

## FARM BUILDINGS EXEMPTION STUDY - BACKGROUND MEMORANDUM

The chairman of the Legislative Council has assigned to the interim Taxation Committee the study of application of the property tax exemption for farm buildings. This study is essentially a continuation of a study conducted during the 1995-96 interim.

### BACKGROUND

Farm residences and farm buildings other than residences are exempt from property taxes under North Dakota Century Code Section 57-02-08(15) (copy attached). 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 residences. 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.

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.

### 1995-96 COMMITTEE CONSIDERATIONS

The 1995-96 study arose because of events that transpired in Richland County, although the topic is of relevance 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 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 hogs 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 informed the 1995-96 interim Taxation Committee that most of their members earn 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 1995-96 interim Taxation 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. The amount of tax liability in

controversy may be substantial because of the value of the structures. Each finishing barn for raising turkeys is capable of holding approximately 10,000 turkeys and costs 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 located 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 most of the road deterioration.

The committee considered several factors to distinguish industrial or commercial operations from agricultural operations, but none of the factors provided a solution without problems. Basing the exemption on 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 eligible for exemption 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 and an interference with management decisions.

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 applied.

## CONCLUSION

The 1995-96 interim Taxation Committee made no recommendation on the farm buildings exemption study. The committee found no workable, fair solution 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. However, as recent events indicate there is likely to be continued growth in the number and impact of livestock and poultry feeding operations, the chairman of the Legislative Council has assigned this subject to the interim Taxation Committee to continue the study begun last interim.

ATTACH:1

15. a. All farm structures and improvements located on agricultural lands. This subsection shall be construed to exempt farm buildings and improvements only, and shall not be construed to exempt from taxation industrial plants, or structures of any kind not used or intended for use as a part of a farm plant, or as a farm residence. Any structure or improvement used in connection with a retail or wholesale business other than farming, any structure or improvement located on platted land within the corporate limits of a city, or any structure or improvement located on railroad operating property subject to assessment under chapter 57-05 is not exempt under this subsection.
- b. It is the intent of the legislative assembly that this exemption as applied to a residence shall be strictly construed and interpreted to exempt only a residence which is situated on a farm and which is occupied or used by a person who is a farmer and that the exemption shall not be applied to property which is occupied or used by a person who is not a farmer. For purposes of this subdivision:
- (1) "Farm" means a single tract or contiguous tracts of agricultural land containing a minimum of ten acres [4.05 hectares] and for which the farmer, actually farming the land or engaged in the raising of livestock or other similar operations normally associated with farming and ranching, has not received more than fifty percent of annual net income from nonfarm income, including that of a spouse if married, during each of the three preceding calendar years.
  - (2) "Farmer" means an individual who normally devotes the major portion of time to the activities of producing products of the soil, poultry, livestock, or dairy farming in such products' unmanufactured state and has not received more than fifty percent of annual net income from nonfarm income, including that of a spouse if married, during each of the three preceding calendar years. "Farmer" includes an individual who is retired because of illness or age and who at the time of retirement owned and occupied as a farmer as defined above the residence in which the person lives and for which the exemption is claimed.
  - (3) "Net income from farming activities" described in paragraph 2 means taxable income from those activities as computed for income tax purposes pursuant to chapter 57-38 adjusted to include the following:
    - (a) The difference between gross sales price less expenses of sale and the amount reported for sales of agricultural products for which the farmer reported a capital gain.
    - (b) Interest expenses from farming activities which have been deducted in computing taxable income.
  - (4) When exemption is claimed under this subdivision for a residence, the assessor may require that the occupant of the residence who it is claimed is a farmer provide to the assessor for the year or years specified by the assessor a written statement in which it is stated that fifty percent or more of the net income of that occupant was, or was not, net income from farming activities; provided, that if that occupant is married and both spouses occupy the residence, it shall be stated in the written statement whether their net income from farming activities was fifty percent or more of their combined net income from all sources.
  - (5) In addition to any of the provisions of this subsection or any other provision of law, a residence situated on agricultural land is not exempt for the year if it is occupied by an individual engaged in farming who had nonfarm income, including that of a spouse if married, of more than forty thousand dollars during each of the three preceding calendar years. The provisions of this paragraph do not apply to an individual who is retired because of illness or age and who at the time of retirement owned and occupied as a farmer the residence in which the person lives and for which the exemption is claimed.
  - (6) For purposes of this section, "livestock" includes "nontraditional livestock" as defined in section 36-01-00.1.
  - (7) A farmer operating a bed and breakfast facility in the farm residence occupied by that farmer is entitled to the exemption under this section for that residence if the farmer and the residence would qualify for exemption under this section except for the use of the residence as a bed and breakfast facility.