Report of the

PROPERTY TAX MEASURE REVIEW COMMITTEE

submitted to the

NORTH DAKOTA LEGISLATIVE MANAGEMENT

May 2012

Representatives
David Drovdal, Chairman
Larry Bellew
Wesley R. Belter
Tracy Boe
Chuck Damschen
Glen Froseth
Joyce Kingsbury
Kim Koppelman
Ralph Metcalf
Dan Ruby
Clark Williams
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Steven L. Zaiser

Senators
Dwight Cook
Joe Miller
Carolyn C. Nelson
Dave Oehlke, Vice Chairman
Ronald Sorvaag

Legislative Council Staff
Becky Keller, Senior Fiscal Analyst

PROPERTY TAX MEASURE REVIEW COMMITTEE

The Property Tax Measure Review Committee was assigned the responsibility of studying the potential effects of initiated measure No. 2 appearing on the primary election ballot on June 12, 2012, to prohibit imposition of property taxes.

Committee members were Representatives David Drovdal (Chairman), Larry Bellew, Wesley R. Belter, Tracy Boe, Chuck Damschen, Glen Froseth, Joyce Kingsbury, Kim Koppelman, Ralph Metcalf, Dan Ruby, Clark Williams, Lonny B. Winrich, and Steven L. Zaiser and Senators Dwight Cook, Joe Miller, Carolyn C. Nelson, Dave Oehlke, and Ronald Sorvaag.

STUDY OF THE POTENTIAL EFFECTS OF INITIATED MEASURE NO. 2

Background

Summary of Initiated Measure

Initiated measure No. 2 would amend Sections 1, 4, 14, 15, and 16 and repeal Sections 5, 6, 7, 9, and 10 of Article X of the Constitution of North Dakota to eliminate property taxes, poll taxes, and acreage taxes, effective January 1, 2012. The measure would require the Legislative Assembly to develop a formula to replace the lost property tax revenue with allocations to political subdivisions from state-level revenues.

Related Legislation

North Dakota Century Code Section 16.1-01-17 provides that at least 90 days prior to the statewide election at which an initiated measure will be voted upon, the Legislative Council is to coordinate the determination of the estimated fiscal impact of the initiated measure. The Legislative Management is to hold hearings, receive public testimony, and gather information from agencies and institutions relating to the estimated fiscal impact of the initiated measure. At least 30 days prior to the election, the Legislative Council is to provide information regarding the estimated fiscal impact to the Secretary of State, who shall include a notice within the analysis of the initiated measure specifying where copies of the statement of the estimated fiscal impact of the initiated measure can be obtained.

Section 16.1-10-02(1) provides that no person may use any property belonging to or leased by the state or any state agency or any service which is provided by the state or a state agency or political subdivision for any political purpose. The definition of political purpose included in Section 16.1-10-02(2) was amended by the Legislative Assembly in 2011 Senate Bill No. 2327 to include a statewide initiated or referred measure, a constitutional amendment or measure, and a political subdivision ballot measure. The Legislative Assembly in 2011 also amended subsection 2 to provide that "[f]actual information may be presented regarding a ballot question solely for the purpose of educating voters if the information does not advocate for or against or otherwise reflect a position on the adoption or rejection of the ballot question."

Property Tax

Property tax is assessed on the value of all real property unless the property is specifically exempted. Except for a one-mill levy for the University of North Dakota School of Medicine and Health Sciences, property taxes are determined, levied, collected, and expended at the local level for support of schools, counties, cities, townships, and other local political subdivisions. The property tax is determined by multiplying a mill rate times the real property's taxable value. A mill rate is the amount of tax paid per dollar of the taxable value of property. One mill is equal to one-tenth of one cent or $1 for each $1,000 of taxable value. The mill rate is determined by dividing the total taxes to be collected (revenue needs) in each taxing district by the total taxable value of property within the district. The total taxes to be collected is determined by the governing body of the political subdivision through the budgeting process but subject to maximum levy limitations established by statute.

Taxable Value

Taxable value of property is determined based on the true and full value and the assessed value of the property. The true and full value of residential and commercial property is the local assessor's estimate of the market value of the property. For residential property, the assessed value is 50 percent of the true and full value, and the taxable value is 9 percent of the assessed value. For commercial property, the assessed value is 50 percent of the true and full value, and the taxable value is 10 percent of the assessed value.

The true and full value of agricultural property is based on productivity and is calculated by North Dakota State University (NDSU) using the capitalized average annual gross return of the land. The Tax Commissioner receives information from NDSU and certifies to the county directors of tax equalization the estimated average true and full agricultural value of farm and grazing land in each county. The assessed value of agricultural property is 50 percent of the true and full value, and the taxable value is 10 percent of the assessed value.

Property tax assessments for railroads, investor-owned public utilities, and airlines are determined by the State Board of Equalization. The assessed value of these centrally assessed properties is 50 percent of the true and full value, and the taxable value is 10 percent of the assessed value.

Other Taxes

Taxes collected in lieu of property taxes include:

- **Telecommunications carriers** - Telecommunications carriers are assessed a tax of 2.5 percent of their adjusted gross receipts by the State Board of Equalization.
- **Rural electric cooperatives** - Effective January 1, 2010, property of rural electric cooperatives is subject to generation, distribution,

and transmission taxes pursuant to Chapter 54-33.2.

- **Coal conversion facilities** - The coal conversion tax is in lieu of property taxes on investor-owned or cooperative electrical generating plants which have at least one unit with a generating capacity of 10,000 kilowatts or more of electricity, other coal conversion facilities which consume 500,000 tons or more of coal per year, or coal beneficiation plants. The lands on which the plants are located remain subject to the ad valorem property tax.
- **Oil and gas gross production tax** - Oil and gas gross production tax is imposed in lieu of property taxes on oil and gas-producing properties. The gross production tax for oil is based on the gross value at the well of oil produced. The gross production tax for gas is an annually adjusted flat rate per thousand cubic feet of all nonexempt gas produced in the state.
- **Tourism or concession license fee** - A license fee in lieu of property taxes is imposed for state-owned property leased from the superintendent of the State Historical Board or the director of the Parks and Recreation Department and used for tourism or concession purposes.
- **Potash** - A tax of 2 percent on the sale price of potash and 4 percent on the gross value of all subsurface mineral byproducts of potash production has been imposed in lieu of property taxes for taxable production occurring after June 30, 2011. The land and processing facility, mining facility, or satellite facility is assessed and taxed the same as other property within the taxing district in which the potash property is located.

Statewide Property Taxes

The committee received the following information relating to statewide average mill rates, property tax valuations, and ad valorem property taxes levied as reported by the Tax Commissioner for taxes payable in 2001 through 2010:

	Average Mill Rate	Taxable Value	Taxes Levied[1]
2001	392.07	$1,298,333,166	$509,032,721
2002	390.33	$1,364,577,713	$532,629,675
2003	392.78	$1,427,642,584	$560,751,909
2004	399.24	$1,468,874,722	$586,412,017
2005	402.70	$1,534,816,263	$618,065,693
2006	401.66	$1,642,672,714	$659,789,374
2007	397.41	$1,777,593,059	$706,427,621
2008	392.15	$1,888,388,390	$740,540,738
2009	390.02	$1,990,645,138	$776,398,475
2010	319.37[2]	$2,125,303,286	$678,749,378[2]

[1]The amounts shown include ad valorem property taxes only and do not include payments in lieu of taxes.

[2]The Legislative Assembly in 2009 Senate Bill No. 2199 provided property tax relief by appropriating $295 million from the general fund to the Department of Public Instruction for allocation to school districts to reduce school district property taxes for the 2009-11 biennium. The funding provides for a reduction of up to 75 mills in school district property tax levies and replacement of the revenue to school districts by providing mill levy reduction grants.

Political Subdivision Bonded Indebtedness

The committee received information regarding bonded indebtedness based on a Legislative Council survey of political subdivisions. The survey was distributed to all cities and counties. Twenty-two cities and 31 counties responded. The most common type of current outstanding debt reported by cities was special assessments accounting for 33 percent and revenue bonds accounting for 28 percent. The most common type of current outstanding debt reported by counties was special assessments accounting for 58 percent and general obligation (GO) bonds accounting for 27 percent. Twelve cities and 11 counties reported future anticipated indebtedness in the next 24 months.

Property Tax Foreclosures

The committee received information regarding the number of properties foreclosed on due to nonpayment of property taxes based on the Legislative Council survey of political subdivisions. The committee learned 30 counties reported a total of 265 properties foreclosed on in 2008, 195 properties foreclosed on in 2009, and 446 properties foreclosed on in 2010.

Types of Bonded Indebtedness

Under current constitutional provisions, a political subdivision's outstanding debt may not exceed 5 percent of the assessed value of taxable property in the political subdivision. The committee received information on the following types of bonded indebtedness that may be incurred by political subdivisions:

- General obligation bonds - Most political subdivisions are authorized to issue GO bonds for building projects, infrastructure, and equipment. At the time GO bonds are issued, Article X, Section 16, of the Constitution of North Dakota, requires an irrepealable tax levy until the bonds are paid.
- Limited tax bonds - Limited tax bonds are payable from property tax, like GO bonds, but are limited to a certain number of mills. Limited tax bonds are considered part of the political subdivisions' constitutional debt limit.
- Certificates of indebtedness - For the financing of current budgets and cashflow needs, North Dakota law permits political subdivisions to issue certificates of indebtedness against anticipated revenues in the form of levied but uncollected taxes and distributions of state and federal funds.
- Special assessment bonds - Cities, counties, and certain other political subdivisions are authorized to finance improvements through special assessments. Public school districts do not have special assessment authority. If special assessment collections are insufficient to pay the bonds, the political subdivision is required to certify an excess mill levy without limit on all taxable property to pay the bonds. Special assessment bonds are not subject to the constitutional debt limit.
- Revenue bonds - Several political subdivisions, including cities, park districts, water districts, and

water resource districts are authorized to issue revenue bonds. Revenue bonds are payable solely from user revenues generated by a particular enterprise or sales tax. Revenue bonds are not subject to the constitutional debt limit.

- Tax increment bonds - Cities are authorized to finance public improvements for slum and blighted areas through the issuance of tax increment financing (TIF) revenue or GO bonds.
- Lease financing - In the context of public finance, lease financing includes various types of agreements, such as installment purchase contracts, installment sales contracts, and purchase orders, in addition to leases. Lease purchase financings result in the acquisition of the building or equipment at the end of the lease term.

Initiated Measure Construction

The committee received information from the Legislative Council legal staff relating to the construction of an initiated measure. The committee learned there is very little, aside from voter approval of a correction, which could be done to correct errors or discrepancies that may be discerned in an initiated constitutional amendment. If the words of the measure are not ambiguous, they must be given effect. If words are ambiguous, established rules of construction may be applied. If the plain meaning or construction of the words yields an undesirable result, the only option is to amend the law, which would require approval of a majority of votes at a statewide election. The only authority for corrections aside from approval at a statewide election would apply to misspelling or grammatical or punctuation errors, and even in those cases, extreme caution would be needed to avoid any substantive change.

Attorney General Opinion

An Attorney General opinion (Letter Opinion 2011-L-10) was issued on November 1, 2011, regarding the effective date of the initiated measure. In his opinion, the Attorney General stated the initiated measure, if approved by the voters at the June 12, 2012, primary election, is retroactively effective as of January 1, 2012.

Analysis of Initiated Measure No. 2

The committee received information from the Legislative Council legal staff relating to an analysis of the initiated measure prohibiting property taxes. The following is a summary of the analysis:

- Effective date - The effective date of the initiated measure, or the date when the measure should be applied, is January 1, 2012. The measure would be effective for the entire 2012 tax year. The measure does not affect taxes levied but not paid by December 31, 2011, because the Supreme Court has ruled that repeal of law does not extinguish the liability of taxes imposed before the law is repealed.
- Elimination of property taxes - If the initiated measure is approved by North Dakota voters in June 2012, property taxes levied on the assessed value of property would be eliminated. This would include elimination of property taxes dedicated to retirement of political subdivision GO bond issues because the taxes levied for those purposes are a tax on assessed value of real property. However, bonded indebtedness is issued under a contractual agreement between the political subdivision and the bondholders that dedicated property taxes will be levied until the bonded indebtedness is retired. This contractual agreement would be "substantially impaired" if the measure is interpreted to remove the authority to levy the property taxes required to make payments to bondholders, which may be a violation of the contract clause of Article 1, Section 10, of the United States Constitution. Therefore, to comply with the United States Constitution, the measure may be interpreted by a court to require property tax levies relating to GO bonds to continue until those bonds issued prior to the effective date of the initiated measure are retired.
- Special assessments - Special assessments would not be eliminated by enactment of initiated measure No. 2. The amount of special assessments against a property is not allowed by law to be based on the assessed value of the property but are required to be based on the property's "just proportion of the total cost of such work" and "not exceeding the benefits" to the property (Section 40-23-07).
- In lieu of property taxes - The following taxes imposed as in lieu of property taxes would not be affected by the initiated measure because they are not based on the assessed valuation of property:

  Oil and gas gross production tax.

  Oil extraction tax.

  Coal severance tax.

  Coal conversion tax.

  Electric generation, distribution, and transmission taxes.

  Telecommunications tax.

  Financial institutions tax.

  Taxes on the following types of property would be eliminated because the payments in lieu of property tax are based on the assessed value of the property:

  Farmland and ranchland owned by nonprofit organizations for conservation purposes.

  Game and Fish Department lands.

  National Guard land.

  Land owned by the Board of University and School Lands or the State Treasurer.

  Carbon dioxide pipelines.

  Devils Lake project land.

  Workforce Safety and Insurance building.

- Replacement of revenue - Because the word "used" is included in subsection 1 of Section 2 of the measure rather than the word "levied," it appears the intention of the drafters of the measure is to require the state to replace expenditures from property taxes rather than levied and collected. Subsection 1 of Section 2 appears to establish a baseline funding level of 2011 calendar year expenditures from real property tax revenues of the political subdivision and certain in lieu of tax revenues. This appears to be the amount of funding the state is required to replace for the political subdivisions.
- Legally imposed obligations - Subsection 3 of Section 2 of the measure requires the Legislative Assembly to allocate a share of state taxes to "fully and properly fund the legally imposed obligations" of political subdivisions. However, because the measure does not define "legally imposed obligations" or "fully and properly fund," the measure appears to provide the Legislative Assembly discretion in determining the proper level of funding.
- Market value of property - Market value is not defined by the measure or by statute, except as one component of determining "true and full value." Even if it is interpreted as equivalent to "true and full value," market value for agricultural property is clearly not the value determined by the productivity valuation formula. It appears that the word "taxable" was removed by the drafters of measure No. 2 because upon enactment there will no longer be "taxable" property. However, removal of the word "taxable" leaves the word "property" standing alone, which includes all property. The plain language of the provision appears to require determination of market value of real and personal property, and the measure does not appear to allow any discretion for the Legislative Assembly to exclude any kind of personal property. Literal application of this language would result in an enormous expansion of assessment responsibilities, costs, and intrusion into what citizens have deemed to be outside the reach of governmental inquiries. This expansion of assessment would serve only the limited purpose of determining debt limits for the state and political subdivisions.

Other Testimony and Information

Initiative Petition Sponsoring Committee

The committee received information from the initiative petition sponsoring committee, including analyses of the provisions of the initiated measure and a report from Beacon Hill Institute commissioned by the sponsoring committee. Analyses provided by the initiative petition sponsoring committee included the following:

- Revenue from property taxes would be replaced with revenues from the proceeds of state sales taxes, individual and corporate income taxes, oil and gas production and extraction taxes, tobacco taxes, lottery revenues, financial institution taxes, and other state sources.
- The state would be required to provide funding for the share of elementary and secondary education not funded through state revenue sources before 2012.
- School boards would have sole discretion of determining expenditures of the new funding provided by the state.
- The state would be required to devise a formula to fully and properly fund the legally imposed obligations of political subdivisions.
- Political subdivisions would have sole discretion of determining expenditures of the funding provided by the state.

The Beacon Hill report included the following estimates:

- Property tax administration costs local governments approximately $25 million per year.
- The elimination of property taxes would increase private sector jobs by 11,789 in the first year.
- The increase in private sector jobs would be offset by the loss of 11,908 public sector jobs in state and local governments.

The Beacon Hill report provided an analysis of three different scenarios for replacement of revenues if the measure is approved by voters. The scenarios included no sales tax increase, increasing sales tax to provide 50 percent of the property tax revenue loss, and increasing sales tax to provide 100 percent of the property tax revenue loss. The report indicates if property taxes are eliminated, the private sector economy would benefit; however, if sales tax rates are increased to replace all or a portion of the property tax revenue loss, many of the benefits would be reduced or become negative.

North Dakota Association of Counties

The committee received testimony from the North Dakota Association of Counties regarding the potential effect of the initiated measure on county revenue sources. The committee learned counties are concerned that if the initiated measure is approved by voters there could be a reduction in services in rural counties, and over time revenues which are meant to replace property taxes will not be sufficient to provide for increased costs in the counties.

North Dakota League of Cities

The committee received information from the North Dakota League of Cities regarding the tax levies in North Dakota cities as follows:

	2010	2009	2008	2007	2006
Cities levying 200 or more mills	5	3	3	3	2
Cities levying 150-199 mills	19	20	19	15	15
Cities levying 100-149 mills	64	66	73	79	84
Cities levying 90-99 mills	23	23	23	27	29
Cities levying 80-89 mills	27	31	38	29	27
Cities levying 70-79 mills	39	48	34	32	34
Cities levying 60-69 mills	38	29	37	35	31
Cities levying 50-59 mills	31	30	29	31	36
Cities levying 40-49 mills	47	48	42	47	37

	2010	2009	2008	2007	2006
Cities levying 30-39 mills	37	34	30	29	36
Cities levying 20-29 mills	5	5	6	6	4
Cities levying 10-19 mills	3	3	5	5	4
Cities levying under 10 mills	6	5	6	5	5
Cities with no levy	13	12	12	14	13
Total number of cities	357	357	357	357	357

North Dakota School Boards Association and North Dakota Council of Educational Leaders

The committee received testimony from the North Dakota School Boards Association and the North Dakota Council of Educational Leaders regarding the potential effect of the initiated measure on school district revenue sources. The committee learned school districts are concerned that the initiated measure would have a significant impact on the funding formula currently in place for school districts and potentially result in inequitable distribution of funding among school districts. The committee also learned that school districts are concerned that total dependence on state funding would prevent school districts from addressing unique needs of each school district.

Other Testimony

The committee received other reports and testimony, including testimony from citizens of North Dakota in support of and opposed to the initiated measure. Opinions expressed to the committee include:

- Property taxes are an ineffective, inefficient method to tax citizens for local services.
- North Dakota Century Code allows for a perpetual lien on property which can be exercised if a person becomes delinquent on the payment of property taxes. The perpetual lien on property is not affected by any statute of limitation.
- Debt levels of local governments are increasing.
- The initiated measure will not result in a reduction in the aggregate tax liability but only how the taxes are paid and who pays them.
- The administrative cost of assessing property is overstated in the Beacon Hill report.
- State and local governments could not eliminate all full-time equivalent positions related to property value assessment because the initiated measure requires the continuation of this assessment to determine debt limits for political subdivisions.

Estimated Fiscal Impact of Initiated Measure No. 2

The committee received information from the Tax Commissioner's office regarding the estimated fiscal impact of initiated measure No. 2. A copy of which is attached as an appendix. The committee learned the measure will repeal ad valorem property taxes effective January 1, 2012. The amount of property taxes that would be eliminated upon successful passage of the measure would total $812,225,000 for 2012. The estimated fiscal impact assumes the effective date of the measure would initially impact and repeal 2012 property taxes that would be due and payable in 2013. The estimated fiscal impact reflects only one year of the 2011-13 biennium. The impact for subsequent bienniums would reflect a two-year period. Based on the historical property tax growth of 7.7 percent per year, the estimated fiscal impact of the measure for the 2013-15 biennium would be $1.8 billion.

The committee discussed the potential need for a special legislative session prior to the 2013 regular session to provide funding to political subdivisions beginning January 1, 2013, if the measure is approved.

ATTACH:1