North Dakota Legislative Council
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PROPERTY TAX CLASSIFICATION AND EXEMPTION AUTHORITY

This memorandum provides information regarding legislative authority to classify and exempt property under constitutional provisions. This memorandum discusses the primary constitutional provisions related to the authority to classify and exempt property, but is not exhaustive in its reference to or discussion of every constitutional limitation that may be implicated by a particular property tax classification or exemption.

CONSTITUTION OF NORTH DAKOTA - ARTICLE X, SECTION 5

The Legislative Assembly derives its authority to classify and exempt property from the Constitution of North Dakota. Section 5 of Article X of the Constitution of North Dakota provides:

> **Section 5.** Taxes shall be uniform upon the same class of property including franchises within the territorial limits of the authority levying the tax. The legislative assembly may by law exempt any or all classes of personal property from taxation and within the meaning of this section, fixtures, buildings and improvements of every character, whatsoever, upon land shall be deemed personal property. The property of the United States, to the extent immunity from taxation has not been waived by an act of Congress, property of the state, county, and municipal corporations, to the extent immunity from taxation has not been waived by an act of the legislative assembly, and property used exclusively for schools, religious, cemetery, charitable or other public purposes shall be exempt from taxation. Real property used for conservation or wildlife purposes is not exempt from taxation unless an exemption is provided by the legislative assembly. Except as restricted by this article, the legislative assembly may provide for raising revenue and fixing the situs of all property for the purpose of taxation. Provided that all taxes and exemptions in force when this amendment is adopted shall remain in force until otherwise provided by statute.

A brief review of the history of this constitutional provision and case law interpreting the provision provides helpful context to the legislative authority granted under this section.

This section, as enacted in the 1889 Constitution of North Dakota, was Article XI, Section 176, and the initial clause stated:

> Laws shall be passed taxing by uniform rule all property according to its true value in money….

In 1914, the voters of the state approved an amendment that changed the first clause of the section to read as follows:

> Taxes shall be uniform upon the same class of property, including franchises within the territorial limits of the authority levying the tax….

The objective of the 1914 amendment was to replace the requirement that all property be uniformly taxed with a grant of authority to the Legislative Assembly to recognize different classifications of property and apply uniform taxation within each classification created.

Despite the 1914 constitutional authority, prior to 1981, the Legislative Assembly did not provide for statutory classification of property; instead, North Dakota law called for equal assessment of all taxable property at true and full market value. However, a system evolved which was characterized by disparity of assessments within and among types of property and taxing districts, essentially creating a de facto property classification system. This de facto property classification system caused a disproportionate shift of tax burden to railroad and utility property, which resulted in litigation involving the Soo Line Railroad Company. The Soo Line Railroad Company challenged the assessments of its property in North Dakota for the years 1974, 1975, and 1976 on the grounds that the valuations were grossly excessive.

In *Soo Line Railroad Company v. State of North Dakota*,[1] the North Dakota Supreme Court held the use of a higher assessment ratio for centrally assessed property as compared to locally assessed property was impermissible, and the de facto classification system in place at that time was no longer acceptable, absent legislation permitting such classification under then Section 176 of the Constitution of North Dakota. The court stated "[w]e will no longer countenance de facto classification of property in North Dakota for purposes of taxation." The court held "[a]ll tax assessments, beginning with the 1980 computations, must be uniform in North Dakota until such time as the legislature provides for classification of different levels of property for purposes of taxation." This decision was the catalyst for the substantial restructuring and classification of the property tax system by the 1981 Legislative Assembly. The legislative response to the *Soo Line* decision included the passage of Senate Bill No. 2323 (1981), which extensively reshaped the state's property assessment procedures. Statutory classifications of real property were created, including classifications for agricultural property, centrally assessed property, commercial property, and residential property.

The North Dakota Supreme Court has on several occasions discussed legislative authority to classify property for taxation purposes. In the 1979 decision in *Caldis v. Bd. of Cnty. Comm'rs, Grand Forks Cnty.*,[2] the court reviewed the history of its rulings on classification of property for tax purposes and stated:

> The Legislature is vested with broad power to classify property for ad valorem tax purposes under § 176 of the North Dakota Constitution, *Signal Oil and Gas Company v. Williams County*, 206 N.W.2d 75, 81 (N.D. 1973). The only material restriction placed upon this legislative power is one of reasonableness. In order to constitute a valid classification for taxation, the subjects within the class must be segregated based upon a legitimate distinction in tax treatment. "A basis for classification must be such as naturally inheres in the subject matter." *Souris River Telephone Mutual Aid Corp. v. State*, 162 N.W.2d 685, 689, (N.D. 1968). There must be some consideration given to differences in the type, character, or use of the property to justify disparate tax treatment. *Gamble-Robinson Fruit Co. v. Thoresen*, 53 N.D. 28, 204 N.W. 861, 864 (1925).
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> Ordinarily, a statutory discrimination will not be set aside if any state of facts reasonably may be conceived to justify it. *State v. Gamble Skogmo, Inc.*, 144 N.W.2d 749, 758 (N.D. 1966). To avoid a violation of the equal protection clause, the classification made by a challenged statute must bear some rational relationship to a conceivable legislative purpose, and the classification must apply uniformly to those similarly situated within the class. *Signal Oil and Gas Company v. Williams County*, supra, 206 N.W.2d at 81; *Ferch v. Housing Authority of Cass County*, 79 N.D. 764, 59 N.W.2d 849, 864 (1953). Although there is nothing in the Fourteenth Amendment which requires tax burdens to be just or equal in all respects, the aim of taxation should be to produce, as nearly as possible, equality in the burdens imposed. This does not require the adoption of an iron rule of equal taxation, nor does it prevent legislative discretion in the selection of subjects for classification. *Signal Oil and Gas Company v. Williams County*, supra, 206 N.W.2d at 81, 82. Generally, every presumption is applied in favor of upholding laws which deal with regulation of the economy, the public health, or the collection and disbursement of taxes. *Romero v. Hodgson*, 319 F.Supp. 1201, 1202 (N.D.Cal. 1970), affirmed, 403 U.S. 901 (1971).

In the 1968 decision in *Souris River Telephone Mutual Aid Corp. v. State*,[3] the court stated:

> The 1914 amendment to § 176 of the North Dakota Constitution changed the State's method of taxation from one of uniform rule upon property according to its true value to one of legislative discretion to classify subjects, including property and persons, for tax purposes. This legislative authority is subject only to the limitation precluding arbitrary classification as prohibited by the Fourteenth Amendment to the United States Constitution. *State ex rel. Fargo v. Wetz*, 40 N.D. 299, 168 N.W. 835, 5 A.L.R. 731 (1918). It is apparent that under the rules enunciated in *State ex rel. Fargo v. Wetz*, supra, the Constitution of this State confers upon the Legislature the widest discretion in classifying property for purposes of taxation that might be conferred upon it.

In the 1972 decision in *Signal Oil and Gas Co. v. Williams County*,[4] the court stated:

> The question of classification of property for tax purposes is one that has caused much difficulty in many jurisdictions, and the courts have not always agreed as to what constitutes an unlawful classification. A careful study of the long line of decisions by the United States Supreme Court in which it has traced the effect of the Fourteenth Amendment on the power of the States to classify property for purposes of

[1] 286 N.W.2d 459 (1979).
[2] 279 N.W.2d 665, 670 (N.D. 1979).
[3] 162 N.W.2d 685, 690 (N.D. 1968).
[4] 206 N.W.2d 75, 81 (N.D. 1973).

> taxation, however, indicates that the Court has adopted a position of judicial restraint by investing tax legislation of the States with a presumption of constitutionality and requiring merely that the classification made by a challenged statute bear some rational relationship to a conceivable legislative purpose. *Allied Stores of Ohio v. Bowers*, 358 U.S. 522, 79 S.Ct. 437, 3 L.Ed.2d 480 (1959) and cases cited.

More recently, in *Haugland v. City of Bismarck*,[5] the North Dakota Supreme Court stated under Section 5 of Article X of the Constitution of North Dakota, "a tax must impose like burdens upon those similarly situated and not be arbitrary" and reiterated the analysis under the section "is similar to the standard for equal protection under the federal constitution."

CONSTITUTIONAL GUARANTEE OF EQUAL PROTECTION

The federal constitutional right to equal protection is provided in the 14th Amendment, which states:

> No state shall … deny to any person within its jurisdiction the equal protection of the laws.[6]

Sections 21 and 22 of Article I of the Constitution of North Dakota, provide the state constitutional guarantee of equal protection:[7]

> **Section 21.** No special privileges or immunities shall ever be granted which may not be altered, revoked or repealed by the legislative assembly; nor shall any citizen or class of citizens be granted privileges or immunities which upon the same terms shall not be granted to all citizens.
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> **Section 22.** All laws of a general nature shall have a uniform operation.

"The equal protection clauses of the state and federal constitutions do not prohibit legislative classifications or require identical treatment of different groups of people."[8] Rather, the equal protection clause "prohibits the government from treating individuals differently who are alike in all relevant aspects."[9] Legislative classifications are subject to different levels of judicial scrutiny, and the level applied depends on the right infringed by the challenged classification.[10] The North Dakota Supreme Court outlined the three levels of scrutiny courts apply to equal protection claims:

> We apply strict scrutiny to an inherently suspect classification or infringement of a fundamental right and strike down the challenged statutory classification "unless it is shown that the statute promotes a compelling governmental interest and that the distinctions drawn by the law are necessary to further its purpose." When an "important substantive right" is involved, we apply an intermediate standard of review which requires a "close correspondence between statutory classification and legislative goals." When no suspect class, fundamental right, or important substantive right is involved, we apply a rational basis standard and sustain the legislative classification unless it is patently arbitrary and bears no rational relationship to a legitimate governmental purpose.[11]

For purposes of the federal equal protection analysis, most tax laws are subject to rational basis review and courts generally give due deference to state legislatures in classifications for the purpose of taxation.[12] The United States Supreme Court stated under equal protection analysis, "[l]egislatures have especially broad latitude in creating classifications and distinctions in tax statutes."[13] Similarly, North Dakota courts "have generally applied the rational basis test to statutory classifications which involve economic or social matters and do not deprive a class of plaintiffs from access to the courts."[14]

To survive constitutional scrutiny under the rational basis test, differential treatment of classes for taxation purposes must be rationally related to a legitimate state interest. Courts have described the rational basis test as "a relatively relaxed standard reflecting the Court's awareness that the drawing of lines that create distinctions is

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[5] 2012 ND 123, ¶ 42, 818 N.W.2d 660.
[6] Art. XIV, § 1.
[7] In re P.F., 2008 ND 37, ¶ 15, 744 N.W.2d 724.
[8] State v. Leppert, 2003 ND 15, ¶ 7, 656 N.W.2d 718 (citations omitted).
[9] Hector v. City of Fargo, 2014 ND 53, ¶ 34, 844 N.W.2d 542 (citing Hamich, Inc. v. State ex rel. Clayburgh, 1997 ND 110, ¶ 31, 564 N.W.2d 640).
[10] Leppert, 2003 ND 15 at ¶ 7.
[11] In re P.F., 2008 ND 37 at ¶ 15 (quoting Gange v. Clerk of Burleigh County Dist. Court, 429 N.W.2d 429, 433 (N.D.1988)).
[12] *See* Nordlinger v. Hahn, 505 U.S. 1, 11 (1992).
[13] Armour v. City of Indianapolis, Ind., 566 U.S. 673, 680, (2012) (quoting Regan v. Taxation With Representation of Wash., 461 U.S. 540, 547, (1983)).
[14] Bismarck Pub. Sch. Dist. No. 1 v. State By & Through N. Dakota Legislative Assembly, 511 N.W.2d 247, 257 (N.D. 1994).

peculiarly a legislative task and an unavoidable one. Perfection in making the necessary classifications is neither possible nor necessary."[15] The North Dakota Supreme Court stated:

> For purposes of rational basis review, equal protection does not demand that a legislature or governing decisionmaker actually articulate at any time the purpose or rationale supporting its classification; however, there must be an identifiable purpose that may conceivably or reasonably have been that of the government decisionmaker. Thus, if a reviewing court can conceive of a reason justifying the choice made by the legislature or government decisionmaker in service of a legitimate end, the statute [or ordinance] does not violate the equal protection clause.[16]

While it is relatively uncommon for a court to find a tax statute unconstitutional, courts have struck down state tax statutes on equal protection grounds. For example, the United States Supreme Court struck down a statute that imposed a substantially lower state gross premiums tax rate on domestic insurance companies than out-of-state insurance companies[17] and a statute that provided for graduated rebates for residents based on how many years the resident had lived in the state.[18] Thus, it is important to keep in mind the state and federal constitutional guarantee of equal protection when considering property classifications or exemptions.

OTHER POTENTIAL CONSIDERATIONS

This memorandum provides a broad overview of constitutional authority to classify and exempt property. However, determining whether a constitutional limitation or concern is implicated by a particular property classification or exemption is a fact-specific inquiry, which may require analysis of additional constitutional provisions or laws depending on the specific classification or exemption at issue.

For example, a classification that distinguishes between residents and nonresidents may require analysis of a number of state and federal constitutional provisions in addition to the provisions discussed above, such as the Privileges and Immunity Clause[19] and the Commerce Clause.[20]

Additionally, in the case of railroad property, federal law provides additional limitations on a state's ability to classify or exempt property. The Railroad Revitalization and Regulatory Reform Act of 1976, often referred to as the 4-R Act, prohibits states from discriminatorily taxing railroad property. The legislation was "aimed to halt the economic decline of the rail industry by, among other means, barring discriminatory state taxation of railroad property."[21] Under the 4-R Act, a state is prohibited from unreasonably burdening or discriminating against interstate commerce.[22] A state or locality may not engage in any of the following acts, which have been deemed to unreasonably burden and discriminate against interstate commerce:

1. Assessing rail transportation property at a value that has a higher ratio to the true market value of the rail transportation property than the ratio that the assessed value of other commercial and industrial property in the same assessment jurisdiction has to the true market value of the other commercial and industrial property.
2. Levying or collecting a tax on an assessment that may not be made because the assessment is in violation of the restriction against valuing rail transportation property at value that has a higher ratio to true and full value as compared to other commercial and industrial property, as described above.
3. Levying or collecting an ad valorem property tax on rail transportation property at a tax rate that exceeds the tax rate applicable to commercial and industrial property in the same assessment jurisdiction.
4. Imposing another tax that discriminates against a rail carrier providing transportation subject to the jurisdiction of the Surface Transportation Board of the United States Department of Transportation.

The 4-R Act defines an "assessment" as a valuation for property tax levies; an "assessment jurisdiction" as a geographical area in a state used in determining the assessed value of property for ad valorem taxation; "rail transportation property" as property owned or used by a rail carrier providing transportation subject to the jurisdiction of the Surface Transportation Board of the United States Department of Transportation; and "commercial and industrial property" as property, other than transportation property, land used for agricultural purposes, or timber-

[15] Hamich, 1997 ND 110, ¶ 31, 564 N.W.2d 640 (quoting Massachusetts Bd. of Ret. v. Murgia, 427 U.S. 307, 314 (1976)).
[16] Ferguson v. City of Fargo, 2016 ND 194, ¶ 10, 886 N.W.2d 557, 560 (citations omitted).
[17] Metropolitan Life Insurance Co. v. Ward, 470 U.S. 869 (1985).
[18] Zobel v. Williams, 457 U.S. 55 (1982).
[19] U.S. Const. Art. IV § 2.
[20] U.S. Const. Art. I, § 8.
[21] CSX Transp., Inc. v. Georgia State Bd. of Equalization, 552 U.S. 9, 12 (2007) (internal quotation omitted).
[22] 49 U.S.C. 11501.

growing property, devoted to a commercial or industrial use and subject to a property tax levy.[23] A court has determined the term "commercial and industrial property" includes public utilities and airline company property subject to central assessment in North Dakota.[24]

The 4-R Act has been the subject of numerous court cases over the course of several decades. When analyzing a tax scheme that treats railroad property differently than commercial or industrial property, it is prudent to conduct a careful review of the statute and case law interpreting the statute.

[23] 49 U.S.C. 11501(a).
[24] Ogilvie v. State Bd. of Equalization of State of N. D., 657 F.2d 204, 209 (8th Cir. 1981).