<u>HCR 4006 – Testimony by Dustin Gawrylow (Lobbyist #266) North Dakota Watchdog Network</u>

The debate over using property taxes for education is at least a 40 year old debate, if not longer.

Back in the 1980's, Democratic Party members argued that the phrase "shall provide for" clause in Section 1 of Article VIII of the state constitution meant the state should pay for K-12 education – possible all of it.

At the same time, Republicans argued that "shall provide for" meant that the state will let local school boards levy taxes to raise funds for education.

I encourage legislators to seek out this particular study – I have included it in my testimony documents, as it is a fascinating guide to why property taxes have gone up so much since the late 90's – it was no accident.

Key Points from 1997 Study (Highlighted Sections are interesting):

During the 1993-94 interim, the Legislative Council's Taxation Committee contracted with a consultant for preparation of a study of tax burden comparisons within the state and with neighboring states during the period from 1960 to 1992. The study converted tax collections to "real" dollars for comparison. Comparison of tax trends over time can be misleading unless adjustments for inflation are made. For example, a $300 tax per capita in 1960 would have reduced a person's disposable income more than a $1,400 tax per capita did in 1992. All tax collections reported in nominal dollars were converted into real 1994 dollars using the consumer price index. Updating the statistics in the study would require analysis by the consultants who prepared the 1994 study because figures were converted to 1994 dollars by the consultants.

In 1960 local tax collections accounted for 55 percent of all state and local taxes in North Dakota, but in 1992 state taxes accounted for 66 percent of all state and local taxes in North Dakota. During the period from 1960 to 1984, the local share of the overall tax burden decreased steadily. The state and local tax burdens were about equal in 1970. By 1984 the state share of tax collections was at 73 percent, a maximum for the period from 1960 through 1992. Since 1984 the trend has reversed and the local portion of tax collections is increasing.

The relative share of collections among tax types also shifted over the period from 1960 to 1992. The most notable change is that the proportion of property taxes in total tax collections fell during the years 1960 through 1984. The steepest decline in property tax collections occurred after 1969 when personal property was exempted and eliminated from the local property tax base. Increases in the sales tax rate and a business privilege tax were used to offset the loss of tax revenue resulting from exemption of personal property. Energy tax collections had a sharp peak in 1982 due to high energy prices. The loss in energy tax revenues after 1982 was replaced by increasing sales tax and individual income tax revenues. Local sales taxes became a factor in the overall tax structure during the 1980s. In 1992 state sales and use taxes accounted for about 37 percent of all state and local tax collections in North Dakota and property taxes accounted for approximately 34 percent.

State shares of all state and local taxes for the study states range from 56 percent in South Dakota to 68 percent in Minnesota. North Dakota, with 66 percent of state and local tax revenues collected at the state level, is slightly above the six-state average of 63 percent.

Differences in tax balance were identified among the six study states. North Dakota and South Dakota rely most heavily of these states on sales tax revenues, and South Dakota also has relatively heavy reliance on property taxes. Minnesota relies approximately even on sales and income taxes. Montana relies most heavily on income taxes, and Wyoming and Nebraska rely on property taxes more than the other states in the region.

In North Dakota the share of the overall property tax burden on different classes of property has changed over the past three decades. Shares of the total property tax burden for agricultural and centrally assessed property have remained steady or declined slightly, while shares for residential and commercial properties have increased. In 1960 residential and commercial property represented 10 percent and 11 percent, respectively, of all taxable value in the state. By 1992 their shares of statewide taxable value had increased to 28 percent and 20 percent, respectively.

Comparisons were made of county, township, school district, and city property tax revenues. Taxes levied by school districts increased 37 percent between 1960 and 1969, but by 1981 school tax levies fell 39 percent from the 1969 level and were approximately the same in real dollars as they had been in 1960. Township taxes declined by 60 percent between 1960 and 1991. County and city levies increased by 16 percent and 14 percent, respectively. Special assessments levied by local governments have become an increasingly important part of local government revenues, rising to about $50 million per year.

North Dakota has relied heavily on stable tax sources such as sales and property taxes. This policy maintains tax collections in times of a stable or declining economy but does not capture benefits of a growing economy as would occur with heavier reliance on an income tax, which grows with the economy. For a time, North Dakota placed a heavy reliance on energy taxes, which are subject to the state of the world economy and the vagaries of the international oil market. This reliance diminished the degree of reliability of the tax system to generate a reliable flow of revenue.

The study pointed out that the effect of state and local taxes on federal income tax liability affects the total impact of taxes on taxpayers. For example, a Minnesota taxpayer would pay less in federal income taxes than a North Dakota taxpayer with the same income and deductions, credits, and exemptions and equal property valuation. This is because a greater share of Minnesota's state and local tax burden consists of property taxes and income taxes, which are deductible for federal income tax purposes. In Minnesota a taxpayer is able to deduct approximately 68 percent of state and local taxes while a North Dakota taxpayer is able to deduct only 46 percent. Reliance on taxes that are deductible for federal income tax purposes allows a taxpayer to "export" a part of his state and local tax burden to other federal taxpayers through federal income tax deductions.

The study points out that taxes as a percentage of personal income do not differ substantially among the six study states, especially when factors such as federal tax liability and energy tax shifting are considered. The difference among the tax systems is mainly in the perception of the burden, based on the type of tax. For example, income taxes are highly visible and most taxpayers realize exactly how much they pay in income taxes each year. Sales taxes may be perceived as less onerous, because few taxpayers know precisely how much sales taxes they pay each year and the taxes are collected from taxpayers in relatively small increments. Even less visible to taxpayers are energy, commercial property, and corporate income taxes, which may be part of the prices of products or passed on to shareholders.

Total state and local tax collections in North Dakota rose from about $1,100 per capita in 1960 to about $1,800 per capita in 1992. The 1992 per capita tax burden in North Dakota is approximately four percent lower than the national average. Comparison of North Dakota with neighboring states shows that North Dakota falls in the middle of the range of tax per capita. Minnesota, Wyoming, and Nebraska collect more state and local taxes per capita while Montana and South Dakota collect less. On a regional basis, current state and local tax collections as a percentage of personal income ranged from eight percent in South Dakota to 13 percent in Wyoming. As a percentage of personal income, North Dakota state and local taxes fell from 11.7 percent in 1960 to 11.2 percent in 1991. The only other state in the study that had a similar reduction of taxes as a percentage of personal income during the study period was South Dakota.

The study concluded that North Dakota relies on sales taxes more than the other states considered in the study except South Dakota. North Dakota's sales and use taxes paid by a typical family of four are the highest of any state in the study. However, local sales taxes were not included in these computations and many South Dakota cities impose a two percent local sales tax.

The study concluded that North Dakota's reliance on property tax is the lowest of the six states in the study, even though North Dakota has shown a recent increased reliance on property tax revenues. Some of the burden of North Dakota property taxes has shifted from agricultural and centrally assessed property to residential and commercial property. Notwithstanding the study conclusion, the committee received testimony indicating that recent increased reliance on property tax revenues has been too extensive. Whether this is a result of what was described to the committee as "taxation by referral" is debatable, but several groups and individuals suggested that tax policy should reverse the trend to increased reliance on property tax revenues.

The study concluded that assessment of the size of the tax bite, its burden on taxpayers, and its adherence to principles of public finance depend in large part on perspective. North Dakota's tax burden has shifted from local to state sources while increasing in real terms and, at the same time, decreasing relative to income. Personal income has grown faster than the cost of government in North Dakota, causing taxes as a percentage of personal income to decline. Compared to neighboring states, North Dakota's tax structure is about average in the amount collected and distribution of the tax burden.

Copies of the 1994 study have been distributed to committee members. Attached as Appendix "B" are copies of several pages from the State Tax Department publication *State and Local Taxes in North Dakota, An Overview and Comparative Guide*, published in April1996, to illustrate more recent comparisons and trends. The Tax Department will be updating this information during the interim and will share information with the committee as requested.