the dwelling occupied as a primary residence in this state and any residential or agricultural property owned by the individual in this state. Property taxes eligible for the credit do not include special assessments. The amount of the homestead income tax credit for a year may not exceed $1,000 for married persons filing a joint return or $500 for a single individual or married individuals filing separate returns. Persons owning property together must share one credit for that parcel of property in

percentages equal to their ownership interests in the property.

The amount of the homestead income tax credit exceeding the taxpayer's income tax liability may be carried forward for up to five years or the taxpayer may request that the Tax Commissioner issue the taxpayer a certificate in the amount of the excess. A certificate issued to a taxpayer may be used by the taxpayer against property or mobile home tax liability during the ensuing taxable year by delivering the certificate to the county treasurer of the county in which the taxable property or mobile home is subject to taxes. The county treasurer is to forward redeemed certificates to the Tax Commissioner, who will issue payment to the county in the amount of the certificates. The estimated reduction in general fund revenues for 2007-09 is $112 million from the homestead income tax credit. If the total amount of homestead income tax credits claimed by November 15, 2008, exceeds $47 million, the rate of the credit is subject to adjustment to limit the amount of revenue impact in the second year of the biennium.

3. A commercial property income tax credit was provided for an individual or corporation for taxable years 2007 and 2008 in the amount of 10 percent of commercial property taxes or commercial mobile home taxes that became due during the income tax year and have been paid. Property taxes eligible for the credit do not include any special assessments. The amount of the credit for commercial property for a year may not exceed $1,000 for any taxpayer and is limited for individuals to $1,000 for married persons filing a joint return or $500 for a single individual or married individuals filing separate returns. Persons owning property together must share one credit for that property in percentages equal to their ownership interests in the property. A passthrough entity entitled to the commercial property income tax credit must allocate the amount of the credit in proportion to ownership interests in the passthrough entity. The amount of the commercial property income tax credit exceeding the taxpayer's tax liability may be carried forward for up to five years. If the total amount of credits claimed for commercial property exceeds $7 million on November 15, 2008, the Tax Commissioner may adjust the maximum amount of the credit to control the revenue impact from the credit for the second year of the biennium.

Funding

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

Property Tax Determination and Collection

The property tax liability of a property owner is determined by multiplying combined mill rates for all taxing districts in which the property is located times the taxable value of the property. All locally assessed property taxes are collected by the county and distributed among appropriate taxing districts. Property taxes are due January 1 following the year of assessment and are payable without penalty until March 1 of the year they are due. If property taxes are paid in full by February 15, the taxpayer is entitled to a 5 percent discount. Penalties begin to accrue if property taxes are not paid by March 1. Taxpayers have the option of paying property taxes in installments.

Determination of Mill Rate

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

The amount budgeted by a taxing district may not result in a tax levy exceeding levy limitations established by statute. Since 1981 the Legislative Assembly has provided optional authority to levy taxes with a maximum amount determined by comparison with a base year levy amount in dollars.

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

Local Assessment

Real property must be assessed with reference to its true and full value on February 1 of each year. Residential and commercial property is assessed by local assessors. True and full value is determined by considering the earning or productive capacity, if any; the market value, if any; and all other matters that affect the actual value of the property. For agricultural property, true and full value is based on a productivity formula. The assessed value of property is equal to 50 percent of the true and full value of the property (North Dakota Century Code (NDCC) Section 57-02-01).

Taxable valuation of property is a percentage of assessed valuation, which is 9 percent for residential and 10 percent for agricultural, commercial, and centrally assessed property. The mill rate for the taxing district is applied to the taxable valuation to determine the tax liability for property.

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

Central Assessment

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

Property Tax Statistics and Political Subdivision Revenues

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

	Percentage of Statewide Property Taxes and Special Taxes[1] Levied in 2006	Percentage Increase in Property Taxes and Special Taxes[1] Levied 1993 Through 2006
School districts	55.57%	94.3%
Counties	23.71%	78.2%
Cities	13.08%	78.6%
City park districts	4.56%	116.3%
Townships	1.74%	33.4%
Rural fire protection	.60%	78.0%
Garrison Diversion	.20%	108.3%
Soil conservation districts	.19%	142.0%
State Medical Center	.25%	81.1%
Other[2]	.10%	50.0%

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

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

From 1993-95 to 2007-09 there has been an increase of 66.2 percent in state appropriations and revenue allocations to political subdivisions. This can be compared with an increase of 88.1 percent in political subdivisions' property taxes and special taxes levied from 1993 to 2006.

Home Rule Sales Taxes

Another significant source of revenue for cities and counties is revenue from home rule sales taxes. Grand Forks imposed the first city home rule sales tax in 1985. In 1990, six cities imposed home rule sales taxes. By 2008 home rule sales taxes have become a significant revenue source for 118 cities and 3 counties. The following table illustrates the growth in home rule sales tax collections for selected years:

Fiscal Year	Home Rule Sales Taxes
1996	$36,534,413
2000	$58,711,263
2004	$68,644,864
2006	$87,563,544

Special Assessments

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

$50 in property tax collections for each $1 in special assessments collections. In Stark County, the ratio is 85-to-1. In Ward County, the ratio is 42-to-1. In Morton County, the ratio is almost 7-to-1. In Cass County, the ratio is almost 5-to-1.

Committee Consideration

From 1983 through 2006 property taxes collected in North Dakota more than tripled from about $230 million to more than $700 million. The most notable change during that time period among the four property classifications is that agricultural property went from paying 37 percent to 25 percent of all property taxes and residential property went from paying approximately 32 percent to 45 percent of all property taxes.

Much of the reason for the shift in property tax burden to residential property is attributable to the fact that there has been a significant increase in the amount of residential property and the amount of agricultural property has remained about the same. The other significant factor is that the market value of all property has increased substantially, but agricultural property is the only property classification that is not assessed based on market value. For 2007 it appears that 64 percent of increased residential property taxable value was due to valuation increases of existing property and approximately 36 percent of increased residential property taxable value was attributable to new residential property.

Another means of comparing the relative burden of property taxes among classifications and among taxing jurisdictions is determination of an effective tax rate for property. An effective tax rate is determined by dividing total property taxes by the true and full valuation of the property. The resulting percentage is the effective tax rate. The effective tax rate varies among taxing districts. On a statewide basis, the 2007 effective tax rate was 1.9 percent for residential property, 2.21 percent for commercial property, and 1.61 percent for agricultural property. However, the effective tax rate for agricultural property for 2007 based on market value was .81 percent because the market value for agricultural property is approximately twice the true and full value of agricultural property determined under the agricultural property valuation formula.

The committee obtained an analysis of valuation and property tax payment changes for the years 1997 to 2007 for actual parcels of agricultural and residential property from six different counties. During those years pastureland had the lowest rate of increase in valuation (29 percent) and property taxes paid (28 percent). Cropland had an increase of 31 percent in valuation and 30 percent in property taxes paid. City residential properties had an increase of 43 percent in valuation and 38 percent in property taxes paid. Rural residential property had an increase of 50 percent in valuation and 47 percent in property taxes paid.

The state's share of elementary and secondary education funding declined from 58.5 percent in 1981-82 to 39.7 percent in 2005-06. During this time period, school district property taxes levied increased from $63 million per year to $329 million per year despite the fact that state funding increased from $207 million to $342 million and federal source funding increased from $23 million to $120 million.

The Tax Department administered the property tax relief credits against income tax liability under Senate Bill No. 2032. The department believes the property tax relief program was successful in providing tax relief to citizens. Preliminary reports were that more than $5 million had been provided to individual taxpayers in property tax certificates and more than $37 million in income tax credits had been provided to individual and corporate taxpayers. Although there were still tax returns to be filed, the Tax Department believed at the time that it would not be necessary to adjust the credit for the second year of the biennium. However, the department described problems encountered in administration of the property tax relief programs. Some of the issues may be resolved through legislative changes, but many of the issues cannot be solved due to inherent differences between property tax and income tax concepts and the numerous ways in which title to property can be held. The Tax Department recommended that without substantial changes to the program, the income tax is not the best delivery system for property tax relief.

During the interim the Governor announced plans to introduce legislation during the 2009 Legislative Assembly to provide property tax relief through allocations of funds to school districts and required reductions in school district property tax levies. The Lieutenant Governor described the proposal to the committee, calling for allocation of $200 million in the 2009-11 biennium for statewide school district mill levy reductions to replace the current property tax relief allocation based on the income tax system. Under the plan, funds would be distributed on a per student basis with factors used for weighted student units to fit a permanent education funding formula combined with a reduction in school district general fund property tax levy authority equal to $200 million. Later in the interim, the Governor suggested that the property tax relief amount would be increased to $300 million. The Governor also recommended additional funding of $100 million for school districts without the requirement of a property tax levy reduction. The Governor's Commission on Education Improvement was examining the mechanics of delivery of property tax relief under the proposal.

In 2008 petitions were filed to place an initiated measure on the November 4, 2008, general election ballot to reduce individual income tax rates by 50 percent and corporate income tax rates by 15 percent. The estimated fiscal effect of the measure for the 2009-11 biennium is a reduction in state general fund revenues by more than $414 million. One of the most significant administrative difficulties with property tax relief provided through the income tax system under Senate Bill No. 2032 is the large number of taxpayers whose refund exceeds income tax liability and requires issuance of a property tax credit certificate. The Tax Department estimated that if the initiated income tax measure is approved by the voters, an additional 15,000 certificates would have to be issued to taxpayers.

The two most practical approaches to provide property tax relief are by allocations to school districts to reduce school district tax levies or by allocation of property tax credits through the income tax system. Both options were complicated by developments during the interim. The Governor has announced a plan to provide allocations to school districts to reduce property tax levies. Details of how the funds will be allocated among school districts and how property tax levy limitations will be imposed were not finalized by the Governor's Commission on Education Improvement when the Taxation Committee held its final meeting. This made it difficult for the committee either to react to the proposal or initiate consideration of a similar proposal. The income tax option was complicated by the filing of a petition that placed an initiated measure on the general election ballot to cut income tax rates by half. The income tax option also was complicated by difficulties encountered by the Tax Department in administering the income tax relief program under 2007 legislation.

Conclusion

The committee makes no recommendation regarding property tax reform and relief.

OIL AND GAS TAX ALLOCATION STUDY

Background

North Dakota imposes two separate taxes on oil production--the oil extraction tax and the oil and gas gross production tax. Only under the oil and gas gross production tax are any direct revenue allocations made to political subdivisions.

Oil Extraction Tax Allocation

On November 4, 1980, the voters of North Dakota approved initiated measure No. 6 on the general election ballot and established an oil extraction tax as a companion tax to the oil and gas gross production tax that had existed since 1953. The oil extraction tax rate was established at 6.5 percent of the gross value of oil at the well.

In June 1990 the Constitution of North Dakota was amended to establish the resources trust fund as a constitutional trust fund and to provide that the principal and income of the fund could be spent only upon legislative appropriations for constructing water-related projects, including rural water systems and energy conservation programs. The constitutional provision, Article I, Section 22, of the Constitution of North Dakota, allows the Legislative Assembly to determine the share of extraction or production tax revenues which will go to the resources trust fund.

In November 1994 the voters of North Dakota approved a constitutional amendment, Article X, Section 24, of the Constitution of North Dakota, to provide that 20 percent of oil extraction tax collections be divided in equal amounts to the common schools trust fund and the foundation aid stabilization fund (used to offset any foundation aid funding reductions resulting from allotments pursuant to NDCC Section 54-44.1-12).

In 1995 the Legislative Assembly established the current allocation formula for oil extraction taxes which is 20 percent to the resources trust fund; 20 percent pursuant to Article X, Section 24, of the Constitution of North Dakota; and 60 percent to the state general fund.

Oil and Gas Gross Production Tax Allocation History

The oil and gas gross production tax was imposed in 1953 at a rate of 4.25 percent of gross value at the well of oil and gas. In 1957 the rate of the tax was increased to the current rate of 5 percent. The total net proceeds collected from the gross production tax increased from $306,000 in fiscal year 1954, to over $76 million in fiscal year 1982, and to over $104 million in fiscal year 2006. Current forecasts estimate gross production tax collections to exceed $250 million per year for the 2009-11 biennium.

From 1957 to 1981 revenue from the first 1 percent of gross value at the well of oil and gas produced was credited to the state general fund and the balance was distributed as follows:

1. Of the first $200,000, 75 percent to the producing county and 25 percent to the state general fund.
2. Of the next $200,000, 50 percent to the producing county and 50 percent to the state general fund.
3. All remaining revenue, 25 percent to the producing county and 75 percent to the state general fund.

A 1981 amendment did not change the disposition of the first 1 percent of gross value at the well of oil and gas produced which is credited to the state general fund, but remaining tax revenue from oil and gas produced in each county was reallocated as follows:

1. Of the first $1 million, 75 percent to the producing county and 25 percent to the state general fund.
2. Of the next $1 million, 50 percent to the producing county and 50 percent to the state general fund.
3. All remaining revenue, 25 percent to the producing county and 75 percent to the state general fund.

The overall effect of the 1981 amendment was to give each producing county $600,000 per year more than before 1981 if that county generated $2.5 million or more in annual gross production tax revenue.

Caps, or maximums, upon annual revenues producing counties could receive from the gross production tax were imposed in 1981 based on county population. Amounts exceeding a county cap were retained in the state general fund. Although the caps were scheduled to expire in 1983, the caps were increased by $100,000 in each population category and were extended to 1985. In 1985 the caps were made permanent at the following levels:

1. For counties with a population of 3,000 or fewer - $3,900,000.
2. For counties with a population from 3,001 to 5,999 - $4,100,000.
3. For counties with a population of 6,000 or more - $4,600,000.

Beginning in 1981, county revenues were distributed 45 percent to the county general fund, 35 percent to the school districts within the county, and 20 percent to the incorporated cities within the county. The 1981 legislation also imposed caps upon revenues that could be received by school districts and cities. School districts were limited to a maximum of 70 percent of the county per student cost times the number of students in attendance or in the school census, whichever was greater, unless the district had an average daily attendance or school census fewer than 400, in which case that district could receive up to 120 percent of the county average per student cost times the number of students in attendance or in the school census, whichever was greater. Incorporated cities were limited to a distribution not exceeding $500 per capita in any fiscal year. Amounts exceeding the caps for school districts or cities reverted to the county general fund.

In 1989 an allocation was provided of up to $5 million per biennium from the first 1 percent of oil and gas gross production tax revenues to the oil and gas impact grant fund and a continuing appropriation was provided in that amount for allocation by the Energy Development Impact Office to oil and gas-impacted political subdivisions. In 2005 the allocation for the oil and gas impact grant fund was increased from $5 million to $6 million per biennium beginning with the 2007-09 biennium.

Senate Bill No. 2178 (2007) allowed a county that reaches the annual cap on oil and gas gross production tax revenue to receive an additional $1 million in revenues if the county levies a total of at least 10 mills for county road and bridge, farm-to-market and federal aid road, and county road purposes. The additional $1 million of revenues to counties is not for allocations for political subdivisions in the county but must be credited entirely to the county general fund. Proponents of the bill said counties are experiencing increased road impact and increased road maintenance costs.

House Bill No. 1044 (2007) increased allocations to a producing county from oil and gas gross production taxes by revising the schedule for division of revenues between the producing county and the state general fund as follows:

1. The first $1 million is allocated to the producing county.
2. Of the next $1 million, 75 percent goes to the producing county and 25 percent to the state general fund.
3. Of the next $1 million, 50 percent goes to the producing county and 50 percent to the state general fund.
4. All remaining revenue is distributed 25 percent to the producing county and 75 percent to the state general fund.

The net effect of House Bill No. 1044 for a county is a potential increase in allocations to the county of up to $750,000 per year. The allocation change in House Bill No. 1044 became effective August 1, 2008.

Special Provisions Affecting State General Fund Allocation of Oil and Gas Tax Revenues

Under NDCC Section 57-51.1-07.2, all revenue deposited in the state general fund exceeding $71 million during a biennium from combined oil and gas gross production taxes and oil extraction taxes must be transferred to the permanent oil tax trust fund. Earnings of the permanent oil tax trust fund may be transferred to the state general fund at the end of each fiscal year, but the principal of the permanent oil tax trust fund may not be expended except upon a two-thirds vote of the members elected to each house of the Legislative Assembly. Because this is a statutory provision, the two-thirds vote requirement does not apply to subsequent legislative action.

Under NDCC Section 57-51.1-07.3, 2 percent of the state's share of oil and gas gross production tax and oil extraction tax revenues must be deposited in the oil and gas research fund, not exceeding $3 million per biennium. All money deposited in the oil and gas research fund is provided as a continuing appropriation to the Oil and Gas Research Council.

In 2007 the Legislative Assembly approved House Concurrent Resolution No. 3045 for placement of a measure on the state general election ballot in November 2008 to establish a constitutional permanent oil tax trust fund. If approved by the voters, the measure will require all oil and gas production or extraction tax revenue exceeding $100 million during a biennium to be transferred to the permanent oil tax trust fund. The measure would require interest earnings of the permanent oil tax trust fund to be transferred to the general fund at the end of each fiscal year. The measure would prohibit expenditures from the principal of the permanent oil tax trust fund except upon a vote of three-fourths of the members elected to each house of the Legislative Assembly and not more than 20 percent of the principal could be expended during any biennium. If approved by the voters, the measure will become effective on July 1, 2009. If the measure is approved by the voters, Senate Bill No. 2178 repeals the statutory provision for a permanent oil tax trust fund under NDCC Section 57-51.1-07.2 effective July 1, 2009.

Energy Development Impact Grant History

In 1975 the Legislative Assembly established a coal severance tax and a coal impact aid program. The Coal Development Impact Office was established within the Governor's office and was provided an appropriation of $5 million for grants to cities, counties, school districts, and other taxing districts impacted by coal development.

In 1979 the Coal Development Impact Office was moved from the Governor's office to the Board of University and School Lands. In 1981 the Coal Development Impact Office was renamed the Energy Development Impact Office and the office was authorized to provide impact grants for coal development and oil and gas development. By 1987 impact grant funding dwindled to approximately $1 million for coal and $2 million for oil.

In 1989 coal taxes were restructured and coal impact grants were eliminated. Since 1989 oil impact grants have been administered by the Energy Development Impact Office under a continuing appropriation of $5 million per biennium for grants. Under 2007 legislation the continuing appropriation for oil impact grants was increased to $6 million per biennium.

Committee Consideration

The North Dakota Association of Oil and Gas Producing Counties commissioned a study by an NDSU research scientist to identify oil and gas impact costs to producing counties. The study attempted to isolate local government costs attributable to oil and gas development and exclude consideration of the normal cost increases of local government which are experienced by all political subdivisions. The study identified increased workloads and costs for general county offices and county road departments. The study concluded that the total general county office impact costs and county road impact costs attributable to oil and gas impact falls within a range of $36.9 million to $45.2 million per year.

The committee heard a substantial amount of testimony from local government officials from the oil and gas impact area. Local officials described the many kinds of increased costs to local government from oil and gas development impact, not the least of which is that it is difficult for local government to attract and retain employees because salaries offered by local government are not competitive with salaries offered in the oil industry.

The Department of Transportation provided information on extraordinary road and bridge impact costs. The drilling rig count in North Dakota is at a level that has not been seen since about 1983. Oversized vehicle permits issued by the department increased more than 16 percent from 2006 to 2007. The department estimated truck movement associated with oil and gas production at a daily average of 4,575 truckloads. The total of materials and equipment needed at the site of a vertical well is 400 truckloads and for a horizontal well the total is 600 truckloads to 1,000 truckloads. In addition to equipment hauled to drilling sites, oil, water, and equipment must be hauled away from drilling sites. Trucks haul approximately 65 percent of oil production, while pipelines carry approximately 35 percent of oil to refineries. Saltwater recovered in drilling operations must be disposed of, and approximately 35 percent is hauled by truck totaling more than 23,000 truckloads per year.

The number of oil drilling rigs in the state has been on a steady increase during 2007 and 2008. Horizontal wells in the Bakken Formation took an average of 65 days to complete in 2007 and the industry has reduced the drilling time to an average of 29 days for those wells in 2008. The Department of Mineral Resources expects that before the activity in current drilling areas is completed, every section of land in Dunn County and Mountrail County will have an oil well on it. The department expects the trend in drilling activity will be for drilling permit areas to move north and west from Mountrail County, and that Burke County and Divide County will probably be the next areas of extensive oil exploration. As oil production increases and the production areas expand, a growing level of impact will be experienced by a greater number of counties.

The committee reviewed the details of the oil and gas impact grant rounds conducted in 2007 and 2008. In 2007, 377 grant requests were received requesting a total of more than $40 million. The total amount requested was inflated by a request for $17.4 million from Williams County for a combined law enforcement and correctional center. The total amount awarded for all grants in 2007 was $2,471,000, which was the full amount available. Almost half of the amount awarded in 2007 went to townships for township road impacts because townships receive no direct allocation of oil tax revenues.

In 2008, 376 grant requests were received totaling $29.1 million. The Energy Development Impact Office awarded 265 grants totaling $3 million to 241 political subdivisions. Over 75 percent of grant funds were allocated to transportation projects and over 17 percent went to support fire protection services. Disqualifying factors applied in evaluating grant applicants include a large cash balance on hand, a low mill levy, or large amounts of unused grants from previous years.

The committee obtained fiscal information on removing statutory caps on oil and gas gross production tax allocations to counties and to the impact grant fund. Removing caps on statutory allocations of revenue to producing counties would reduce state general fund or permanent oil tax trust fund revenue by $42 million per year. Most of the benefit of increased revenues to counties would be received by Bowman and Mountrail Counties, which would receive a combined total of $30 million per year additional revenue. Eliminating the $6 million cap on deposits in the oil and gas impact grant fund would increase revenues to the impact grant fund by $28.4 million per biennium, with a corresponding reduction in permanent oil tax trust fund revenue. Impact funding is viewed as a critical component of funding for political subdivisions because such funding is targeted to areas of demonstrated impact need that is not adequately addressed by direct allocations.

Recommendation

The committee recommends Senate Bill No. 2051 to eliminate statutory caps on oil and gas gross production tax allocations to counties and to eliminate the cap on allocations to the oil and gas impact grant fund.

INCOME TAX STUDY

Background

In 1919 the state's first income tax law was enacted. In 1923 the state income tax was linked to the federal income tax provisions. Income tax rates were adjusted in 1933, 1953, 1973, and 1978.

In 1981 the Legislative Assembly created a simplified optional method of computing individual income taxes (the "short-form" method) which allowed most individual income taxpayers a substantial income tax liability reduction. The simplified optional method of computing individual income tax liability provided that individual liability was equal to 7.5 percent of an individual's adjusted federal income tax liability. The preexisting method of determining income tax liability based upon a percentage of federal taxable income ("long-form" method) was retained, and, since that time, taxpayers have had the option of filing under either of the two different methods. For the great majority of individuals, the short form provides a considerably lower tax liability than the tax determined using the long-form return.

In 1983 several legislative changes combined to increase individual tax liability:

1. Elimination of the $100 energy cost relief credit created by 1980 initiated measure No. 6.
2. Increase of the tax rate on the short-form return from 7.5 percent to 10.5 percent of adjusted federal income tax liability.
3. Adjustment of the rates on the individual long-form return to provide rates ranging from 2 percent of taxable income up to $3,000 and 9 percent on taxable income in excess of $50,000.

During a 1986 special session, legislation was passed to provide mandatory state income tax withholding for all employees subject to federal income tax withholding, to increase the short-form tax rate from 10.5 percent to 14 percent of federal tax liability, and to increase long-form rates by a corresponding amount to provide a highest rate of 12 percent on income exceeding $50,000. The 1986 legislative changes were referred to the electorate and were approved by voters on March 18, 1987.

In 1987 a 10 percent surtax on state individual income tax liability was created to apply for taxable year 1987.

In 1989 the Legislative Assembly increased the short-form income tax rate from 14 percent to 17 percent of adjusted federal income tax liability and increased long-form rates by corresponding percentages. The legislation providing these rate increases was referred and disapproved by the voters in the December 1989 special election.

In 2001 the Legislative Assembly revised the application of the short-form method. This change eliminated reliance on federal income tax liability as a starting point for the short-form return and substituted use of federal taxable income as the starting point to calculate North Dakota taxable income. This change was made because a substantial federal income tax reduction was anticipated, which would have had a substantial negative revenue impact to the state, the amount of which was unknown during the 2001 legislative session. The revised short-form method is roughly equivalent to the previous method because it applies a set of graduated tax rates that are 14 percent of the federal tax rates at the time and the rates are applied to five income brackets that were established to mirror federal brackets at that time. In addition, the 2001 legislation established use of the same inflation indexing factor that applies under federal law so that the income brackets will keep pace with changes to federal income brackets. To reflect the fact that the vast majority of taxpayers file under the short-form method, the statutory reference to an "optional" method of computing tax was moved from the short-form to the long-form return method. In addition, references to short form and long form were replaced with references to "Form ND-1" (previous short form) and "Form ND-2" (previous long form). The income brackets established by the 2001 legislation for Form ND-1 are unchanged in the statutory provision (NDCC Section 57-38-30.3). However, the income amounts in the brackets are subject to indexing in the same manner federal income brackets are indexed, and because of application of annual indexing, actual income brackets for taxable year 2007 are substantially higher than the income brackets that appear in the statutory provision.

Recent Changes

In 2007 an income tax marriage penalty credit of up to $300 per couple was created to offset any marriage penalty incurred for couples with incomes up to $154,200. A homestead income tax credit was created for individuals for taxable years 2007 and 2008 in the amount of 10 percent of property taxes or mobile home taxes that become due during the tax year and have been paid on the individual's homestead--i.e., the dwelling occupied as a primary residence in this state and any residential or agricultural property owned by an individual in this state. The amount of the homestead income tax credit may not exceed $1,000 for married persons filing a joint return or $500 for a single individual or married individuals filing separate returns. The amount of the homestead income tax credit exceeding a taxpayer's income tax liability may be carried forward for up to five years or the taxpayer may request that the Tax Commissioner issue the taxpayer a certificate in the amount of the excess. A certificate issued to a taxpayer may be used by the taxpayer against property or mobile home tax liability during the ensuing taxable year by delivering the certificate to the county treasurer of the county in which the taxable property or mobile home is subject to taxes. The county treasurer is to forward certificates redeemed in payment of tax obligations to the Tax Commissioner, who is to issue payment to the county in the amount of the certificates. A commercial property income tax credit is provided for an individual or corporation for taxable years 2007 and 2008 in the amount of 10 percent of commercial property taxes or commercial mobile home taxes that became due during the income tax year and have been paid. The amount of the credit for commercial property for a year may not exceed $1,000 for any taxpayer and is limited for individuals to $1,000 for married persons filing a joint return or $500 for a single individual or married individuals filing separate returns. An individual and corporate income tax credit was created for angel fund investments, internship employment, and workforce recruitment for hard-to-fill employment positions, and the income tax credit for research and experimental expenditures was expanded to apply to individual taxpayers. The aggregate amount of seed capital investment tax credits allowed was increased from $2.5 million to $3.5 million for each calendar year and biofuels production facilities were added to businesses for which agricultural business investment tax credits are available. Angel fund investments were allowed under the seed capital investment income tax credit. The purchaser of a geothermal, solar, or wind energy device installed after December 31, 2006, was allowed to claim the income tax credit for such devices if ownership of the device is transferred to the purchaser at the time installation is complete. Biomass energy devices were added to devices eligible for the income tax credit for geothermal, solar, or wind energy devices. Assignment of a wind energy device installation income tax credit was allowed but assignment may be made only to the purchaser of the power from the device under a power purchase agreement or a taxpayer that constructs or expands an electricity transmission line in North Dakota after August 1, 2007. An individual income tax deduction for up to $5,000, or $10,000 on a joint return, was created for contributions under a higher education savings plan administered by the Bank of North Dakota. The individual income tax credit for planned gifts to nonprofit organizations was expanded to provide a corporate income tax credit and to include gifts to qualified endowments. The credit for individuals was increased from 20 percent to 40 percent of the charitable gift and the maximum credit for individuals was increased from $5,000 per year to $10,000 per year or $20,000 for married individuals filing a joint return. The credit allowed for a corporation is 40 percent of a charitable gift to a qualified endowment and the maximum credit for a corporation is $10,000 per year. An individual and corporate income tax credit was created for operation of a microbusiness, defined as a business employing five or fewer employees inside an economically viable small community. A taxpayer certified as a microbusiness is entitled to a credit equal to 20 percent of new investment and new employment in the microbusiness during the taxable year, limited to not more than $10,000 in credits over any combination of years. An individual income tax exemption was provided for income of a taxpayer from activities or sources within the boundaries of any Indian reservation in this state if the taxpayer resides within the boundaries of any reservation in this state and is an enrolled member of a federally recognized Indian tribe.

Committee Consideration

North Dakota has two individual income tax systems, but both systems are essentially long forms. Both forms start with federal taxable income and have several credits and deductions in common. However, there are substantial differences in deductions and credits available on the two forms, and the two forms have vastly different tax rates. The tax rates on Form ND-1 continue to be among the lowest in the nation. The rates on Form ND-2 are at the high end when compared to tax rates around the country. Another significant difference is that Form ND-1 may be e-filed and is supported by electronic filing vendors, which is not the case for Form ND-2.

The committee examined all deductions and credits allowed on Form ND-1 and Form ND-2. Of the deductions available only on Form ND-2, the most significant deductions are for federal income taxes paid, medical expenses not allowed on the federal return, military retirement pay, and interest income from North Dakota financial institutions. The most significant tax credits available only on Form ND-2 are for long-term care insurance and contributions to nonprofit private high schools or colleges.

Despite the fact that more deductions and credits are available on Form ND-2, only approximately 2 percent of income tax returns are filed on Form ND-2 and those returns pay less than one-half of 1 percent of income tax collections.

Sampling by the Tax Department of income tax returns indicates that the average savings for the typical Form ND-2 filer over what the filer's liability would be on Form ND-1 is approximately $25. It appears there is generally a tax preparation cost involved in filing Form ND-2. Of approximately 6,500 Form ND-2 returns processed in 2007, only 233 were prepared by the taxpayers themselves. Costs associated with preparation of two income tax returns by tax practitioners probably offset or eliminate some of the savings for taxpayers.

Approximately two-thirds of Form ND-2 filings are by nonresidents. In addition, some individuals who file on Form ND-2 would achieve a reduced income tax liability if they filed on Form ND-1.

The estimated biennial fiscal effect of moving all deductions and credits from Form ND-2 to Form ND-1 is a revenue loss of approximately $99 million to $117 million.

It was estimated that the Tax Department would save approximately $25,000 per biennium if Form ND-2 were eliminated, and the department would have to administer only one income tax return form. It was estimated that if Form ND-2 were eliminated the fiscal effect to the state would be a revenue gain of approximately $150,000 per year.

If the voters of the state approve the initiated measure to reduce only Form ND-1 individual income tax rates by 50 percent, which is on the November 2008 general election ballot, there would be no taxpayer who would benefit from filing on Form ND-2.

The committee considered, but did not approve, a bill draft to eliminate Form ND-2 and make a small adjustment in Form ND-1 rates to make the bill approximately revenue-neutral. Committee members pointed out that even though the bill draft was approximately revenue-neutral to the state, some individual taxpayers would have a resulting income tax increase due to losing the option of filing Form ND-2.

Conclusion

The committee makes no recommendation regarding the income tax study.

POLITICAL SUBDIVISION EFFICIENCY STUDY

Background

The Constitution of North Dakota allows agreements, including those for cooperative or joint administration of any powers or functions, to be made by any political subdivision with any other political subdivision, with the state, or with the federal government. The Legislative

Assembly has enacted statutory provisions for joint powers agreements among political subdivisions and with tribal governments. Statutory authority is provided for joint exercise of governmental powers, joint issuance of bonds for projects, county or city home rule, combined county and city home rule, and transfer of local government powers to the county in which a political subdivision is located. In short, North Dakota law provides ample opportunities for political subdivisions to combine, consolidate, or receive approval from voters to exercise their authority in ways that are most efficient for the taxpayers.

Committee Consideration

The objective of the committee was to determine whether political subdivisions are using authority provided by law to achieve efficiency in local government administration, whether there are provisions of law that require change to provide greater opportunity for efficiency, and whether there are aspects of local government administration in which it would be appropriate to mandate consolidated or cooperative administration.

During the past 25 years, counties have taken the initiative to consolidate and share services in appropriate circumstances. Examples of intercounty consolidation of services exist in the state for social service administration, correctional services, child protection investigation, software sharing and hosting, child care assistance eligibility, 911 dispatch services, public health services, tax director services, in-home services, county superintendents of schools, county state's attorneys, and children's special health services. There are numerous examples of consolidation of services involving the county working with cities and other political subdivisions. These sharing arrangements involve services for mandated drug and alcohol testing, special operations support, technology support, marriage license software, office supply purchasing, workers' compensation and safety, 911 implementation, and record preservation. Counties also provided examples of internal consolidations resulting in a net reduction from 2003 to 2007 of 75 full-time county officials.

The North Dakota Association of Counties pointed out an issue faced by some counties with a constitutional residency requirement for county offices and filling the office of state's attorney when the county does not have an attorney who is a resident of the county. The committee deferred consideration of this issue in light of the study of this issue by the Advisory Commission on Intergovernmental Relations.

The North Dakota Association of Counties described a 1996 study done at NDSU regarding consolidation of counties and county services. The conclusion of the study was that forcing consolidation of counties and county services will not always result in reduced costs for county government services. The report pointed out that substantial cost-savings could be achieved for some services in some regions of the state, but those results cannot be expected for all services in all regions. It was suggested that it is most appropriate to provide flexibility for political subdivisions to work together to find methods to consolidate or combine services with other political subdivisions to achieve greater efficiency in providing services to the public.

Conclusion

The committee makes no recommendation regarding the study of political subdivision efficiency.

SOIL SURVEY IMPLEMENTATION FOR AGRICULTURAL ASSESSMENTS

Background

Since 1981 state law has required county assessment officials, whenever possible, to use soil type and soil classification data from detailed and general soil surveys in determining relative value of agricultural lands within the county. During consideration of legislation in 2007, the Legislative Assembly discovered that most counties have not implemented use of soil surveys in assessments and, as a result, there is a lack of uniformity among agricultural property assessments in the state. House Bill No. 1303 made it mandatory for counties to use soil survey information in agricultural assessments and set a deadline to require all counties to implement use of soil surveys by taxable year 2010 or a noncomplying county would incur withholding of 5 percent of the county's allocation from the state aid distribution fund until the county implements use of soil survey information.

Committee Consideration

At the request of the committee, the Property Tax Division of the Tax Department developed criteria to determine when a county has fully implemented soil survey use in assessments. The Tax Department worked with the North Dakota Association of Counties, assessment officials, and state geographic information system personnel to assist counties in implementing the use of soil surveys and agricultural assessments. After reviewing the status of each county, the Tax Department determined that 19 counties are in the early stages of implementation of use of soil surveys, 13 counties are in transition to full implementation, and 21 counties are fully compliant with use of soil surveys in agricultural assessments. Every county is at least in the process of implementing use of soil surveys. However, the committee was advised that several counties would not be able to meet the deadline of 2010 for full implementation of use of soil surveys and agricultural assessments.

Recommendation

The committee recommends Senate Bill No. 2052 to extend the deadline for county implementation of soil survey use in agricultural assessments from 2010 to 2012.