NORTH DAKOTA LEGISLATIVE MANAGEMENT

Minutes of the

TAXATION COMMITTEE

Wednesday, October 19, 2011
Roughrider Room, State Capitol
Bismarck, North Dakota

Senator David Hogue, Chairman, called the meeting to order at 9:00 a.m.

Members present: Senators David Hogue, Randy Burckhard, Dwight Cook, Lonnie J. Laffen, Dave Oehlke, Ronald Sorvaag; Representatives Craig Headland, Wesley R. Belter, David Drovdal, Glen Froseth, Lyle Hanson, Patrick Hatlestad, Richard Holman, Jim Kasper, Shirley Meyer, Marvin E. Nelson, Mark S. Owens

Members absent: Senator Jim Dotzenrod; Representatives Larry Bellew, Mike Nathe, Roscoe Streyle

Others present: See Appendix A

It was moved by Representative Drovdal, seconded by Senator Burckhard, and carried on a voice vote that the minutes of the August 2, 2011, meeting be approved as distributed.

PROPERTY TAX STUDY

Chairman Hogue called on Ms. Marcy Dickerson, State Supervisor of Assessments, and Director, Property Tax Division, Tax Department, for presentation of information (Appendix B) in response to several questions posed by the committee.

Ms. Dickerson said information was requested on the total 2010 property taxes, special taxes, special assessments, and payments in lieu of property taxes. She said the information provided shows 2010 property taxes total approximately $722 million, special taxes total approximately $11.8 million, and special assessments total approximately $82.4 million. She said the total of property taxes, special taxes, and special assessments is approximately $816.2 million. She said payments in lieu of property taxes total approximately $516 million. An attachment to her testimony shows the totals of these collections for each county and on a statewide basis.

Ms. Dickerson said effective tax rates for agricultural, residential, commercial, and centrally assessed property are shown by county on an attachment to her testimony. She said for agricultural property the effective tax rate is shown on the basis of assessed value and market value. She said the agricultural property valuation formula generates a lower assessment than would exist for market value. She said effective tax rates for residential property are lower than commercial property because taxable value is 9 percent of assessed value for residential property and 10 percent of assessed value for commercial property. She said centrally assessed property has generally a lower effective tax rate than commercial property because most centrally assessed property is taxable in townships, which generally have lower tax rates than cities, where the majority of commercial property is located.

Ms. Dickerson reviewed information on homestead credit payments to counties for the 2010 tax year. Senator Hogue said the homestead credit payments for 2010 seem lower than the estimated fiscal note for the 2011 legislation. Ms. Dickerson said that is correct, and fiscal notes are very difficult to determine for homestead credit expansion. She said expanding eligibility covers individuals who were not previously eligible and are not included in statistics available to the Tax Department. She said awareness issues are another consideration and efforts by the Tax Department to notify the public of the expansion of the homestead credit resulted in an increased number of claimants.

Representative Owens asked if the effective tax rates computed for property classifications would be higher without the buydown in property taxes by the Legislative Assembly in 2009 and 2011. Ms. Dickerson said the effective tax rate computations reflect the reduced property tax impact because of the buydown provided by legislative allocations.

Ms. Dickerson reviewed the information provided on use of the disabled veteran property tax credit.

Ms. Dee Wald, Legal Counsel, Tax Department, said she would address questions posed by the committee about administrative difficulties of providing property tax relief through the income tax structure, which was a result of 2007 legislation. She said the property tax credit was restricted to individuals with a primary residence in North Dakota. She said property held by a trust, estate, corporation, or other legal entity other than an individual was ineligible for relief. She said many property owners in the farming industry did not receive property tax relief because partnerships, S corporations, or limited liability companies owning agricultural property were ineligible. She said individuals residing outside North Dakota were not eligible for a property tax credit even though they own residential or agricultural property in this state, pay property taxes, and pay income taxes. She said many negative comments were received from nonresidents. She said several questions arose regarding transfer of property during the tax year and eligibility for the credit. She said for individuals not subject to a North Dakota income tax filing requirement or whose income tax liability is exceeded by the property tax relief credit, certificates had to be developed to be redeemed by the county treasurer. She said county officials did a lot of extra work to make the credit workable.

Senator Burckhard said he understood corporations are not allowed to own agricultural land. Ms. Wald said family farm corporations are allowed and other kinds of ownership are possible.

Senator Hogue asked if the Legislative Assembly went back to the 2007 income tax approach to property tax relief, would it be more workable if relief was narrowed to a smaller group. Ms. Wald said she believes the 2007 approach missed providing assistance to a lot of individuals who would have been entitled to the credit. She said even a more-focused group of eligible parties would have the same problem of making individuals aware of the credit that would exist. She said the current approach avoids that issue by delivering relief to reduce property tax mill rates.

Senator Hogue asked if the 2007 property tax relief approach caused additional staff to be added to the Tax Department. Ms. Wald said the Tax Department adds additional staff during income tax filing season, but no additional staff was added specifically for the property tax relief component. She said there were added costs for administration by the department and a slowdown of processing income tax returns.

Senator Cook asked if a homestead credit for all primary residences would be an option for consideration to limit property tax relief to North Dakota residents. Ms. Wald said that would be a viable option, and it could be administered more easily than the 2007 approach.

Representative Froseth asked Ms. Dickerson why there was such a substantial increase in the number of applicants for the disabled veterans homestead credit in Cass County in 2010 than in 2009. She said it appears efforts to make veterans aware of the credit were effective in 2010, which is reflected in the increase in claimants.

Ms. Dickerson returned to coverage of the issues in her prepared testimony about the flooding impact to 2011 property valuations. She said abatements and assessment reductions provided for flood-damaged property would cause a shift of approximately $4.6 million from flood-damaged property to unaffected properties. She said new growth in some of the affected areas has offset all or part of the loss in taxable valuation, which would reduce the effect of shifting property taxes.

Mr. Kevin Ternes, City Assessor, Minot, provided copies of prepared testimony (Appendix C).

Mr. Ternes said 130 homes to 140 homes in the flooded area in Minot have been sold as they were after floodwaters receded. He said these sales have been at approximately 40 percent to 50 percent of preflood value.

In response to a question from Senator Hogue, Mr. Ternes said it appears a 30-mill increase in property tax levies will persist into 2012 and will gradually be reduced as damaged property comes back to normal valuation.

In response to a question from Representative Headland, Mr. Ternes said it will take time for people to determine whether to stay in Minot. He said in his opinion a majority of affected homeowners will not be able to afford to move. He said valuation of property on the hills outside the Minot flood zone is much higher than the values of property in the flood zone. Representative Kasper said it appears likely that in many cases loans taken to repair a flood-damaged house in Minot will make the debt against that property higher than the value of the property. Mr. Ternes said that will be true for many homeowners.

Senator Burckhard said many Minot homeowners will repair the flood-damaged home but will not fix the basement. He asked how that will affect valuations. Mr. Ternes said a finished basement usually accounts for perhaps 10 percent to 15 percent of value, so there should not be too much effect on values from unfinished basements.

Representative Drovdal said Minot is experiencing increased economic activity and increasing market values of property. He asked how that will affect decisions to repair property. Mr. Ternes said without the flood event, Minot is experiencing 10 percent to 12 percent growth per year in valuations, and those increases over time can make home repair worthwhile.

Senator Cook inquired about federal Emergency Management Agency (FEMA) trailers in place in Minot. Mr. Ternes said the trailers are located on group sites--one containing about 600 trailers and one containing about 100 trailers. He said FEMA trailers will also be located on the property of homeowners whose homes were damaged by flooding. He said in these cases connections to water and sewer and utilities must be made. He said one cause for concern with FEMA trailers is that they are not well-insulated. He said estimates have been made that heating bills for the trailers could run in the range of $400 to $600 for each winter month.

Information on Burleigh County flooding abatements was distributed to committee members (Appendix D).

Ms. Dickerson presented a portion of her prepared testimony relating to the effect of home rule on property taxes. She said a home rule city or county with unlimited levy authority in its home rule charter may levy an unlimited number of mills. She said home rule cities and counties also are able to impose a sales tax, which may allow a lower property tax levy. She said the variable effect of home rule on city and county mill rates is reflected in the table attached to her prepared testimony.

Ms. Dickerson reviewed the information in her written testimony about identifying residency of property owners. She said it appears there is no method to identify which residential properties are homesteads or how to determine residency of other owners of property without information from the property owner. She said to encourage property owners to provide information, it appears some incentive is necessary. Representative Meyer asked if there is any information available on owners of mineral acreage who are nonresidents. Ms. Dickerson said there is no information available, and it would be virtually impossible to compile information. Representative Meyer asked what kind of incentive Ms. Dickerson believes might identify resident property owners. Ms. Dickerson said a homestead credit broadly available appears to work in some states to identify those property owners. She said the difficulty is it cannot be anticipated what the cost might be for that kind of property tax credit because it is not known how many would qualify.

2013-15 Property Tax Relief Projections

Chairman Hogue called on Mr. Jerry Coleman, Director of School Finance, Department of Public Instruction, for presentation (Appendix E) of mill levy reduction grant information for the 2013-15 biennium.

Mr. Coleman said he was requested to compute the projected cost for property tax relief through mill levy reduction grants on the same basis as provided in 2011 House Bill No. 1047. He said a growth factor of 7.7 percent per year was used in making the projections. He said use of this growth factor would bring the 2013-15 biennium cost of the grants to $403,407,374. He said this would be an increase of $66,264,434 over the estimated cost of the grants for the 2011-13 biennium. He said the 2011 appropriation was approximately $341 million and the final cost is currently estimated to be approximately $337 million, so there will be adequate funding to complete the biennium grant distributions. He said the last page of the information he prepared shows the relative cost increases using other inflator factors from 5 percent to 10 percent. He said it is anticipated there will be an increase of approximately 20 percent in 2012 for agricultural property values due to a change in the capitalization rate in the valuation formula.

Building Authorities

Chairman Hogue called on committee counsel for presentation of a memorandum entitled *Building Authority Financing of Public Buildings for Political Subdivision Use*. Committee counsel said a public building authority may be established in North Dakota as an alternative financing method for public building construction. He said bonds issued by a building authority must qualify for the federal income tax exemption for bondholders to make the bonds an attractive investment. He said an Internal Revenue Service ruling regarding the income tax exemption for bondholders requires a privately established nonprofit corporation to issue indebtedness and construct the building. When the indebtedness is retired, the state or political subdivision must obtain legal title to the property. The political subdivision would make lease payments from available sources until the indebtedness is retired. Because revenue and appropriations of the political subdivision are an annual decision, bondholders run the risk of the political subdivision not appropriating funds to pay the lease rentals. Bondholders would have no recourse against the political subdivision in the event of default. He said the increased risk to investors means interest rates on the bonds are higher than traditional financing methods.

Committee counsel said one aspect of building authority financing that has drawn criticism is that use of a building authority avoids the requirement of voter approval and the constitutional debt limit for political subdivisions.

Committee counsel said information was requested on the extent of the use of building authorities. He said there is no central source for information but review of the records of the Secretary of State identifies 28 building authorities registered as corporations in North Dakota, which are listed in the memorandum. He said obtaining information from these corporations would require contacting each entity.

Senator Hogue said the GuideStar website has information on nonprofit entities. He said useful information on building authorities might be available on the website.

Senator Cook said efforts should be made to obtain information on building authority levels of indebtedness.

Representative Kasper said he has been raising issues about use of building authorities in recent legislative sessions. He said he believes it is important to gain a better understanding of the extent to which these entities are being used and the level of indebtedness that has been accumulated.

Committee counsel said he would investigate methods of requiring building authority information to be reported to a central gathering point.

Representative Kasper said many taxpayers in Fargo are not happy with approximately $200 million of public school construction in recent years without an opportunity for taxpayers to vote on incurring the indebtedness.

Department of Commerce Tax-Exempt Property Study

Chairman Hogue called on Mr. John Schneider, Executive Director, Agricultural Products Utilization Commission, Department of Commerce, for presentation of information on a study conducted by the department on tax-exempt property. Mr. Schneider distributed copies of the report (Appendix F). He said 2009 Senate Bill No. 2018 directed the department to compile information identifying tax-exempt property by school district. He said the department hired two summer interns to work on the study who contacted each county requesting information on tax-exempt property within county school districts. The study eventually narrowed to seven counties, the number of counties that appeared to have most of the requested information. County representatives identified challenges with the study effort. Technological and staff differences between counties make uniform reporting and collection of information difficult. No counties collect or track information in the manner in which it was requested for the study. Due to the lack of consistency in collecting and reporting data on tax-exempt property, the department was unable to secure the information needed to complete the study. The report summarizes the information that the department was able to gather.

Committee Discussion

Chairman Hogue said it appears the committee will have to address the issue of whether a mill levy buydown property tax relief following the model of 2011 legislation will be sustainable.

Senator Cook said he believes there are two things to explore on this topic. He said consideration should be given to how a homestead tax credit similar to the one in Minnesota could be applied to provide tax relief for only a primary residence. He said consideration must also be given to the dissatisfaction that was the impetus for initiated measure No. 2 to eliminate property taxes. He said he foresees dissatisfaction with the fairness of the property tax system in use of exemptions for economic development, exemption of farm residences, and agricultural property valuation under the formula for determining value. He said these reasons have been advanced by many as the reason to eliminate property taxes. He said many taxpayers are of the opinion that the effective tax rate compared to the market value of agricultural land is far too low. He said consideration should be given to placing a floor on how far the agricultural property valuation formula can drop values below market value. He said a bill draft should be prepared and discussion should be held on this topic.

Chairman Hogue said two bill drafts should be prepared--one to establish a homestead credit for all primary residential property and one to establish a percentage of market value floor on agricultural property valuation under the formula.

Representative Kasper said numerous questions have been raised on initiated measure No. 2 to eliminate property taxes. He asked if a memorandum is being prepared to address these issues. Committee counsel said a memorandum is being prepared and will be presented to the Property Tax Measure Review Committee at its November 2, 2011, meeting. Representative Kasper requested that the memorandum be distributed to all legislators, perhaps during the November special session.

Representative Headland said the Minnesota homestead tax credit may not be a good model. He said he believes Minnesota ran into serious budget difficulties. He said information should be provided on how Minnesota budget problems developed and if the homestead credit was a factor.

Representative Owens said Alabama provides a homestead credit for residential property which might be useful to examine.

SPECIAL ASSESSMENT STUDIES

Chairman Hogue called on committee counsel for presentation of a memorandum entitled *Special Assessment Imposition and Challenges*.

Chairman Hogue called on committee counsel for presentation of a memorandum entitled *Special Assessments and Alternative Funding Methods for Public Improvements in Other States*.

Committee counsel said a question was raised at the previous committee meeting regarding the possibility of imposing special assessments for removing emergency dikes and other costs of flood defense efforts. He said a copy of North Dakota Century Code Section 40-22-01.1 was distributed to committee members. He said this section allows a city that has constructed temporary emergency flood control protection devices or works to remove the material and repair any damages caused by installing or removing the flood protection systems. He said the city is allowed to establish a special assessment district for the area and impose special assessments to cover the costs incurred by the city. He said the resolution of necessity and opportunity to protest special assessments do not apply to these assessment projects.

Representative Kasper said the city of Fargo levied special assessments for extension of a major street, and neighboring landowners were subjected to extremely high special assessment costs. He asked if the city could have drawn the entire city into the district for special assessment for the street project. Committee counsel said he cannot make a judgment about whether Fargo could have incorporated the entire city under the circumstances of the project described, but the statutory provisions would allow a city to extend a special assessment district to everything within city boundaries if the city perceives a benefit to all property within the boundaries.

Chairman Hogue called on Ms. Doreen Riedman, Executive Officer, North Dakota Association of Builders, for information on the effect on residential property costs of using special assessments or development costs paid by the property developer. Ms. Riedman said Mr. Don Dabbert Jr., Dabbert Custom Homes, Fargo, would address these issues on behalf of the North Dakota Association of Builders. Mr. Dabbert said use of special assessments is a tool very important to developers of property and to cities. He said special assessments allow growth to occur in times when banks will not finance property development.

Mr. Dabbert said in Fargo property developers must put up an initial funding commitment or promissory note to initiate a development project. He said this demonstrates the commitment of the developer to a project before the city initiates proceedings to establish a special assessment district to put infrastructure in place.

Mr. Dabbert said booms in North Dakota economic sectors have pumped-up market values of land. He said this is generally a good thing, but complications are created for property developers.

Mr. Dabbert said he is glad to see that North Dakota does not use impact fees as an alternative to special assessments. He said imposition of impact fees on developers is detrimental to property development.

Mr. Dabbert said new housing pays its own way. He said it generally takes less than one year for a new home to repay its costs to local government.

Senator Cook said the common denominator of approaches to funding infrastructure development is the question of who takes the risk. Mr. Dabbert said the question of risk is part of these funding decisions. He said Fargo has had the foresight to establish a rainy day fund as a backup for special assessment projects.

Senator Cook said that in consideration of issues the committee should discuss at the next meeting, he believes several topics should be included with regard to the property tax study. He said a bill draft should be prepared to continue property tax relief based on the model of the 2011 property tax relief bill. He said with regard to special assessments, the amount of bonded indebtedness is a concern. He said special assessment debt is not considered debt under the constitutional restriction. He said he has requested research on why special assessment debt is not considered for constitutional debt purposes if city property tax authority remains liable for payment in the event of default. He said a memorandum should be presented on this issue. He said if initiated measure No. 2 passes and eliminates property taxes, the perspective will change on special assessment. He said the committee should await the result of the June election on completing recommendations regarding special assessments. He said some of the sponsors of initiated measure No. 2 suggested that special assessments can be levied by political subdivisions as a substitute for some property tax revenues. He said he does not believe this is true, especially for political subdivisions like school districts that cannot impose special assessments. He said information should be provided on the extent to which special assessments could be used as a replacement for property tax revenues.

Senator Sorvaag said information was provided that Fargo requires a letter of credit or other funding commitment from developers before special assessment projects are initiated. He said information should be obtained on how other cities require a commitment from a developer for an initiation of a special assessment project.

Representative Kasper said a successful protest against a special assessment district requires protest by owners of a majority of the area within the proposed district. He said districts could be established in which the city, park district, or other public entity owns the majority of the area, and owners of private property would have no method of making a successful protest. He said this issue should be reconsidered by the committee.

OIL EXTRACTION TAX STUDY

Chairman Hogue called on Mr. Lynn Helms, Director, Department of Mineral Resources, for testimony (Appendix G) on several issues regarding oil development and taxation.

Mr. Helms said he was requested to provide information on stripper wells, including the production levels of stripper wells and drilling of new wells on existing stripper well properties plus the aging of Bakken wells and anticipated time when infill drilling will occur. He said three categories of stripper wells exist based on the depth of the well. The information he provided to the committee shows the number of active stripper wells and average production in each of the three categories. He said approximately 60 percent of existing wells in the state are stripper wells. However, he said, many stripper wells are inactive, and only 37 percent of active wells are stripper wells. He said only 6.4 percent of state oil production qualifies for the stripper well extraction tax exemption.

Mr. Helms said there are 3,458 stripper well properties in North Dakota. He said 194 infill wells have been drilled on those properties, and 188 of those are enhanced oil recovery wells. He said the obvious policy question that must be addressed is whether someone who drills a new well beside a stripper well should receive the stripper well exemption. He said infill wells drilled to this point are almost exclusively enhanced oil recovery wells, which would entitle those wells to the enhanced recovery tax exemption, which is limited to a term of 5 years or 10 years rather than being unlimited like the stripper well exemption.

Mr. Helms said there are 390 Bakken stripper well properties. He said on those properties one infill well has been drilled and four infill wells are being drilled. He said the stripper well incentive was enacted to keep low-production wells pumping. He said the stripper well incentive was extended to a "property" because drilling in that property was a much riskier investment.

Senator Hogue said there is concern that "gaming" by oil companies could obtain an extraction tax exemption for a high-production well drilled on a stripper well property. Mr. Helms said that is a valid concern for Bakken and Three Forks Formation drilling. He said in the Madison Formation, drilling is much riskier, so stripper well property treatment is appropriate.

Representative Meyer said early Bakken wells were not as efficiently fracked, and drilling technology has substantially improved. She said reentries in those properties are likely, and stripper well status would exist. Mr. Helms said that is correct, and those new wells could be entitled to stripper well status as the law currently exists.

Representative Drovdal said many permits for Bakken wells are based on 1,280-acre spacing. He said on that size of spacing unit, six wells could be drilled. He asked if the driller could complete one well and drain it down to stripper well status and then finish five other wells in the spacing unit with the stripper well property exemption. Mr. Helms said that would be possible as the law currently exists. He said that situation will have to be addressed by legislative changes. He said it is fortunate that it will be several years before substantial infill drilling occurs, so the Legislative Assembly has time to consider how to address the issue.

Representative Froseth said it appears there could be problems if Madison Formation stripper well properties are the site of Bakken well drilling or Bakken Formation stripper well properties are the site of Three Forks Formation drilling. He asked if the formation of production matters under the stripper well exemption. Mr. Helms said the stripper well property exemption is pool-specific, meaning that only the Bakken pool would have stripper well property status and wells drilled into the Three Forks Formation on that property would not be entitled to the stripper well property exemption.

Mr. Helms said a chart in the material he provided shows typical Bakken well production decline for the life of a well. He said newer wells have been completed with improved technology, and it will take about 15 years for 2011 Bakken wells to decline to stripper well production status. He said for 2008 or earlier Bakken wells, it will take approximately 10 years to reach stripper well production status.

Senator Hogue asked what is the industry practice on refracking Bakken wells. Mr. Helms said there has been some refracking of Bakken wells in Montana, but no refracking operations are contemplated in North Dakota for wells completed with multistage fracks. He said for North Dakota Bakken wells completed in 2006 to 2008 without multistage fracks, the operator can reenter and do multistage fracking to improve production.

Mr. Helms said he was requested to provide information on the number of new wells expected to come into production. He said it is expected that 2,000 new wells will be completed per year, but the total number could range from 1,100 to 2,700 wells per year. He said it is anticipated that 225 drilling rigs will operate in the state and that 5,000 wells are needed to secure the leases that have been obtained. He said 225 rigs can complete the 5,000 wells in a minimum of 2.5 years. He said the spacing unit development will require approximately 28,000 wells, which could be completed by 225 drilling rigs in a minimum of 14 years. He said the net result of this activity would be 33,000 new wells, and each new well is equivalent to one long-term job. He said the number of new wells over the next 14 years would generate 30,000 to 35,000 long-term jobs in western North Dakota. He said no serious infill drilling will take place before the 2.5 years expected for a completion of the wells needed to secure existing leases. He said when drilling is completed to secure existing leases, a period of 10 years to 14 years of intense infill drilling will follow.

Representative Drovdal said infill drilling is subject to variables. He said it appears likely that smaller mineral acreage holding companies will begin infill drilling before big acreage holders who have more wells to drill to secure existing leases. Mr. Helms said that is correct. Representative Drovdal asked if he is correct in assuming that a whole property is not a stripper well property until all wells on that property are producing at or below stripper well levels. Mr. Helms said that is correct.

Mr. Helms said he was requested to provide information on projected production and export capacity. He said we have a transportation capacity problem coming and need to be looking for projects beyond the Keystone XL project. He reviewed information on existing and planned pipeline and rail export projects.

Mr. Helms said he was requested to provide information on possible federal regulatory action that could disrupt North Dakota oil and gas production. He said there are a number of possible federal regulatory issues that would have a potential to reduce activity in North Dakota oilfields. He said minor source air permitting is a potential problem. He said the United States Environmental Protection Agency (EPA) has taken over minor source air permitting on the Fort Berthold Reservation and that will cause a slowdown on reservation oil development. If the EPA moves to supplant regulation by the State Department of Health, serious disruption of oil drilling will occur. He said the state of North Dakota does minor source air permitting in four days or five days. He said the EPA does minor source air permitting in about 12 months. He said this would possibly have a serious impact on drilling activity.

Mr. Helms said cap and trade proposals being considered in Congress could reduce oil development in North Dakota by 35 percent to 40 percent. He said the current administration's budget contains tax rules changes that could reduce oil development an estimated 35 percent to 50 percent. He said if oil prices fall below $50 per barrel, activity could be reduced an estimated 25 percent to 30 percent. He said EPA regulation of hydraulic fracturing could halt drilling activity for 18 months to 24 months and reduce production by 25 percent to 30 percent. He said the EPA has issued a guidance document saying the EPA can regulate the presence of diesel fuel for water protection purposes. He said the EPA has pushed its position that anything contained in diesel fuel is included, which would mean fracking fluids used for oil production would become subject to EPA regulation.

Representative Belter said President Barack Obama is seeking to take away "subsidies" for certain industries and asked if that would include the oil depletion allowance and accelerated depreciation for oil companies. Mr. Helms said those are an apparent target of administration proposals, and it appears only the oil industry is the target although all industries get this tax treatment. He said those changes would be very harmful to the domestic oil industry.

In response to a question from Senator Hogue, Mr. Helms said EPA rules shut down the coalbed methane industry in Alabama for two years, and that industry has not come back. He said that experience was the basis for his estimate for the possibility of halting oil drilling activity under EPA regulation of hydraulic fracturing.

In response to a question from Senator Burckhard, Mr. Helms said the area causing concern to the federal government exists with hydraulic fracturing occurring in Pennsylvania. He said the Pennsylvania problem is much different, because Pennsylvania geology is much different from geology underlying North Dakota. However, he said, EPA rules would affect the entire country, not just Pennsylvania.

Representative Meyer asked how much of the state's bonding authority for pipelines has been used. Mr. Helms said none of the state bonding authority for pipelines has been used, and all of that authority remains available.

Representative Drovdal asked if Canadian oil sands production requires batching with Bakken oil to flow in the Keystone XL pipeline. Mr. Helms said that is correct and Bakken oil should get a premium price as a result of that requirement.

In response to a question from Representative Froseth, Mr. Helms said North Dakota exports about 92 percent of oil production and 8 percent of natural gas production on a British thermal unit basis, but on a dollar value basis, natural gas exports are only about 3 percent of exports.

SALES TAX EXEMPTION STUDIES

Chairman Hogue called on Mr. Myles Vosberg, Director, Income, Sales and Special Taxes Division, Tax Department, for a presentation of information on the sales tax exemption studies assigned to the committee. Mr. Vosberg distributed copies of information (Appendix H) showing city sales tax collections, 1 percent equivalents, and sales tax per capita, which were requested by the committee. Representative Drovdal asked if these statistics could be produced based on state sales taxes for these cities. Mr. Vosberg said the information could be prepared.

Mr. Vosberg distributed copies of information (Appendix I) on sales tax exemptions by category which was requested by the committee. He said the request was to show exemptions categorized by qualification for the exemption by the seller, purchaser, or the product or service. He said the information also provides the cost of sales tax incentive exemptions for fiscal years 2001 to 2011. He said for some categories of exemptions, very few taxpayers are eligible, and confidentiality requirements do not allow disclosure of annual totals but total amounts are shown for the category.

Mr. Vosberg distributed copies of information (Appendix J) on sales by retailers to tax-exempt entities. He said information was requested by the committee on what procedures retailers should follow to protect themselves from becoming liable for sales taxes when making sales to entities asserting tax-exempt status. He reviewed the procedures and forms to be used in these situations.

Mr. Vosberg said the committee requested information on the sales tax exemption for voluntary health associations and the role of the National Health Council in obtaining that exemption. He said Section 57-39.2-04(32) requires nonprofit voluntary health associations to be recognized by the National Health Council to be eligible for the sales tax exemption. He said the National Health Council was added to the exemption to maintain a relatively narrow coverage of the exemption. He said an issue arose when a group of clinics called federally qualified health centers sought exemption but have not been recognized or become members of the National Health Council.

Senator Cook requested research on Idaho, South Dakota, and Wyoming sales tax treatment of purchases by Montana residents. He also requested information on how states bordering Canada treat Canadian citizens' purchases for sales tax purposes.

INCOME TAX STUDIES

Chairman Hogue called on Mr. Justin Dever, Manager, Office of Innovation and Strategic Initiatives, Department of Commerce, for information (Appendix K) on the study of effectiveness of tax credits for economic development.

Representative Headland said Mr. Dever's testimony shows 111 new jobs created by the renaissance zone program for the 2009 calendar year. He asked what the total cost of renaissance zone credits was for that year. Mr. Dever said the approximate costs in credits were $1.1 million.

Senator Hogue said the tables attached to Mr. Dever's testimony prepared by the Tax Department show the effect of individual income tax and corporate income tax credits through the 2009 tax year. He asked if that information could be provided for 2010. Mr. Dever said the Tax Department prepared the information and would have to address the question of whether 2010 information is available.

Senator Sorvaag said it should be remembered that a renaissance zone project does not just generate jobs but also increases property values. He said renaissance zone projects will provide enhanced tax revenues and other benefits for the future.

Mr. Dever introduced Mr. Rod Backman, Covenant Consulting Group, Bismarck, to provide an overview of a study of 2007-09 incentive expenditure reports prepared by Covenant Consulting Group. A copy of the report is included in the testimony provided by Mr. Dever in Appendix K.

Mr. Backman reviewed the study report and said tax incentive studies are very hard to do, and there is no way to know for certain if company growth is attributable to a tax credit or if the company would have located elsewhere without the credit availability.

Mr. Hogue called on Mr. Cory Fong, Tax Commissioner, Tax Department, for testimony (Appendix L) relating to the Business Activity Tax Simplification Act (BATSA) of 2011.

Mr. Fong said BATSA (H.R.1439) would greatly restrict states' ability to tax in-state business activity.

Senator Cook asked if Mr. Fong can estimate the fiscal effect of enactment of BATSA for the state of North Dakota. Mr. Fong said the Tax Department estimates the legislation, if enacted, would have a negative fiscal effect for North Dakota income tax collections of approximately $3.5 million to $6.8 million per year. He said the Congressional Budget Office has estimated a $20 billion cost to state tax collections over 10 years. He said the Tax Department thinks the Congressional Budget Office estimate is conservative, and state losses would exceed that amount.

Representative Nelson asked if BATSA would impact North Dakota's ability to license businesses and individuals. Mr. Fong said he does not know if the legislation would affect licensing, and agencies that handle licensing responsibilities would be better able to address that question.

Chairman Hogue called on Ms. Mary Loftsgard, Assistant Director of Tax Administration, Tax Department, for testimony on several issues relating to income taxes. Ms. Loftsgard said she was requested to provide information on the effect of acquisition of property and mineral rights in North Dakota by oil companies and how North Dakota apportionment factors of those companies have been affected. A copy of a table provided by Ms. Loftsgard is attached as Appendix M. She said the table shows the growth of North Dakota apportionment percentages for oil exploration and production corporations for the years 2007-09. She said the apportionment percentage has almost doubled and so has the corporation income apportioned to North Dakota for these corporations.

Ms. Loftsgard said she was requested to provide information on state apportionment factors for corporate income. She said under the Uniform Division of Income for Tax Purposes Act, three-factor apportionment was originally provided with equal weighting for property, payroll, and sales factors. She said many states have altered formulas to provide unequal weighting of the apportionment factors. She said the table (Appendix N) she provided to committee members shows the weighting of apportionment factors for states imposing income taxes and the District of Columbia. She said Alabama is shown on the table as a three-factor state but has recently changed to provide double weighting for the sales factor.

Senator Cook asked if there have been recent changes by states. Ms. Loftsgard said there have been movements by states on apportionment factors, and in recent years the movement has been to heavier weighting on sales.

Senator Cook asked if there is anything North Dakota should do on sourcing provisions for tax purposes. Mr. Fong said there are options North Dakota could consider, but uniformity of sourcing provisions among states is desirable for businesses. Senator Cook asked if it would be advisable to wait for a recommendation from the Multistate Tax Commission. Mr. Fong said waiting for an option that would achieve greater uniformity among states makes sense.

Ms. Loftsgard distributed copies of statistical information (Appendix O) from tax year 2009 individual and corporate income tax statistics showing the number of returns, tax liability, percentage of total tax liability, and average tax liability per return for each tax bracket.

TOBACCO TAX STAMP STUDY

Chairman Hogue called on Mr. Vosberg for information (Appendix P) on the cost of requiring tax stamping for cigarettes. He said the cost to the state for purchasing stamps for cigarettes would be approximately $1 million to $1.45 million for a biennium.

Chairman Hogue called on Mr. Mike Rud, President, North Dakota Petroleum Marketers Association, and President, North Dakota Retail Association, for comments (Appendix Q) on the cigarette tax stamping study. Mr. Rud said the organizations he represents oppose mandating cigarette tax stamping in North Dakota.

Chairman Hogue called on Mr. John Olson, Counsel, Altria Client Services Inc., and Philip Morris USA Inc., who presented written testimony (Appendix R) of Altria Client Services relating to the tobacco tax stamp study.

Chairman Hogue called on Ms. Jeanne Prom, Executive Director, Center for Tobacco Prevention and Control Policy, for testimony (Appendix S) relating to the tobacco tax stamping study.

In response to a question from Senator Hogue, Ms. Prom said Minnesota cigarette taxes are approximately $1.40 per pack, Montana taxes are approximately $1.50 per pack, South Dakota taxes are approximately $1.40 per pack, and national average state taxes for a pack of cigarettes are approximately $1.46. She said North Dakota is substantially below the average for cigarette taxes.

Representative Kasper asked if there is any evidence that North Dakota cigarettes are being smuggled out of the state for resale. Ms. Prom said that is not an issue her organization has investigated.

Senator Hogue asked if Montana has a law that a Montana resident cannot buy 30 cartons of cigarettes in North Dakota. Ms. Prom said she does not think Montana has such a law, but the concern is primarily with buying cigarettes in bulk for resale to avoid taxes.

Representative Headland requested research on whether the state of North Dakota could use tobacco settlement funds to cover the state cost of tax stamps for cigarettes.

Chairman Hogue called on Mr. John Job, Amcon Distributing Company, for comments on the tobacco tax stamping study. Mr. Job said his concern is that the cost of stamping would have to be absorbed by distributors. He said distributors know where every cigarette goes after they bring it into the state.

Chairman Hogue called on Mr. Fong for comments on the tobacco tax stamping study. He said unless North Dakota would provide law enforcement saturation, the Tax Department does not believe tax stamps on cigarettes would be effective deterrents for any market in untaxed cigarettes. He said if North Dakota required tax stamps for cigarettes, the only apparent beneficiaries would be surrounding states that have higher tax rates. He said if surrounding states are to benefit, perhaps they should pay the cost of stamping.

Chairman Hogue called on Mr. Brad Borkhuis, Chief Executive Officer, Wholesale Supply Company, Minot, who said Wholesale Supply Company has no tax stamping equipment, which means his business would face costs from the ground up to acquire equipment and stamps. He said he is not aware of any instance of tobacco smuggling involving North Dakota products. He said he understands that the stories relating to Michigan tobacco smuggling operations he has heard include information that Michigan tobacco smugglers were able to counterfeit tax stamps. He said stamping requirements simply created another method for smugglers to avoid taxes.

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

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John Walstad
Code Revisor

ATTACH:19