NORTH DAKOTA LEGISLATIVE MANAGEMENT

Minutes of the

TAXATION COMMITTEE

Thursday, May 6, 2010
Roughrider Room, State Capitol
Bismarck, North Dakota

Senator Dwight Cook, Chairman, called the meeting to order at 9:00 a.m.

Members present: Senators Dwight Cook, Jim Dotzenrod, Joe Miller, Tracy Potter, Bob Stenehjem; Representatives Larry Bellew, Wesley R. Belter, David Drovdal, Robert Frantsvog, Glen Froseth, Craig Headland, Jim Kasper, Louis Pinkerton, Arlo Schmidt, Gary R. Sukut, Dave Weiler, Lonny Winrich, Dwight Wrangham

Members absent: Senators John M. Andrist, George Nodland, Constance Triplett; Representative Scot Kelsh

Others present: Representative Shirley Meyer, member of the Legislative Management, was also in attendance.

See Appendix A for additional persons present.

It was moved by Representative Drovdal, seconded by Senator Stenehjem, and carried on a voice vote that the minutes of the previous meeting be approved as distributed.

ASSOCIATION OF OIL AND GAS PRODUCING COUNTIES

Chairman Cook called on Ms. Vicky Steiner, Executive Director, North Dakota Association of Oil and Gas Producing Counties, Dickinson, for introduction of topics to be covered by representatives of the association. Ms. Steiner distributed a map (Appendix B) showing the 18 counties of western North Dakota which are members of the association.

Ms. Steiner described changes made to the statutory oil tax revenue allocation provisions in 2009. She said spreadsheets illustrating the allocation are available on the website at *ndenergy.org*.

Ms. Steiner said the association contracted with Mr. Dean A. Bangsund and Dr. F. Larry Leistritz, economists at North Dakota State University, for preparation of a study of the effects of petroleum industry activity on county government costs in North Dakota. She introduced Mr. Bangsund to review the report prepared for the association.

Mr. Bangsund distributed copies of PowerPoint slides (Appendix C) accompanying his presentation.

Mr. Bangsund said the objective of the study was to document how recent increases in oil and gas exploration and production have affected the cost of providing county government services. He said the approach was to survey county officials to document effects on individual offices.

Mr. Bangsund said county offices were divided into two categories--one to focus on general county government offices and one to focus on road departments. He said responses to the survey were received from 72 offices and departments in 15 counties. He said the response rate was about 33 percent, which is statistically sound.

Mr. Bangsund said general county offices were surveyed with respect to only changes in petroleum sector activities in the past 12 months. He said 83 percent of general county offices reported increased workloads. He said general county offices internalized additional workload by adding staff, extra hours of work for existing staff, or purchases of additional equipment. He said 86 percent of general county offices with increased workloads reported that costs increased. He said the overall response rate was about 72 percent for general offices that reported cost increases.

Mr. Bangsund said survey responses were averaged across all county offices to avoid estimating cost impact for specific offices within county government.

Mr. Bangsund said as a result of cost projections for county general offices, results showed either moderate impact or high impact from oil and gas industry activity. He said six high-impact counties were identified--Burke, Divide, Dunn, McKenzie, McLean, and Mountrail. He said the average net cost increase per general office in those counties for 12 months was approximately $32,800. He said the estimated number of offices in those counties multiplied by the average net increase per office indicates increased cost to general offices in those counties totaling $2,066,000. He said the average net cost increase per general office in moderate-impact counties averages approximately $14,800 and the total estimated cost to general offices in moderate-impact counties was $1,557,000. He said the estimated total increase for county general offices in impacted counties was approximately $3,623,000 for 12 months.

Representative Weiler said he believes it is not valid to isolate cost increases without also including consideration of revenue enhancement from increased collection of fees from increased activity in county offices. He said hiring additional staff or requiring additional hours from existing staff has a cost, but there is an offsetting benefit to the county from increased collections. Mr. Bangsund said the study directive was to focus on costs of providing services, and the study excluded consideration of revenue changes. Representative Kasper said he agreed with Representative Weiler that not considering revenue enhancement from increased industry activity leaves out an important part of the analysis of industry impact.

Committee counsel said he was surprised to see that Bowman County did not rank as a high impact county because Bowman County has been the focus of impact discussions in recent years. He asked if Bowman County is not ranked as high impact because it is a more mature oilfield. Mr. Bangsund said Bowman County was ranked as a high-impact county two years ago.

Mr. Bangsund said analysis of effects to county road departments presented challenges. He said effects in each county differ in miles of roads affected, characteristics of impacted roads, location of oil activity within the county, intensity of road use and traffic patterns, and costs of road operations. He said it is important to consider that escalating input costs for road departments for costs such as gravel and fuel would occur even in the absence of petroleum industry activity. He said it was necessary to evaluate road costs over broader timeframes because a majority of road operations are not performed on all roads each year. He said a separate questionnaire and analysis was used for road departments. He said county officials provided information for impacted and nonimpacted roads to identify miles by road type and 12 separate maintenance, repair, reconstruction, or surfacing operations. He said the questionnaire attempted to have county road departments estimate the cost of maintaining impacted roads and the cost of maintaining roads in the absence of oil industry activity. He said the difference between the estimates would be the cost increase attributable to oil industry activity.

Mr. Bangsund said the general findings from the survey were that for impacted roads the frequency of repair or improvement operations is substantially higher, there is a greater disparity of need for the most costly operations, and many road operations are more expensive to perform on impacted roads.

Representative Winrich asked how the study defined impacted and nonimpacted roads. Mr. Bangsund said it was left to the county reporting information to determine roads impacted by petroleum industry activity.

Mr. Bangsund said analysis of information on average cost increase for road impacts shows annual costs for impacted counties totaling from $51.8 million to $54.2 million per year for 2010 through 2012. He said combining these costs with cost increases estimated for general county offices provides estimated impact cost increases per year of $55.4 million to $57.8 million.

Senator Potter said some of the costs for roads result in road improvements, rather than maintenance. He asked if the cost increases include road improvements. Mr. Bangsund said improvements are included in the cost estimates and in some cases the decision is made to make improvements to reduce future maintenance costs.

Senator Cook said the question asked of county road departments was how much cost would be incurred to obtain the roads the county wants. He said non-oil counties may have provided similar answers on increased costs. He said it would be useful to compare responses from non-oil counties to the responses received from the survey. Mr. Bangsund said that is a good point, but the comparison requested was to focus on extracting information for oil-impacted counties.

Representative Pinkerton asked what is the estimated cost per mile for petroleum industry road damage repairs. Mr. Bangsund said some data collected indicates costs of approximately $300,000 to $500,000 per mile. In response to another question from Representative Pinkerton, Mr. Bangsund said data was not collected on the miles of road damaged. He said the survey focused on collecting information from county road departments on what they can do and what is needed.

Senator Potter asked if the survey indicated whether some county offices are impacted more than other offices. Mr. Bangsund said the study did not compile estimated impact by office but averaged impact costs of all general offices by county.

Representative Froseth said he believes the study is focused on the front end of oil industry impact for some counties and there will be additional costs in counties outside the group studied. He said he believes the study conclusion is a conservative cost estimate.

Representative Drovdal said petroleum industry road impacts occur outside the identified impacted counties. He asked if road impacts outside impacted counties would be relatively low. Mr. Bangsund said he would be speculating but outside the impact area, state roads would probably be impacted but county roads would not experience as significant a level of impact.

Ms. Steiner said the association is trying to contract with the Upper Great Plains Transportation Institute for more detailed information on road maintenance and upgrade costs for impacted counties.

Ms. Steiner introduced Mr. Greg Boschee, Mountrail County Commissioner, Parshall, to provide information on the Mountrail County experience. Mr. Boschee said the infrastructure fund established by 2009 legislation is working very well, but it is short on funding. He said introduction of the infrastructure fund has allowed the county to do some good things and has brought county commissioners together with local government representatives, which has provided a mutual benefit.

Mr. Boschee said 2009 legislation removed the cap on county allocations of gross production taxes and substituted an allocation at $18 million under which the county receives 10 percent of additional revenues. He said he believes the 10 percent allocation should be increased to 25 percent in Mountrail County. He said funding demands exceed availability. He said particularly for townships, the need for funding is greater than the funding available.

Mr. Boschee said as an example of impact cost increases, the Mountrail County road budget was $1 million in 2006 and is $12 million for 2010. He said Mountrail County has already reached the level under the formula at which it receives only 10 percent of production tax revenues, and that is not enough to meet demands.

Representative Headland said counties have difficulty meeting road budgets and asked where Mountrail County obtains necessary funds to support an $11 million county road cost increase. Mr. Boschee said in Mountrail County, most of the funding for the road cost increases comes from federal leasing revenues. In response to another question from Representative Headland, Mr. Boschee said Mountrail County has approximately 1,300 miles of county and township roads to protect. He said Mountrail County will receive approximately $14 million this year from oil gross production tax allocations, but it is not enough to meet demands. He said Mountrail County residents give up a lot to obtain the benefit of increased oil production for the state.

Representative Meyer asked how many roads in Mountrail County have gone from paved roads to gravel roads just because the county cannot maintain them. Mr. Boschee said he does not know the total, but there have been probably 30 miles of paved roads that have gone to gravel surfacing this year.

Senator Stenehjem asked if Mountrail County charges a ton/mile fee. Mr. Boschee said Mountrail County charges a $500 fee for moving a drilling rig but does not charge a ton/mile fee. He said Mountrail County has designated main haul roads to concentrate traffic and through a uniform county truck permit program, the county has something similar to a ton/mile fee. Senator Stenehjem said there are things the county can do to protect roads by traffic restrictions. He said the state shares tax revenues from all sources with all counties for road purposes, and the state is trying to meet the needs of all counties.

In response to a question from Representative Drovdal, Mr. Boschee said there is a significant difference between farm traffic and oil industry traffic. He said farmers do not drive on wet roads, which is when roads are most susceptible to damage. He said the oil industry drives every day, in all weather conditions, and uses heavier equipment.

Mr. Cliff Ferebee, Dunn County Commissioner, Halliday, said it is impossible to appreciate the activity on roads in oil counties unless you observe it. He invited committee members to come out to Dunn County to see first hand the degree of traffic.

Mr. Boschee distributed copies of the Mountrail County policy adopted and used to determine allocation of financial assistance to townships and schools from the infrastructure fund established under the oil and gas gross production tax. He also provided copies of the form used for applying for financial assistance from the infrastructure fund. Copies of the guidelines and forms are attached as Appendix D.

Ms. Linda Svihovec, McKenzie County Treasurer, Watford City, distributed copies of testimony (Appendix E) she presented on production tax allocations. She said 6 of the 18 counties receiving production tax distributions receive over $1 million but less than $5 million, which means schools in those counties do not receive their full production tax funding and would not receive full funding unless the county exceeds $5 million in tax revenue.

Ms. Svihovec said the current formula achieves good objectives, including additional revenue to larger producing counties, additional revenue to cities, and a mechanism for townships impacted by oil and gas development to access funds for road repairs and improvements. She said she thinks the formula could use some adjustment to assure full funding for schools and to simplify the formula. Senator Cook said it would be useful to obtain information on revenues for permits and similar fees for oil-producing counties. Ms. Svihovec said she has access to that information and can provide it to the committee. Chairman Cook requested Ms. Svihovec to provide the information (Appendix F) to committee counsel for distribution to committee members.

Ms. Svihovec said some tweaks to the formula may be appropriate. She said she will consult with state and local officials to see if improvements could be recommended at a later meeting.

Senator Cook said it appears that an evaluation of funding needs is necessary. He said the question is whether funding priorities are correct. He said one school district received a large settlement payment from the Corps of Engineers and is not able to spend the money. Ms. Svihovec said the school district payment Senator Cook referred to is a one-time payment and an unusual situation. She said evaluation of funding needs should be a continuing process.

Representative Meyer said on the front end of the distribution formula, special provision is made for allocation of funds to Williston and Dickinson. She asked if the association has discussed how that part of the formula might be adjusted. Ms. Svihovec said that issue has not been discussed to her knowledge.

Ms. Svihovec said it is important to remember that local government employment is another big issue in oil-impacted counties. She said government employees need increases to remain in government service because they can get substantially more in salary through oil industry employment.

Mr. Steven Holen, Superintendent of Schools, McKenzie County Public School District, Watford City, provided copies of his written testimony (Appendix G). He reviewed 2007 and 2009 legislative changes affecting school districts' allocation of funds from oil and gas gross production taxes. He said the 2009 legislation was intended to hold harmless school district allocations under the formula, but it is probable some school districts will receive less funding compared to the previous biennium.

Mr. Holen said another issue that has developed is that revenue received from the infrastructure fund by school districts is currently imputed through the state aid to schools formula. He said he does not believe it was intended that infrastructure fund revenue be imputed for school districts.

Mr. Holen said school districts have not received increases in gross production tax revenue from 2007 and 2009 legislative changes. He said to a great degree, school districts have gone backward in production tax revenue. He said school districts in the areas with an influx of oil activity must quickly react to changes in enrollment, including special education and English language learner students. He said school districts require additional funding to meet these demands. He said school districts are forced to compete with oilfield wages in obtaining essential personnel, such as custodial workers and busdrivers. He said in most cases, wages have to be dramatically increased or positions are not filled. He said salaries available in oil-related fields reduce free and reduced meal percentages, which negatively affects federal funding through programs such as Title I and school food service.

Mr. Holen said the current state aid to schools funding formula only allows spring average daily membership numbers to determine state aid payments. He said districts that experience increased enrollments from one year to the next are not provided state funds to reflect the enrollment increases. He said the payments remain one year behind, which puts additional burden on local district revenue. He said the 2009 legislative cap of 110 mills for school districts and the 12 percent cap on increases restrict local efforts to meet emerging needs.

Mr. Holen said another biennium of school district omission in the availability of additional funds is not acceptable for students of western North Dakota. He said he hopes the committee and legislature are willing to consider options involving favorable treatment of school districts in the gross production tax allocation formula.

Representative Meyer asked if the committee can obtain information on why infrastructure fund allocations to school districts are imputed for state aid to schools purposes. Chairman Cook asked committee counsel to obtain information for the committee on that topic.

Mr. Lynn Brackel, Bowman County Commissioner, Bowman, provided copies of information (Appendix H) on Bowman County gross production tax allocations.

Mr. Brackel said through March 2010 state taxes taken out of Bowman County from gross production tax and oil extraction tax plus state-owned mineral rights and leases total more than $47 million. He said the county allocation from that is approximately $7 million, which must be further allocated among the county, cities, school districts, and infrastructure funds. He said total receipts for county government are approximately $3.3 million, which is an increase of only $515,935.34 over the previous formula that imposed a cap on funds to counties. He questioned why Bowman County does not receive more benefits from the tax dollars taken out of the county by the state.

Senator Cook asked if Bowman County receives other federal money from oil and gas lease revenues. Mr. Brackel said Bowman County receives funds through the Bureau of Land Management and other federal sources. He said that revenue has saved Bowman County.

Ms. Steiner distributed copies of a letter (Appendix I) to the committee from Mr. Eric A. Dillé, Government Relations Director, EOG Resources, Inc. Mr. Dillé expressed EOG Resources' support for the Mountrail County commissioners' request for additional the state funding to mitigate impacts to county roads due to oil and gas company operations.

DEPARTMENT OF COMMERCE

Chairman Cook called on Mr. Shane C. Goettle, Commissioner, Department of Commerce, for testimony (Appendix J) on housing issues in oil production counties.

Mr. Goettle said the *New York Times* recently had a front page article about ample jobs but housing shortages in North Dakota oilfields. He said the *New York Times* also produced an accompanying video, which he ran for the committee.

Mr. Goettle said discussions with employers in northwest North Dakota show the chief concern for growing businesses is long-term housing. He said employers have taken steps to address housing in the short term, such as putting up crew camps near Stanley and Williston.

Mr. Goettle said Governor John Hoeven and he met with city and finance officials in Williston and discussed a concept that is being presented to housing developers. He said it takes about $40,000 to develop a housing lot in Williston and about half of the cost is to acquire the land and install belowground infrastructure. He said the other half of the cost is for aboveground improvements, such as streets, lights, and sidewalks. He said the concept is for the developer to purchase the lot and pay for belowground infrastructure and that bonds would be issued to finance aboveground work, to be paid back through special assessments. He said the risk of the bond issuance would be shared by the state and city. He said the Bank of North Dakota would issue a letter of credit to guarantee the state's risk on the bonds. He said Williston could use the North Dakota Public Finance Authority to issue the bonds or could issue them separately. He said this is viewed as a pilot project in Williston, which could be used as a basis for consideration of a permanent solution for the next legislative session.

Mr. Goettle said other state efforts to address housing needs are underway. He said the North Dakota Housing Finance Agency has organized a group of state and federal agencies and nonprofit developers to work with rural communities to devise housing strategies, develop projects, and help address financing issues. He said the group is called the

Statewide Technical Assistance Team and the group has held more than a dozen housing roundtables with participation of approximately 400 individuals representing 134 communities.

Mr. Goettle reviewed the other programs of the North Dakota Housing Finance Agency to assist communities in addressing unmet housing needs.

Mr. Goettle said the Department of Commerce community development block grant program has given preliminary approval for funds to acquire the former Stanley Community Hospital building for conversion into 16 units of rental housing.

In response to questions from Senator Cook, Mr. Goettle said the pilot project for Williston is a temporary program based on acute housing needs and is not being offered in other communities at this time. He also said he has not examined the level of indebtedness already assumed by the City of Williston.

Senator Cook said he believes Morton County already has higher special assessments than Williams County. He said it will be important for the state to determine how to provide housing assistance across the state. Mr. Goettle said it has not been ironed out what share of risk the state might assume on housing needs. He said private developers have not come forward to meet housing demands and the intent of the pilot program is to draw the interest of private developers. He said housing needs are great and immediate and the effort being made is to spur private development. He said he hopes to bring information to the legislative session based on what is learned from the pilot project.

Senator Cook said Morton County and Burleigh County housing authorities are being impacted by new residents coming from outside the state. He said state agencies should bear in mind that housing issues are not limited to oil-producing counties.

Representative Froseth said strong growth in wind energy, potash and uranium mining, and oil and gas means housing will be needed in all of western North Dakota.

Representative Sukut said from the perspective of the City of Williston, the oil bust of the early 1980s left $20 million of indebtedness for the city and the experience makes Williston officials cautious about indebtedness. He said part of the reason Williston requested state help is that there is a significant benefit to the entire state from oil activity and city officials think the state should share in a portion of the risk of expanded housing.

Representative Meyer said Dunn County commissioners held a forum and many of the comments related to housing problems in Killdeer and other areas. She asked what the state can do to assist with these problems. Mr. Goettle said one of the things we need to assess is how much risk the Bank of North Dakota can take on to help with housing issues. He said the state resists the idea that the state should take all of the risk in housing development, but it has not been determined how much risk is appropriate for the state. He said one of the difficulties is that housing studies are out of date.

Representative Meyer said another issue with housing development is that there is an appraisal gap for new construction. She said the cost of construction for new housing often exceeds the appraised market value of the property, which makes traditional bank financing very difficult.

Representative Wrangham said with extreme demands for housing, he would think private capital would flow into the area to meet the demand. He asked if there has been a study of what is holding back private development. Mr. Goettle said there has not been a study, but the problem appears to be that developers are willing to build but lack capital and banks are not willing to take risk on lending. Representative Wrangham said the community development block grant program may be used for low- and moderate-income housing. He asked for information to identify the standards for low and moderate income.

Senator Miller said he understands the oil industry is paying good wages. He asked what is the average salary in oil employment. Mr. Goettle said the wages are good, but it may take time for relocating workers to afford housing because they may have suffered a period of unemployment or be behind on a mortgage in the state from which they have relocated.

DEPARTMENT OF TRANSPORTATION

Chairman Cook called on Mr. Francis Ziegler, Director, Department of Transportation, for testimony (Appendix K) relating to highway program funding and state road projects in western North Dakota.

Mr. Ziegler said the federal transportation bill provided a reduced level of funding for North Dakota for 2010 but the American Recovery and Reinvestment Act of 2009 (ARRA) allocated an additional $170.1 million for North Dakota roads and bridges projects. He said approximately $90 million of ARRA projects were bid and worked on in 2009 and approximately $80 million in ARRA projects will be bid in 2010. He said ARRA projects for 2010 will be bid to fund $63.9 million in state projects, $6.9 million in urban projects, and $4.75 million in county projects.

Mr. Ziegler said the Department of Transportation will have projects to contract this summer in the Devils Lake Basin with a total cost of approximately $156 million. He said the total Department of Transportation construction program for 2010 will be approximately $423 million.

Mr. Ziegler said there are several construction projects over the next few years for western North Dakota. He said more than $60 million will be contracted for improvements to United States Highway 85, including a super 2 highway from Watford City to Williston. He described projects for North Dakota Highways 23 and 8.

Mr. Ziegler said cost of highway construction and maintenance continues to increase. He said from 2001 to 2009, the North Dakota construction cost index rose 88 percent. He said much of the increase is attributable to the cost of petroleum-based building materials. He provided information on the average cost per mile for Department of Transportation projects. He said road project costs range from $28,000 per mile for a seal coat to $1.5 million per mile for interstate concrete paving of two lanes in one direction.

Mr. Ziegler said the Department of Transportation and the Upper Great Plains Transportation Institute held eight public input meetings in April. He said the department has used a preventive maintenance program by placing thin lifts of pavement over existing roadways. He said thin lift overlays create narrower highway shoulders, a feature not preferred by many travelers. He said, however, when given a choice of narrow highway shoulders or enhanced load-carrying capacity, truckers prefer enhanced load-carrying capacity. He said the impression received from the public input meetings is that the public does not want reduced highway services. He said the public appears to believe it is time to move beyond maintenance of our highway system and work on rebuilding and rehabilitating the roads to meet the growing transportation needs of the state.

Mr. Ziegler said one of the challenges that will be faced is the anticipated continuing decline in federal funding. He said the highway trust fund earnings do not meet current needs and funding levels.

OIL TAX REVENUES

Chairman Cook called on committee counsel for presentation of a memorandum entitled *2009-11 Oil Tax Revenue Allocations*. Committee counsel said the information in the memorandum was compiled to show oil and gas tax collections and allocations by county from August 2009 through March 2010. He said the information indicates the allocations to the state general fund and permanent oil tax trust fund plus information for allocations to the Three Affiliated Tribes of the Fort Berthold Reservation and for each city receiving oil and gas tax revenues.

HOLD HARMLESS BILL DRAFT

Chairman Cook called on committee counsel for a presentation of a bill draft [10076.0100] to provide for tax revenue allocations from production within the Fort Berthold Reservation. Committee counsel said the bill draft was requested to address a perceived error in 2007 legislation. He said some members of the conference committee believed the amendment they recommended provided a "hold harmless" provision for allocations to political subdivisions, which would have provided that allocations to political subdivisions would be based on the entire tax imposed on wells within the reservation, but the amount payable to political subdivisions would have come entirely from the state's share of tax revenues. He said the bill draft makes clear that the revenues are to be allocated according to that intention.

Representative Froseth asked Mr. Boschee how the Three Affiliated Tribes work with Mountrail County on roads. Mr. Boschee said the Three Affiliated Tribes has its own road crew and roads to maintain and Mountrail County maintains roads under its jurisdiction. He said the Mountrail County commissioners intend to meet with tribal representatives to discuss road issues but currently the county and the tribes do not have cooperative efforts on the roads they maintain.

Chairman Cook called on Ms. Kathryn Strombeck, Research Analyst, Tax Department, for information (Appendix L) on tax collections from Fort Berthold Reservation production. She said the information she prepared shows gross production tax revenue from Fort Berthold Reservation production and associated revenue for counties for fiscal year 2009 and fiscal year 2010. She said for fiscal year 2009, there was minimal fiscal impact from lack of a "hold harmless" allocation because Dunn, McKenzie, and Mountrail Counties revenues were capped under the allocation formula in place at the time. She said for fiscal year 2010, county gross production tax revenues are not subject to caps and the estimated revenue reduction is more substantial. She said extending projections for a full biennium indicates an estimated revenue loss to counties of almost $2 million. She said the remaining information she prepared was requested to estimate potential gain to counties from production on the Fort Berthold Reservation which may not have occurred without the tribal agreement with the state. She said this estimate indicates approximately $4.6 million of tax revenue to counties which would not have been received without the agreement that sparked oil activity within the reservation.

DEPARTMENT OF MINERAL RESOURCES

Chairman Cook called on Mr. Lynn Helms, Director, Department of Mineral Resources, Industrial Commission, to provide information (Appendix M) on several mineral topics.

Mr. Helms explained a three-dimensional geologic model of the Parshall area prepared by the North Dakota Geological Survey. He said oil and gas, uranium, and potash mining are the topics he was requested to address. He said the geologic model shows the relative depths at which these minerals occur in North Dakota geologic structure. He said uranium is generally in levels nearer to the surface, at a depth of up to 1,500 feet. He said in the Parshall area, oil and gas from the Bakken and Three Forks Formations and Rival and Lodgepole Formations occurs at a depth of 5,000 feet to 7,000 feet and potash occurs at a lower level, with approximate depth ranging from 5,500 feet to 9,500 feet. He said 1986 rules adopted by the Industrial Commission for mining of potash are in place. He said the Department of Mineral Resources would like to do a rewrite of those rules when staff is available. He said there are 20 billion tons to 50 billion tons of potash reserves in

North Dakota. He said the value of potash reserves is from $8 trillion to $25 trillion. He said a working group is examining potash tax structure from other states and will make a recommendation for an appropriate tax structure based on the best features of laws of other states.

Mr. Helms said uranium regulatory rules for mining are in place. He said the Department of Mineral Resources has a triggered full-time equivalent position for uranium mining applications. He said the position is triggered to be filled when the first uranium mining application is filed. He said he estimates there are 1.6 billion pounds of minable uranium in North Dakota. He reviewed a map in the information provided to the committee showing uranium deposits in southwestern North Dakota as identified by the Geological Survey in 2007.

Representative Belter asked if potash is mined in Canada by surface mining. Mr. Helms said Canadian potash mining is a combination of surface mining and subsurface solution mining. Representative Belter asked at what price solution mining of potash is feasible. Mr. Helms said he does not know the economic feasibility price, but the current price for potash makes mining economically feasible.

Representative Kasper asked if potash solution mining would have infrastructure impact comparable to oil extraction impact. Mr. Helms said the impact would be very similar. He said potash solution mining involves drilling pads, horizontal wells with up to eight laterals per drilling pad, and other similar features. He said in potash solution mining, hydraulic fracturing is not necessary but transporting and processing of potash will have road impacts similar to oil development. In response to another question from Representative Kasper, Mr. Helms said he would like to see fertilizer manufacturing and processing follow in North Dakota after production commences. He said in current potash processing, the unprocessed potash is shipped to China for manufacturing into commercial fertilizer and then shipped back for use by farmers in the United States.

Representative Winrich asked if the group working on tax policy has found other states that established a trust fund for some revenue from uranium and potash because they are depletable resources. Mr. Helms said he is not aware of other states that have trust funds for potash and uranium revenues. Representative Winrich said he would like to see the proposal for North Dakota potash and uranium tax structure to provide for deposit of revenues in a permanent trust fund. Senator Cook said he sees three streams for revenue of uranium and potash taxes, including state funding, local funding, and trust fund deposits.

Representative Headland said he is curious why potash processing must be done in China and why potash processing has not been established in the United States. Mr. Helms said he will see if information is available on reasons potash processing has not been established in the United States.

Mr. Helms said there are just over 200 wells that have been completed in the Three Forks Formation. He said the Department of Mineral Resources has been evaluating the Three Forks Formation, and has concluded the Three Forks Formation contains the same quality of oil as in the Bakken Formation, but the Three Forks Formation is a separate oil reserve. He said a recently completed assessment of the Three Forks Formation estimates the expected ultimate recovery of oil from the Three Forks Formation at 1.9 billion barrels compared to the estimated ultimate recovery of 2.1 billion barrels from the Bakken Formation. He said the total expected ultimate recovery from the two formations in North Dakota is 4 billion barrels. He said the information he provided shows estimated combined recovery by county for the Bakken and Three Forks Formations.

Senator Potter asked if the ultimate recovery estimates are based on current prices and technology. Mr. Helms said that is correct and the ultimate recovery could increase with higher prices or improved technology. He said current recovery rates of about 1.5 percent from Bakken wells could go up to as much as 13 percent or 14 percent with improved technologies, such as running several lateral horizontal wells off a single drilling pad.

Senator Stenehjem asked if the Department of Mineral Resources has done a current assessment of oil reserves in the Red River zone. Mr. Helms said exploration in the early 1980s was mostly with vertical wells and many of the producing wells from that exploration are plugged out now. He said Red River prospects are still being identified, but the Department of Mineral Resources has not done a recent Red River assessment, other than for existing wells.

Representative Drovdal asked if water supplies are a critical issue that could curtail oil drilling activity. Mr. Helms said the availability of water and manpower are the limiting factors of most concern at present for the oil industry. He said availability of water will limit the number of rigs that can be working in North Dakota. He said there is probably a limit of about 125 drilling rigs based on water availability.

Chairman Cook said it has been reported to the committee that a group, including himself and committee counsel, Mr. Helms, and Tax Department staff, have been meeting to discuss potash and uranium taxation issues. The chairman said it is his hope that a bill draft will be ready for committee consideration at the next committee meeting.

PROPERTY TAX RELIEF STUDY

Chairman Cook called on committee counsel to present information prepared by Mr. Jerry Coleman, Director, School Finance, Department of Public Instruction, relating to estimation of funding necessary for 2011-13 property tax relief and the status of levy limitations for school districts with current authority to levy more than 185 mills.

Committee counsel said the committee has received an estimate prepared by

Ms. Marcy Dickerson, State Supervisor of Assessments, Tax Department, that property tax relief based on 2009 Senate Bill No. 2199 would require funding for 2011-13 of approximately $341 million. He said he requested Mr. Coleman to run estimates through the allocation formula to see if the estimated cost is approximately the same. A copy of the response received from Mr. Coleman is attached as (Appendix N).

Committee counsel said Mr. Coleman used 6.75 percent as an annual taxable valuation growth factor. Mr. Coleman also calculated the fiscal effect using 5 percent, 6 percent, and 7 percent growth factors. Committee counsel said Mr. Coleman's estimate is that funding for property tax relief under the same formula will cost an additional $41.8 million, requiring total funding for the 2011-13 biennium of $341,357,792.

Committee counsel said he requested Mr. Coleman to analyze the authority for school districts currently having authority to levy more than 110 mills for general fund purposes. Committee counsel said it is important to examine the reasons for excess levy authority because the 2009 legislation eliminated voter approval of unlimited levy authority and placed time restrictions on existing or future voter-approved excess general fund levy authority. He said it will be important to consider the consequences to a school district if extended excess levy authority is not approved by voters. He said the apparent intention of legislative discussions in 2009 was that such school districts would be allowed to retain levy authority for the same dollar amount levied in the highest of the most recent three years under North Dakota Century Code Section 57-15-01.1. He said statutory provisions must be made clear that this would be the result in those situations. He said information provided by Mr. Coleman (Appendix O) identifies the 13 school districts with excess general fund levy authority and identifies the reasons for that authority and the time when that authority was initiated.

Committee counsel said he asked Mr. Coleman for his interpretation of what would happen under current law if voters do not approve extended excess levy authority. He said Mr. Coleman's conclusion is that if voter approval fails, the district general fund levy limitation will be reduced to 110 mills. He said this would directly reduce budgets for those school districts.

Committee counsel said tuition and transportation levies allowed by law are unlimited so he asked Mr. Coleman if a school district could shift general fund expenses to tuition and transportation levies to avoid the general fund mill levy limitation. He said Mr. Coleman's response was that tuition and transportation levies are restricted to use for students educated outside the district and revenue from those levies may be used only for that purpose.

Committee counsel said Mr. Coleman pointed out that Chapter 57-16 allows voter approval of excess levies and asked if this chapter is rendered useless for school districts by the 2009 legislative changes. Committee counsel said Chapter 57-16 allows an excess school general fund levy for up to five years by approval of a majority of electors. He said the five-year period for the levy may be extended in five-year increments by unanimous vote of the school board and there is no limit to how many times the excess levy may be extended by school board action. He said the chapter is duplicative of the authority in Section 57-15-14 for voter approval of excess levy authority with the exception that Section 57-15-14 allows approval for up to 10 years by voters and only approval by voters will allow extending excess levy authority under Section 57-15-14. Senator Cook said he believes Chapter 57-16 should be repealed to eliminate the potential conflict and eliminate school board approval of extending excess levies to follow the intention of 2009 Senate Bill No. 2199 that only voters should have authority to approve excess levies.

Chairman Cook called on committee counsel to review a bill draft based on 2009 Senate Bill No. 2199 to extend property tax relief for the 2011-13 biennium. Committee counsel said the bill draft [10028.0200] was reviewed by the committee at the previous meeting but contained unamended provisions. He said changes have been made in this version of the bill draft to incorporate inclusion of certain types of property subject to special taxation methods, such as payments in lieu of taxes or flat rate taxes, and to clarify that if voters do not approve extended excess general fund levy authority, the school district would become subject to a limitation based upon the highest levy in dollars of the most recent three years under Section 57-15-01.1. He said the bill draft still contains blanks to be completed by insertion of dollar amounts of appropriations and transfers necessary to fund 2011-13 property tax relief. Senator Cook said the funding provisions may be unnecessary if the necessary funding has become part of the Governor's budget for 2011-13. Committee counsel said he will investigate whether that has been incorporated in the Governor's budget.

Senator Potter said the approach of property tax relief similar to the 2009 legislation seems to provide a benefit to school districts. He said he thinks the 2007 property tax relief approach through the income tax was a better method. He said the committee should consider a bill draft for property tax relief similar to the 2007 legislation.

Representative Kasper requested information for the committee to indicate by school district the mill levy, taxable valuation, property tax dollars raised, and a breakdown of taxable valuation by commercial, residential, and agricultural property.

Ms. Dickerson said the Tax Department has no information showing property classifications by school district.

Ms. Bev Nielson, North Dakota School Boards Association, said the Department of Public Instruction *School Finance Facts* contains all of the information requested by Representative Kasper, except a breakdown of property classifications within each school district.

Chairman Cook called on Ms. Dickerson for presentation of information (Appendix P) requested by the committee. Ms. Dickerson said at the previous committee meeting, Representative Kasper requested comparison of school levies for 2008 and 2009 and this information is provided on a spreadsheet attached to her testimony.

Ms. Dickerson said a question was raised whether a school district can shift some general fund levy into tuition and transportation levies. She said if a school district were including tuition and transportation levies within its general fund levy, it can move those levies to unlimited levy authority and free up some mills in the general fund for some other purpose.

Ms. Dickerson said she reviewed school districts whose 2009 mill levies increased by more than 15 percent over 2008. She said of 15 districts, 4 districts increased their high school tuition levies substantially, and it is likely some other districts did also. She presented testimony (Appendix Q) relating to another issue she was requested to address--property taxation of federally subsidized low-income housing.

Ms. Dickerson said for a number of years, there has been disagreement on how subsidized housing should be assessed. She said the Legislative Assembly considered but did not enact a 2001 bill that would have reduced valuations of subsidized housing. She said an interim committee bill draft was considered but not recommended in 2002 that would have reduced assessments of subsidized housing. She said neither bill draft previously considered by the Legislative Assembly or an interim committee proposed to exempt low-income subsidized housing from property taxes. She said a 2003 opinion issued by the Attorney General concluded that a low-income housing project in Minot was exempt from ad valorem taxation under Article X, Section 5, of the Constitution of North Dakota, if the housing project is being used exclusively for charitable or other public purposes. She said the opinion of the Attorney General indicated that whether the property is used exclusively for charitable or other public purposes is a question of fact the city must determine. The City of Minot subsequently exempted the properties in question.

Ms. Dickerson said owners of properties in Grand Forks filed applications for abatement of property taxes for several subsidized low-income housing properties. She said Grand Forks County denied the abatements and the district court rendered a decision on appeal in favor of Grand Forks County.

Ms. Dickerson said several of the properties in Grand Forks have been subject to property taxes for decades. She said many of the residents of the property have received the renter's property tax refund, which will no longer be available to them if the properties are exempted. She said the rent for these individuals would not decrease and some would lose the property tax refund as a result of a property tax exemption because under federal regulations, rent is based on the tenant's income. She said only the property owners would receive the benefit of exemption from property taxes.

Ms. Dickerson said this is an issue of statewide concern. She said properties similar to those in Grand Forks are currently exempt in Bismarck and Minot. She said Mandan recently exempted similar property. She said similar properties are subject to property taxes in Fargo, Jamestown, and West Fargo.

Senator Cook said ensuring uniformity of assessments in the state is part of Ms. Dickerson's job as State Supervisor of Assessments. He said it appears differing treatment is applied to these properties in parts of the state. He asked how the Legislative Assembly could make it clear how these properties should be treated. Ms. Dickerson said a statutory provision exists which could be amended to expressly state whether subsidized housing qualifies as property used exclusively for charitable or other public purposes. She said, however, there is a constitutional provision that also states that property used exclusively for charitable or other public purposes is exempt from property taxes. She said she does not know if a statutory provision would be applied by courts as an interpretation of a constitutional provision. Chairman Cook directed committee counsel to prepare a bill draft to clarify that subsidized housing is not charitable property and to research the issue of interpreting a constitutional provision by a statutory provision or statement of intent.

Chairman Cook asked committee counsel to request Mr. Coleman to explain the status of imputing oil impact funding or infrastructure fund funding received by school districts under the state aid formula. He said information should also be obtained on whether there was discussion of this issue in the minutes on 2009 House Bill No. 1304.

In response to a question from Representative Winrich, Ms. Dickerson said charitable use of property is the issue on exemption of subsidized housing. She said she does not believe it is a charitable use of property if federal subsidies allow the owner to operate the property at a profit.

Representative Frantsvog said the options appear to be for the Legislative Assembly to make a statement of statewide policy on taxable status of subsidized housing or to wait for a decision from the North Dakota Supreme Court to resolve the issue by interpreting the constitutional provision. Senator Cook said the committee could consider a bill draft on this issue pending a decision by the North Dakota Supreme Court.

Chairman Cook called on Ms. Sara Meier, Property Tax Specialist, Tax Department, for testimony (Appendix R) regarding agricultural property assessment. Ms. Meier reviewed the factors that determine agricultural valuations for each county. She said the four dominant factors are an eight-year average of annual production; the cost of production; the capitalization rates; and the number of taxable acres for cropland, noncropland, and inundated land. She said of the four major factors that affect agricultural value, the eight-year average of production is identified as the reason for dramatic increases in agricultural land values for 2010. She said the increase in the cost of production and the decreases in the capitalization rate almost cancel each other.

Chairman Cook called on Ms. Meier for presentation of information (Appendix S) on implementation of soil surveys in agricultural valuations by counties. Ms. Meier said of 53 counties, 21 counties have the soil survey method of valuation for agricultural property in place. She said Divide County is implementing soil surveys for the 2010 assessment year. She said the remaining 31 counties are more than halfway through the process. She said about one-half of noncomplying counties expect to implement soil survey use in 2011 and the remainder expect to implement soil survey use in 2012. She said a statutory penalty provision for failure to implement soil survey use by 2012 has a potential problem. She said the statutory penalty provision is to be applied monthly, but state aid distribution funds are paid quarterly.

Chairman Cook called on Ms. Sandy Clark, Public Policy Director, North Dakota Farm Bureau, who requested patience in implementation of soil surveys. She said counties should not be rushed to the point where they make mistakes. She said it is important to get it right in applying soil surveys to assessments. She said the agricultural property valuation formula is working well.

Representative Schmidt said the reduction in the capitalization rate is receiving blame from farmers and local officials for agricultural property valuation increases. He said it is not correct to attribute increases to the capitalization rate changes because it appears the increases are attributable to good agricultural production years. He said we need to get the word out so citizens understand the reasons for the increase.

Chairman Cook requested committee counsel to prepare a bill draft to clarify the issue of monthly or quarterly application of penalties for failure to implement soil survey use in agricultural assessments.

Senator Potter said a bill draft should be prepared for committee consideration based on the 2007 property tax relief method. He said the bill draft should be the same as the 2007 legislation except the credit should be 20 percent of property taxes with a cap of $5,000.

TELECOMMUNICATIONS TAXES AND FEES

Chairman Cook called on committee counsel to present a bill draft to replace 911 services fees with gross receipts tax revenues. Committee counsel said the bill draft [10077.0100] repeals Chapter 57-40.6, which contains the current provisions allowing imposition of 911 fees for telecommunications service and provides for administration of emergency services communication systems. He said a new chapter of the Century Code is created by the bill draft to contain all of the provisions relating to administration of the 911 system and provide for imposition of a gross receipts tax intended to replace the revenue from 911 fees. He said the bill draft contains a blank at the point where a gross receipts tax rate percentage should be inserted. He said the rate is blank until it is determined what tax rate is needed to generate the necessary replacement revenue. He said the bill draft provides for deposit of the gross receipts tax in a special fund and provides for allocation of the revenue in the proportion that 911 fees received by each system were of the total of all such fees in the state for calendar year 2011. He said the directive for the bill draft was to replace the revenues so the allocation is in proportion to the current amount of fees received by each system. He said there is an issue regarding timing of the repeal and replacement of funding in the bill draft. He said the 911 fee receipts are allocated to emergency services communication systems on a monthly basis but gross receipts taxes are collected and allocated on an annual basis. He said gross receipts tax revenues are allocated in March and if the 911 fee is eliminated on July 1, there will be a gap in collections and allocations for several months.

Chairman Cook called on Mr. Myles Vosberg, Director, Tax Administration Division, Tax Department, for presentation of information (Appendix T) on telecommunications service taxes. Mr. Vosberg said he was requested to calculate the rate of telecommunications gross receipts taxes needed to replace 911 fees. He said the telecommunications gross receipts tax rate would need to be increased from 2.5 percent to 4.5 percent of gross receipts to replace 911 fees with gross receipts tax revenue.

Mr. Vosberg said he was also requested to provide information on sales and use tax revenue generated by the telecommunications service industry. He said for calendar year 2009, reports by the telecommunications industry showed $560 million sales, $22.5 million purchases, and total sales and purchases of $582.5 million. He said at a 5 percent sales and use tax rate, industry sales and purchases generate $29.12 million tax revenue. He said this amount of tax revenue is the total reported by the communications industry but does not represent all tax revenue generated by the industry. He said the amount reported does not include tax paid by the industry on purchases of equipment and other taxable personal property when the seller is collecting the tax and remitting it to the Tax Department.

Mr. Vosberg said he was also requested to calculate the fiscal impact of equalizing the tax base for sales taxes and telecommunications gross receipts taxes. He said there are two major differences in the tax base. He said gross receipts tax applies to interstate services and sales tax applies only to intrastate services. He said the sales tax applies to Internet access fees and the gross receipts tax does not apply to Internet access fees. He said expanding the sales tax base to include interstate telecommunications service originating or terminating in North Dakota and billed to an address in North Dakota would provide an estimated revenue increase of $2 million per year. He said it cannot be determined how much gross receipts tax revenue would be generated by taxing Internet access fees without surveying service providers that also provide telecommunications services.

Senator Miller asked if the committee ever obtained any information on the revenue effect of uncollected 911 fees from devices that are not subject to the fees. The chairman said information has not been obtained.

Representative Kasper asked why this bill draft was prepared. Chairman Cook said issues that were debated in the last legislative session initiated this study. He said several issues exist, including the concern of counties that there is a lack of funding for 911 services.

Representative Headland said he cannot support this bill draft. He said he thinks it is unfair to ask the telecommunications industry to bear the burden of additional taxes.

Representative Winrich said if some counties are not getting enough money for operation of 911 services, this approach will not fix the problem because they will receive the same amount of funding.

Chairman Cook said there are several problems that must be addressed and the bill draft was requested for committee consideration. He said the perceived problems are that some counties need more funding, some devices are not subject to 911 fees, and some 911 fees collected are not going to the location where the devices are being used.

Senator Miller said substituting gross receipts for 911 fees is not the best solution. He said the approach does not address all of the problems.

Senator Potter said the bill draft approach would help with the fairness issue by applying taxes to some devices that avoid paying fees. He said the bill draft does not address all of the problems. He said he thinks the funding should just be paid from the state general fund.

Representative Wrangham said he agrees with Senator Potter. He said 911 service is a benefit to all citizens of North Dakota. He said it appears a per line charge is not fair to all users and a gross receipts tax is not either.

Representative Belter said he would prefer to leave the 911 fee as it is. He said a gross receipts tax as a percentage of telephone bills means a customer with a higher bill pays more but receives the same service.

Representative Kasper said he questions if the 911 system is working as it should or whether it can be improved. He said he questions whether this committee should await recommendations from the interim Public Safety and Transportation Committee, which is studying the 911 system.

Senator Stenehjem said everyone in North Dakota has the same need for 911 services. Perhaps a special fee on income tax returns would be appropriate. He said there is a question of exactly what services are paid for with the fees. He said much of the initial cost of the 911 system was for establishing locations and road signs for emergency services. He said most road signs are now in place and the costs for the system should come down.

Senator Potter said perhaps the solution is to eliminate the 911 fee and create some form of revenue sharing formula to provide state funding for operation of 911 services.

Representative Schmidt said 911 services are very important to all citizens. He said a potential solution might be to just add 50 cents to the allowable fee.

Senator Stenehjem said the 911 system and fees were established in 1985. He said cellular phones have changed the landscape of telecommunications since 1985. He said the fee system does not work as it was originally conceived.

Chairman Cook called on Mr. Terry Traynor, Assistant Director of Policy and Programs, North Dakota Association of Counties, for comments on the 911 services study. Mr. Traynor said there are some weaknesses in the current 911 fee. He said he does not know if the gross receipts tax approach fixes the problems. He said there are Voice over Internet Protocol services and prepaid cellular phone companies that pay the fee. He said the problem of a person from Denver using a cellular phone in North Dakota is not fixed by the gross receipts tax. He said such a user would not be subject to a gross receipts tax collected by North Dakota. He said the other difficulty is that embedding current fees in the allocation formula for gross receipts taxes would make permanent any problems that exist now in inadequacy of funding.

Representative Drovdal said the first 911 fee was applied to land lines at 50 cents in 1985. He asked Mr. Traynor when the fee began to be applied to cellular phones. Mr. Traynor said he believes cellular phones were subjected to fees in 1991.

Senator Cook asked Mr. Traynor for thoughts on using the state general fund as a funding source for 911 services. Mr. Traynor said in times of a sound state budget, the general fund as a source would be good, but in harder budget times, he questions whether emergency services and safety would have to compete with other spending demands for funding.

Chairman Cook called on Mr. Brackel for comments on the committee study. Mr. Brackel said Bowman and Slope Counties operate a 911 system. He said in 2009, the system had an $8,000 shortfall, and that shortfall will increase to $13,000 in 2010. He said the counties are seeking voter approval to increase the fee to $1.50. He said if the increase fails to get voter approval, the shortfall will have to be funded with property tax revenues.

Chairman Cook said for the next meeting, one of the issues that needs to be explored is where are we missing out on fees and how can that be addressed.

Representative Wrangham said the other part of the issue that needs to be examined is exactly what expenditures are made with fee collections.

Chairman Cook requested committee counsel to seek information on these issues.

No further business appearing, Chairman Cook adjourned the meeting at 4:30 p.m.

John Walstad
Code Revisor

ATTACH:20