revenues, total gross receipts tax revenues of almost $6.3 million per year, and sales tax revenues from interstate calls of approximately $2.2 million per year.

Although the proposal was intended to be revenue neutral statewide, elimination of property taxes, expansion of the gross receipts tax, and changes in its allocation would make it extremely difficult to provide each political subdivision with the same revenue it had under previous law prior to the sale of the exchanges. Groups representing political subdivisions suggested that allocation within counties should be on the same basis as property tax revenues. Representatives of political subdivisions opposed exemption of real property of telecommunications carriers on the grounds that services provided by political subdivisions to owners of real property justify retaining local assessment and taxation of that property.

Representatives of an economic development association opposed imposing sales taxes on interstate calls. They said taxing these calls would have a chilling effect on business location and expansion decisions for businesses having a high volume of interstate calls. Committee members also expressed concerns about the impact of gross receipts taxes on businesses having high usage of telecommunications services.

Telecommunications carrier representatives asked that gross receipts taxes not apply to universal service fund collections mandated by federal law and transferred to the universal service fund.

At its final meeting, the committee received conflicting estimates of the fiscal effect of the proposal. By some estimates, it appeared the proposal would have a revenue gain of $1 million per year. Committee members stated opposition to having a proposal with a net increase in taxes and approved a motion to eliminate the provision imposing sales taxes on interstate calls.

Committee Recommendation

The committee recommends House Bill No. 1068 to restructure taxation of the telecommunications industry. The bill eliminates central assessment of telecommunications carrier property, eliminates personal property taxes for telecommunications carriers, and retains real property taxes on telecommunications carriers, subject to local assessment and levies. The bill imposes a tax of two percent of the adjusted gross receipts of any telecommunications carrier doing business in the state. Adjusted gross receipts means the gross receipts of the carrier from telecommunications service charges minus state and local taxes on those charges and minus amounts paid by the carrier to another carrier for directory assistance. Telecommunications service includes transmitting for consideration of any two-way communication, including interstate telecommunications service billed to a station in this state. Taxable telecommunications service charges include the charge for the content of the transmission. A hospital, hotel, motel, or similar place of accommodation selling telecommunications service is subject to gross receipts taxes to the extent it imposes separately stated charges for the service. Amounts collected for or from the universal service fund are not included in gross receipts.

The bill requires telecommunications carriers to file gross receipts tax returns with the Tax Commissioner. The Tax Commissioner is to review the return and report to the State Board of Equalization, which is to assess the tax after consideration of any protest by the taxpayer.

The bill limits gross receipts taxes imposed upon any customer to $20,000 per calendar year. Any charges for that customer beyond that amount are exempt and the gross receipts from exempt sales of the providing telecommunications carrier are exempt.

The bill entitles a telecommunications carrier to a credit against gross receipts taxes in the amount of real property taxes paid during the calendar year on property directly used in telecommunications operations. This credit may be fully or partially transferred between a parent and subsidiary telecommunications carrier.

The bill allocates revenue from the gross receipts tax to counties in the proportion that telecommunications property tax and gross receipts tax revenues within the county bears to all such revenues statewide in 1997. The purpose of this allocation is to assure each county the same proportion of all telecommunications taxes that it received before the changes made by the bill. The bill provides a continuing appropriation to the Tax Commissioner for allocation to counties to avoid the need for biennial legislative appropriations to distribute the revenues. Revenues received at the county level must be allocated within the county on the basis on which general property tax revenues are apportioned and distributed in the county. The bill becomes effective in taxable year 1998.

PROPERTY TAX ASSESSMENT SYSTEM STUDY

Background

Property tax liability is determined by multiplying applicable taxing district mill rates times the taxable value of the property. All locally assessed property taxes are collected by the county and distributed among taxing districts according to their interests in the revenues. 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 five percent discount. Penalties begin to accrue if property taxes are not paid by March 1 but taxpayers have the option of paying property taxes in installments.

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, the Legislative Assembly has provided optional authority to levy a percentage increase in dollars over a base year levy dollar amount. This method is 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. Under Senate Bill No. 2081 (1995), taxing districts may elect to levy two percent more in 1995 and two percent more in 1996 than the amount that was levied in the base year. The bill provides that for taxable years after 1996, taxing districts may elect to levy the amount levied in dollars in the base year, but without a percentage increase.

To determine the mill rate for a taxing district, the county auditor determines whether the amount levied is within statutory limitations on the amount levied in dollars and divides the total property taxes to be collected for the taxing district by the taxing district's total taxable valuation. This results in 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 matters 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 the 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.

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

True and full value of agricultural property is based on productivity as established through computations made by the North Dakota State University Department of Agricultural Economics based on the capitalized average annual gross return of the land. Annual gross return 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 totaling annual gross returns for the county for the most recent six years, discarding the highest and lowest annual gross returns from those years, and dividing the resulting figure by four. 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. Personnel from North Dakota State University determine an average agricultural value per acre for cropland and noncropland on a statewide and countywide basis. This information is provided to the Tax Commissioner by December 1 of each year and then provided by the Tax Commissioner to each county director of tax equalization. The county director of tax equalization provides each assessor with an estimate of the average agricultural value of agricultural lands within the assessor's district. The assessor must determine the relative value of each assessment parcel within that district. In determining relative values, local assessment officials are to use soil type and soil classification data whenever possible.

Property of railroads, public utilities, and airlines is assessed by the State Board of Equalization. The assessment process for centrally assessed property differs from the procedure for locally assessed property. The owner of centrally assessed property must file an annual report with the Tax Commissioner by May 1. The Tax Commissioner prepares a tentative assessment for the property by July 15. Notice of the tentative assessment is sent to the property owner at least 10 days before the State Board of Equalization meeting on the first Tuesday in August. At the State Board of Equalization meeting, testimony is received on the value of centrally assessed property and assessments are finalized. The Tax Commissioner certifies the finalized assessments to the counties, to reflect the portion of centrally assessed property for each property owner which is taxable in that county.

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

Some enterprises make payments in lieu of taxes. Cooperative telephone companies pay a gross receipts tax at a rate based on the number of telephones per mile of line. This tax is paid to counties and the revenue is allocated entirely to school districts.

Rural electric cooperatives pay a gross receipts tax in lieu of property taxes for all property except land. The tax rate is one percent in the first five years of operation and two percent thereafter.

Rural electric cooperatives with generating facilities are subject to a transmission line tax of $225 per mile on transmission lines of 230 kilovolts or more.

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

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

Equalization is the process provided by law to adjust property assessments to be consistent with market value or agricultural value. Property owners who are dissatisfied with assessment levels may initially present their concerns for review by the township board of equalization or the city board of equalization in April. The board of county commissioners meets in June to equalize among assessment districts in the county. The State Board of Equalization meets in August to equalize among counties and districts within a county.

Association of Counties Study

Senate Concurrent Resolution No. 4015 directed the Legislative Council to receive the report on the study conducted by the North Dakota Association of Counties regarding improving technology to improve the property tax assessment system and allow sharing of information and resources among state and local governments. The resolution stated that grant funding was received by the association to conduct a study on improving technology and sharing of resources among state and local governments. The association sought committee members to serve on its task force to study this topic. The request was denied by the Legislative Council chairman. No further action was reported by the association.

Assessing Officers' Concerns

Under Senate Bill No. 2081 (1995), assessment officials in the state must establish assessed valuations for all tax-exempt property in the state by 1998. Assessment officials expressed a number of concerns about this requirement, including a shortage of staff and budget among assessment officials, opposition of city and county governing bodies to paying the increased costs of these assessments, fear of property owners that assessment of exempt property is the first step toward taxing that property, and problems with assessing highway rights of way and other governmental property for which assessors perceive no benefit in determining values.

Association of Assessing Officers representatives agreed that association members could establish valuations for exemptions of limited duration. Association representatives opposed assessing all exempt property but agreed that it would be useful to determine values for property exempted by cities or counties under discretionary authority provided by law for specific purposes. Assessments were conducted by local assessors and survey results were compiled by the Tax Commissioner. The association survey focused on exemptions allowed by law for new residential property, property used for day care, pollution abatement improvements, residential and commercial property improvements, and exemptions and payments in lieu of taxes for new and expanding businesses. Forty-seven counties and 11 cities responded to the survey request. From these responses, it was estimated that more than $261 million of property is exempt under these exemptions, which totals about 1.4 percent of all valuation in the state.

Association of Assessing Officers representatives said the requirement of assessing all exempt property is more extensive than necessary. Association representatives said this would include establishing values for all federal, state, and political subdivision land and buildings, churches, all farm buildings, Indian reservation land and buildings, hospitals, day cares, streets, alleys, state and federal highways, county and township roads and rights of way, and other property. Association representatives said asking local assessors how they would accomplish these assessments yielded responses from many that they would quit before going through conflicts with their neighbors to establish values, especially for farm residences and buildings.

Committee members discussed with assessment officials possibilities of eliminating some exempt property from the property that must be assessed under the law. It was also discussed whether there is a possibility of establishing estimated valuations for property without onsite assessment.

Agricultural Property Valuation

The 1996 valuations for agricultural lands statewide increased by more than 12 percent under the agricultural property valuation formula, causing considerable concern and causing many people to question why the increase was so substantial. The effect of the increase was softened somewhat during actual assessments as finalized by the State Board of Equalization, but actual assessments of agricultural land still increased over nine percent statewide in 1996.

Representatives of the North Dakota State University Department of Agricultural Economics reviewed the computation of agricultural property valuations under the statutory formula. The formula requires use of six years of agricultural production statistics from which the high and low production years are dropped and the remaining four years are averaged. For 1996 assessments, the 1988 drought year was replaced by 1994, which was a good crop year. The capitalization rate for agricultural property is an average of 10 of the most recent 12 years of the former Farm Credit Services mortgage rate of interest for North Dakota. The high and the low years are dropped from consideration and in this assessment year a high interest rate year dropped out of the formula and was replaced by a low interest rate year. The combination of a reduced capitalization rate and increased production averages yielded substantial increases in valuations for 1996.

Comparing valuations for property classifications shows that during the late 1980s and early 1990s residential and commercial property valuations statewide increased while agricultural property values decreased. In 1994 and 1995, increases in agricultural values were less than half of the increases in residential and commercial property values. Shifts in property tax burden among classifications of property occur if all property does not increase uniformly in valuation. When agricultural property valuations were falling and residential and commercial property valuations were increasing, the tax burden shifted away from agricultural property. The 1996 increase in agricultural property valuation caused a shift of some of that burden back toward agricultural property.

Examination of agricultural property valuation changes in each county indicates that the lowest agricultural value increases per acre occurred in eastern North Dakota and the highest increases occurred in western North Dakota. The reason for this difference is that the drought of 1988 was more severe in western North Dakota and that drought year has now worked through and dropped out of the computation of values.

An increase in assessed value of taxable property does not translate into an increase in property taxes. The level of tax is determined by the political subdivision's budget and levy. The committee examined data indicating that a 12 percent increase in agricultural property valuation does not translate into a 12 percent increase in taxes. Depending upon the mix of property types within the taxing district, an increase of 20 percent or more in agricultural property valuation may translate into an increase of less than one percent in property tax liability or may amount to a more substantial increase, but it is very unlikely that the increase in taxes would exactly match the percentage increase in valuation.

The committee reviewed assessments of agricultural property for Richland County. Since 1972, Richland County has used a soils committee to assist in agricultural property valuation. The soils committee has nine members, each representing four townships. The soils committee serves in an advisory capacity to the board of county commissioners and has the primary duty of reviewing soil type valuations and recommending necessary changes. Use of modifiers to adjust the value of cropland within a soil classification was said to be important to establishing fair valuations for certain properties.

The committee reviewed the use of modifiers for valuing agricultural property under state law and guidelines. The Tax Commissioner encourages assessment officials to use modifiers when needed to account for unusual conditions such as wet areas, saline, rocks, wooded areas, inaccessibility, nonconformance, or unusable tracts.

Assessment Automation

Property appraisal relies on analysis of a variety of property characteristics and their effects on sales prices. Use of an automated system allows uniform application of these factors. The committee reviewed automation of assessments in Fargo. The Fargo city assessor uses computer applications to produce the assessment roll, maintain and track exemptions and value trends, prepare the sales ratio study, produce automated appraisals, track building permit work and appeals, and provide the public with responses to information requests. The Fargo city assessor is developing software for local assessment officials after finding no suitable prepackaged software assessment systems on the market.

Suggestions to the Committee

The committee received requests from several township officials to limit the annual increase in statewide agricultural property valuations. The committee considered a bill draft that limited the increase or decrease in valuation of agricultural property in any year.

Representatives of the North Dakota Farm Bureau opposed limiting agricultural property valuation changes on the grounds that this would distort the valuation formula. They suggested that the extent of valuation changes could be reduced by expanding the number of years of data used in the valuation formula from six to eight or 10 years.

The committee obtained estimates that use of an eight-year average would have decreased 1996 cropland valuation by 4.36 percent and decreased noncropland valuation by 1.55 percent, and use of a 10-year average would have decreased 1996 cropland valuation by approximately five percent and decreased noncropland valuation by approximately seven percent. These changes would have lessened the 12 percent valuation increase for agricultural property that occurred in 1996.

The committee obtained information on how these suggested changes and resulting decreases in agricultural valuations would affect shifting of taxes among property classifications. Using eight years of data would shift over $700,000 of annual property taxes from agricultural land to other property classifications and using 10 years of data would shift more than $900,000 of annual property taxes from agricultural land to other property classifications.

The data used for these computations using eight or 10 years of data brought the 1988 drought year back into the computation, which had the effect of substantially reducing agricultural valuations statewide. Committee members expressed concern about going to a 10-year average if it meant pulling years back into the formula which caused the recent fluctuation in valuations when they were dropped from the computation. Committee members suggested that bringing years back into the computation could be avoided by phasing in future years' data by adding one year of data to the computation each year until 10 years of data is used in the formula.

Recommendation

The committee recommends House Bill No. 1069 to extend the number of years of production data used in the agricultural property valuation formula from six years to 10 years and retain the provision that the highest and lowest production years are discarded and the remaining years are averaged. 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. This means 1989 will be the first year used in the valuation formula through the 2000 valuation.

The committee makes no recommendation regarding the suggestion of the North Dakota Association of Assessing Officers that the requirements of assessing all exempt property be eased or removed from law.

IRRIGATED LAND ASSESSMENT STUDY

Background

True and full value of agricultural property is the capitalized average annual gross return as determined by the North Dakota State University Department of Agricultural Economics. The formula is described under **PROPERTY TAX ASSESSMENT SYSTEM STUDY** in this report. The county director of tax equalization, whenever possible, is required to use soil type and soil classification data from detailed and general soil surveys to establish values for assessment districts. Each local assessor adjusts the relative values of assessment parcels.

Agricultural property valuation concerns arose before the 1995 legislative session primarily in Sargent and Barnes counties, where recent sharp increases in agricultural property valuations occurred. In Sargent and Barnes counties, soil conditions exist which allow property that would otherwise have very low productivity to produce substantial returns from irrigated crops, particularly potatoes. The production from irrigated land is used to determine the countywide gross return for the year, which is used in the valuation formula to determine the countywide agricultural property valuation. This valuation, increased by production from irrigated land, is applied to all property in the county. Use of only soil survey information in determining values would produce a relatively low value for the poor quality soils of the irrigated lands. The statutory provision requires use of soil surveys to establish valuations for soil types and there is no statutory provision requiring increased valuations to recognize the existence of irrigation. Countywide average agricultural property values are increased by production from irrigated lands and when the increase is not directly assessed against irrigated acreage, nonirrigated agricultural property is given a higher taxable valuation. Irrigated land is some of the most productive in the county and increases county valuations but it is valued among the least productive properties in the county. This results in a shifting of tax burden to nonirrigated farmland. This is the subject of controversy that was intended to be addressed by Senate Bill No. 2524 (1995).

Senate Bill No. 2524 provided that 50 percent of the annual gross income from irrigated cropland must be considered additional expense of production and may not be included in computation of average agricultural value per acre for cropland for the county as determined by the North Dakota State University Department of Agricultural Economics. The 1995 legislation is effective only for taxable years 1995 through 1997 and then becomes ineffective.

Committee Consideration

Although Sargent and Barnes counties were the source of debate leading to 1995 legislation, this study was of statewide interest because every county in the state has issued irrigation permits and has irrigated cropland in production. The amount of cropland and soil conditions determine the impact irrigation has on countywide agricultural valuations. Williams County placed higher valuations on irrigated land before the productivity method of valuing agricultural lands became law and still follows that practice. Most counties have not adjusted property valuations to recognize irrigation effects, under the premise that irrigation is a management decision, like fertilization or tillage practices, and is not a component of property valuation.

The committee discussed using the availability of water for irrigation as a means of determining values for agricultural lands. This approach was characterized as unfair to a farmer who does not wish to irrigate. It was suggested that the issuance of a water permit might be a fairer basis to trigger valuation changes attributable to irrigation because the property owner initiates issuance of a permit.

Farmers with acreage under irrigation informed the committee that their net income does not exceed that of dry land farmers but, because of added cost of irrigation, their risk of loss is greater. They said the adjustments from the 1995 legislation seemed to end complaints that were heard about agricultural valuations before the 1995 adjustment.

Representatives of the North Dakota State University Extension Division and Agricultural Economics Department reviewed a report on the economics of irrigation. The report contained an estimate that 55 percent of increased production is eaten up in irrigation costs for dry beans and potatoes. Authors of the report stated that the 50 percent exclusion for income from irrigated land in the 1995 legislation was close to the correct level of exclusion.

Senate Bill No. 2524 reduced agricultural property valuations in 32 of 53 counties, with maximum decreases of 3.3 percent in Benson and

Cass counties.

The median sale price of land with irrigation potential was 23 percent higher than the price of land with no irrigation potential. Land under irrigation had a median sale price 55 percent higher than land with no irrigation potential. Median taxable value for land with irrigation potential was 11 percent higher than land without irrigation potential but the taxable value of irrigated land was 29 percent below the true and full value of land without irrigation potential. The lower taxable value for irrigated land may result because land under irrigation is generally of a poor soil quality, which under the assessment formula receives a lower valuation.

Recommendation

The committee recommends House Bill No. 1070 to make permanent the changes enacted by Senate Bill No. 2524 (1995). The bill eliminates 50 percent of the annual gross income from irrigated land from consideration in computing average agricultural value per acre for cropland for the county as determined by the North Dakota State University Department of Agricultural Economics. This would extend the application of Senate Bill No. 2524 to taxable years after 1997.

TAX PREFERENCES AND ECONOMIC DEVELOPMENT IMPACT STUDIES

Background

The committee conducted its studies of tax preferences and impact of large economic development projects jointly because the studies involved consideration of many of the same issues. With respect to property taxes, economic development incentives are exemptions or payments in lieu of taxes that may be granted for new industries, new residential property, residential or commercial building improvements, and tax increment financing. With respect to income taxes, preferences exist allowing credits or deductions to encourage seed capital investments, Myron G. Nelson Fund investments, venture capital corporation investments, nonprofit development corporation contributions, and sale or lease to a beginning farmer or business.

Under NDCC Section 40-57.1-03, payments in lieu of taxes on a new industrial project are to be apportioned in the same manner as property taxes. This section was amended by House Bill No. 1275 (1995) to allow a school district and any other taxing district to agree with the city or county on a different allocation of revenues. This section was also amended by Senate Bill No. 2322 (1995) to require a city or county considering a property tax exemption or payments in lieu of taxes for a new industry to include a representative appointed by each affected school district and township as nonvoting ex officio members of its governing body. Senate Bill No. 2322 is effective only through July 31, 1997.

House Bill No. 1520, enacted during the 1994 special legislative session, substantially revised NDCC Chapter 40-57.1 and created a payments in lieu of taxes option that could be used in combination with, or in place of, property tax exemptions for new industry projects. Payments in lieu of taxes may be allowed by a city or county governing body for any revenue-producing enterprise in lieu of the ad valorem taxes that would otherwise be due on buildings, structures, fixtures, and improvements used in operation of the project. The amount of annual payments in lieu of taxes from a project may be set at any amount by the governing body of the city or county. The right to make payments in lieu of taxes may be granted for up to 20 years from the date of commencement of project operations.

The valuation of property subject to payments in lieu of taxes is not to be considered in valuation of the taxing district in which the project is located for purposes of determining the mill rate for the district. Payments in lieu of taxes must be subtracted from the taxing district's budget before the remaining amount is certified as a tax levy to be spread against valuation of property in the district. Thus, revenue from payments in lieu of taxes cannot be used as "off budget" revenues and any amount received must be used to offset budgeted expenditures of the governing body of the city or county and any other political subdivision receiving the revenue. The occasions of the greatest property tax impact of a project making payments in lieu of taxes upon other taxpayers would be when payments in lieu of taxes received by the political subdivision are substantially more or less than budgeted expenditures that are attributable to services provided to the project.

Committee Consideration

The committee reviewed a November 1994 Tax Commissioner report on income and property tax exemptions. The report reviewed a survey of businesses with property or income tax exemptions in 1992, regarding the reasons for locating in North Dakota. The most frequent responses as to why a business located in North Dakota included quality of life, market, work force, expansion, raw materials, and location. Eight percent of respondents cited business climate or tax structure as a location factor and six percent cited tax incentives as a location factor. Committee members pointed out that when factors relating to taxation are combined, they appear to be more significant to location decisions than the individual responses would indicate. Economic development officials pointed out that if all other location factors are equal, having the ability to match tax incentives available in other states becomes critical to attracting new businesses.

The committee reviewed a survey conducted by the Fargo-Cass County Economic Development Corporation on economic development incentive usage. Representatives of the corporation said granting of tax incentives will not make a bad economic project into a good one but there are occasions when tax incentives can be judiciously used to influence location of good economic projects. Once selection of sites is narrowed to a few candidates, tax incentives can play a role in the final location decision for the business. It is at this level of location decisions when it becomes important for economic development officials to be able to match the tax climate or incentives available in competing states. Corporate representatives said the economic development incentives made available by the Legislative Assembly are useful, workable tools.

The Fargo-Cass County Economic Development Corporation is working on computer software that could be used by political subdivisions to measure potential cost and benefit of tax incentives for a new business. This software is intended to give political subdivisions an opportunity to quantify revenue losses from proposed tax incentives versus long-range benefits to the community and state of establishing a new business.

The committee reviewed a Tax Department report on usage and revenue losses for each income tax credit or deduction intended as an economic development incentive.

The committee reviewed information on the extent and amount of property exempted from property taxes under statutory provisions intended to promote economic development. The information is described under **PROPERTY TAX ASSESSMENT SYSTEM STUDY** in this report.

The committee reviewed a report presented by the Department of Economic Development and Finance analyzing real and personal property taxes, workers' compensation insurance rates, state and local sales taxes, unemployment insurance, and corporate income taxes for Iowa, Minnesota, Montana, Nebraska, North Dakota, South Dakota, Wisconsin, and Wyoming. North Dakota has a very low property tax burden compared to the other states in the survey. North Dakota workers' compensation rates are higher than most of the states compared but are lower than the rates in South Dakota and Montana. Workers' compensation rates compared in the report were for agricultural manufacturers and rates for other industries may differ. North Dakota unemployment insurance rates are among the highest of the states compared. North Dakota sales and use tax burdens are relatively low compared to the states in the comparison, especially when consideration includes the sales tax exemption for new manufacturing machinery. Combining all of the categories considered, North Dakota compares favorably to the other states. Tax incentives were described as very important in efforts to attract and retain businesses.

The committee reviewed a study on the impact of the ProGold facility on Wahpeton and Richland County which was prepared by a faculty member from the North Dakota State University Department of Agricultural Economics before the decision to locate the facility in Wahpeton. The report estimated direct new expenditures in several economic sectors totaling approximately $113 million per year during plant construction and $76 million per year during plant operation. The report estimated secondary employment from the facility will total approximately 2,700 jobs beginning in 1997. The report estimated approximately $250 million per year in economic development impact will be attributable to existence of the facility. The report estimated a net gain of about $3.2 million per year in state tax revenues during operation of the facility. The report estimated Richland County finances would have a net gain of about $30,000 per year. The report did not include estimates of property taxes from the facility because the report was prepared before it was known what tax status the plant would have.

A Richland County official said the ProGold facility has agreed with the county to make payments in lieu of taxes over a period of 20 years. For two years, no payments will be made on the facility and for a period of 18 years annual payments of $299,000 will be made. The tax payments were determined by estimating the taxes that would be due over the second 10 years of operation of the facility and spreading that amount of taxes over a period of 18 years. Taxes of $88,000 per year will also be paid on the land on which the facility is located.

Committee members toured the ProGold facility with representatives of Richland County. The committee received information on road improvements that have been made and will be necessary in connection with the facility. The committee received a briefing on operation of the facility including a description of the process for production of high fructose corn syrup and of the truck and train traffic into and out of the facility. The facility will use 2.6 million gallons of water per day but will recycle more than 50 percent of its water consumption to reduce the amount drawn from the Red River. The facility will have its own water treatment facility which the operators believe will return water to the river as good in quality as the water taken from the river.

The committee received a report from the Bismarck city assessor on all exempt property within the city. The two-year residential property exemption in Bismarck was discontinued in 1995. Exemptions for improvements to commercial and residential property totaled more than $200,000 in property tax revenue lost for 1992, more than 90 percent of which was for commercial property improvements. Use of the exemption for new businesses varies from year to year.

A representative of the North Dakota School Boards Association informed the committee that the association approved a resolution to seek legislation allowing school district property tax levies to be unaffected by city or county decisions to grant property tax exemptions for new businesses.

Conclusion

The committee makes no recommendation with regard to its studies of tax preferences and the impact of major economic development projects on political subdivisions. The committee received no suggestions for legislation regarding either study.

FARM BUILDINGS 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 farm buildings other than residences and provides criteria to determine what is a farm and who is a farmer and imposes income limitations on persons who qualify for the exemption for their residence. 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. It is the exemption for farm buildings other than residences that the committee was directed to study.

A 1968 Attorney General's opinion indicated that raising animals may not always qualify as farming for purposes of the farm buildings exemption. The opinion attempted to differentiate between traditional farming and industrial operations such as livestock feeder operations. The opinion stated that the source of feed for animals may determine whether an operation is a farm or an industrial operation.

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 1968 Attorney General's opinion and the 1977 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.

Committee Considerations

This study arose because of events that have transpired in Richland County, although the topic is of application in each county in the state. In 1995, a large turkey-raising operation was established on a section of land in Richland County. The operator has constructed 35 large turkey barns on the property. 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 that raise turkeys, cattle, or pork would also become taxable under the Tax Commissioner's guidelines adopted to implement the *Butts* decision. 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.

North Dakota Turkey Federation representatives said most of their members make the majority of their income from raising turkeys. North Dakota turkey growers produce about 1.5 million turkeys per year, not including the production from the new Richland County operation, which will produce an additional one million turkeys per year. Some members of the federation raise turkeys exclusively and other members raise turkeys and corn or grain. Federation members said in some cases grinding one's own feed is the best management decision but most often purchased feed yields the best profits. Federation representatives recommended that all turkey-raising operations should qualify for the farm buildings exemption. They indicated there does not appear to be any reasonable basis to distinguish among operations for exemption purposes.

North Dakota Corn Growers Association representatives recommended that feedlots and poultry operations should qualify for the farm buildings exemption without limitation.

The committee toured Richland County turkey-raising operations. One operator said his farm has the capacity to grow and process feed for turkeys but it is more economical to buy processed feed. Finishing barns for raising turkeys are capable of holding approximately 10,000 turkeys and cost approximately $200,000 to construct.

The committee toured the new Richland County turkey-raising operation, which is composed of approximately 35 turkey barns, each approximately 660 feet by 60 feet. The operation does not grow corn or grain and the operator does not reside onsite, although trailer homes are onsite for employees.

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 road deterioration.

The committee considered several factors to distinguish industrial or commercial operations from agricultural operations, but none of the factors appears suitable. Basing the exemption upon whether the farm owner 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 the *Butts* decision, 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 interfere with domestic situations and 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 to be exempt 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.

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.

Richland County officials urged the committee to seek a legislative solution to the farm buildings exemption problem. Richland County officials conducted a survey of all 53 counties and found several cattle feeding operations and operations producing hogs, chickens, eggs, bees, llamas, emus, and turkeys that have buildings that are subject to property taxes. They reported that many county tax officials agree that many more operations would be considered industrial enterprises and subjected to taxes on farm buildings if the *Butts* rationale were strictly observed.

Conclusion

The committee makes no recommendation on the farm buildings exemption study. The committee found no workable, fair suggestion that would improve on the criteria established under the Supreme Court's *Butts* decision. Committee members expressed preference for retaining the current law, with flexibility for application by local governing bodies, over establishing statutory criteria that might be excessively rigid and unfair in some situations.