Minutes of the

TAXATION COMMITTEE

Tuesday, July 7, 1998
Roughrider Room, State Capitol
Bismarck, North Dakota

Representative Wesley R. Belter, Chairman, called the meeting to order at 9:00 a.m.

Members present: Representatives Wesley R. Belter, Grant C. Brown, Chris Christopherson, William E. Gorder, Mick Grosz, Ralph L. Kilzer, Kenneth Kroeplin, Alice Olson, Dennis J. Renner, Earl Rennerfeldt, Arlo E. Schmidt, Ben Tollefson; Senators Randel Christmann, Layton Freborg, Meyer Kinnoin, Ed Kringstad, Randy A. Schobinger, Vern Thompson, Herb Urlacher

Members absent: Representatives Edward H. Lloyd, Ronald Nichols

Others present: See Appendix A

It was moved by Representative Rennerfeldt, seconded by Representative Brown, and carried that the minutes of the previous meeting be approved as mailed.

COAL INDUSTRY STUDY

Chairman Belter called on committee counsel for an update on the status of the consultant study and other activities in the coal industry study.

Committee counsel said Dr. Ramsett has completed a rough draft of the study of the lignite industry and its competitive position. He said a copy of the rough draft has not been received by the Legislative Council but is being reviewed by the staff of the Lignite Energy Council. He said Dr. Ramsett anticipates no difficulty meeting the August 1, 1998, deadline for completion of the final report. He said Dr. Ramsett would be available to deliver the report to the Taxation Committee during the first two weeks of August. He said after August 14 Dr. Ramsett would have classroom duties and arrangements for a presentation to the committee would have to accommodate his classroom schedule.

Committee counsel said the Lignite Energy Council had no desire to make a presentation to the committee at this meeting and has no recommendations at this time. He said it may be difficult for the committee to make recommendations after receiving the report under the limited time available for further committee meetings.

Committee counsel said the lawsuit in Minnesota regarding the Minnesota externalities tax law was concluded recently and the North Dakota lignite industry was on the prevailing side. He said Minnesota law would have imposed a heavy tax on consumption of power produced from lignite, with the stated objective of reducing emissions. He said the heavy tax imposed under the law would have made the cost of lignite power too high to compete in the Minnesota market.

PROPERTY TAX EXEMPTIONS EFFECT ON SCHOOL DISTRICTS STUDY

Chairman Belter called on committee counsel to review two bill drafts relating to establishing a role for school districts in decisions on new industry property tax exemptions.

Committee counsel said the first bill draft relating to this topic would provide that a city or county granting an exemption or payments in lieu of taxes for a new industry would not create an exemption or payments in lieu of taxes with regard to property taxes levied by a school district if the school district approves a motion to disallow the exemption or payments in lieu of taxes. Committee counsel said the bill draft contained the same wording as 1997 legislation, and he suggested that if the committee chooses to pursue this approach, the committee may wish to consider rewording the new language as a positive statement rather than providing that tax breaks do not apply if the district approves a motion to disallow the tax breaks.

Committee counsel said the second bill draft relating to this study is patterned after 1995 legislation that expired in 1997. He said the bill draft would provide that a city or county considering a property tax exemption or option to make payments in lieu of taxes for a new industry must include, as nonvoting ex officio members of the city or county governing body, a representative appointed by the school board and the board of township supervisors from each affected school district or township. He said the bill draft contains an expiration date making the law effective for only two years because it was requested that the bill draft be prepared in the same fashion as the 1995 legislation.

Chairman Belter called on Ms. Bev Nielson, North Dakota School Boards Association, for comments on the study. A copy of Ms. Nielson's prepared testimony is attached as Appendix B. Ms. Nielson said the School Boards Association does not oppose economic development property tax exemptions but would like input on granting of exemptions that affect school districts. She said the committee at its previous meeting requested information on the cost impact to a school district of each new student. She said it is not possible to provide this information because one or two new students in a district may necessitate very little additional costs, but a greater number of new students or students having special needs could have variable impacts on costs to the school district. She said if school boards are not allowed to have authority over exempting their levies from exemption decisions of cities and counties, they should at least have one voting member on the city or county governing body making the decision. She said other options for consideration under this study would be to allow imposition of an education impact fee for developers of new industries, as is allowed in New Jersey, or allowing school districts in impacted areas an additional levy authority to meet needs for additional expenditures as they become manifest over time.

Chairman Belter called on Mr. Kevin Cooper, North Dakota Industrial Development Association, for comments on the study. Mr. Cooper said he was requested by the committee to gather information regarding use of property tax exemptions to encourage business investment in communities. He said a study on this topic was done by Charles Bailey and Company and North Dakota State University Professor Larry Leistritz in 1995. He said that study sampled 29 business projects from across the state in rural and urban settings, 13 of which received property tax exemptions. He said that from his conversations with development officials across the state, property tax exemptions are used in approximately 30 percent of development projects. He said property tax exemptions are not provided indiscriminately by local officials.

Mr. Cooper said in 1996, the Fargo-Cass County Economic Development Corporation was involved in 17 business development projects, and only four received property tax exemptions. He said in 1995, the Fargo-Cass County Economic Development Corporation was involved in 12 projects, two of which received property tax exemptions and seven of which were allowed to use the option to make payments in lieu of property taxes.

Mr. Cooper said in the Bismarck community nearly 1,700 new jobs have been created because of the establishment of Sykes, Aetna, and Unisys business locations in Bismarck. He said of these new jobs, fewer than 10 people moved in from out of state. He said the property tax exemptions provided to these businesses clearly provide a positive return.

Mr. Cooper said in Minot there have been numerous economic development projects since 1990. He said seven property tax exemptions have been provided for new businesses and five of those businesses are now on the tax rolls. He said Minot has experienced a substantial increase in housing values and home construction as a result of the economic development activity.

Mr. Cooper said in his efforts to find information on this topic, he has been able to find no example of a business that has left the state after expiration of a property tax incentive provided to the new business. He said there seems to be a lot of misperception about this issue, including the concept that economic development corporations are "giving away the farm" to get business investment in their communities. He said he cannot understand how some people can consider a political subdivision to be losing money it was never receiving in the first place, which he said is the situation with tax exemptions for new businesses. He said it appears that economic development officials use property tax exemptions selectively only when necessary and that the benefits of these efforts accrue to thousands of North Dakotans who have been able to move into higher-paying jobs than were previously available. He said economic development efforts benefit all political subdivisions by helping to create a larger property tax base from which to draw public revenue.

Mr. Cooper said property tax exemptions are important to business development and to make North Dakota competitive with surrounding states in attracting new business. He said the common perception is that North Dakota imposes a relatively low state and local tax burden for businesses. He said this is not necessarily true, and a recent study by Fluor Daniels compared seven midwestern states on the basis of certain taxes and found North Dakota to have a relatively high state and local tax burden.

Mr. Cooper said he thinks the best approach to deal with the impact of exemptions on school districts is to get more school board members, administrators, and teachers involved in economic development boards so they can be in on the front end of economic development decisions. He said many development boards in the state already have representation from education professionals.

Chairman Belter called on Mr. Ben Hushka, Fargo City Assessor, for comments on the study. Mr. Hushka said the new industry exemption has different applications in Fargo and West Fargo than in other North Dakota cities. He said west of Interstate 29, Fargo has authority regarding property tax exemptions, but these decisions affect the West Fargo School District. He said in these situations, this difficulty has been addressed by including Fargo and West Fargo school board representatives in decisions on exemptions. He said another approach that may be different in Fargo than in other communities is that the property tax exemption for new residences is phased down east of Interstate 29. He said the exemption begins to decrease at a home value of

$90,000 and is completely eliminated at home values above $190,000.

Senator Urlacher and Representative Brown said they believe the two-year expiration date should be removed from the bill draft allowing ex officio membership of school board representatives in exemption decisions. Chairman Belter requested the Legislative Council staff to remove the expiration date from that bill draft.

Senator Freborg suggested and Chairman Belter requested that the Legislative Council staff reword the language in the bill draft giving school districts authority over exemption decisions on their levies as a positive statement.

CHARITABLE ORGANIZATION PROPERTY TAX EXEMPTION STUDY

Chairman Belter called on committee counsel for review of information from the North Dakota Healthcare Association relating to the potential effect on North Dakota hospitals of enactment of a law similar to the recent Pennsylvania law on applications of charitable property tax exemption for hospitals. Committee counsel said Mr. Arnold Thomas from the North Dakota Healthcare Association had indicated he would provide a letter on this topic for committee consideration, but the letter had not been received.

Chairman Belter called on committee counsel to review a bill draft requested by the committee relating to limiting the exemption for hospital property to certain areas of the facility. Committee counsel said the bill draft provides that hospital property is eligible for property tax exemption only for the portion of the building used primarily to provide inpatient services or operations essential to the ability to provide inpatient services in the building. He said the bill draft states that any other use would be deemed not to be a use for public charity. He said the statement about application uses the word "primarily" because it would be likely to cause problems in application if exclusive usage is required. He said an exclusive usage limitation would raise questions about hallways, waiting areas, billing and recordkeeping areas, and other parts of a facility. He said the bill draft would apply the exemption to areas used for operations essential to provision of inpatient services such as administrative and laboratory areas but not those areas that are not essential to providing inpatient services such as clinics and pharmacies.

Representative Rennerfeldt asked how clinics are treated under existing law regarding property tax exemptions. Mr. Barry Hasti, State Supervisor of Assessments, said clinics that are operated independently of hospitals are generally subject to property taxes. He said a fuzzy area exists when a hospital opens and staffs a clinic. He said these clinics have generally been treated as tax-exempt as part of the hospital operation.

Representative Thompson asked Mr. Hasti whether he believes the bill draft under consideration would ease problems of classification and assessment of hospital and clinic property. Mr. Hasti said the bill draft under consideration would be more clear to assessment officials than existing law, but there would still be issues causing uncertainty.

Senator Christmann asked Mr. Hasti whether nursing homes are exempt from property taxes under existing law. Mr. Hasti said nursing homes are eligible for property tax exemption if they are owned by a religious or charitable organization.

In response to a question from Representative Kilzer, Mr. Hasti said a facility for senior citizens that does not provide care to residents would not be eligible for property tax exemption.

Representative Tollefson asked Mr. Hasti whether a special assessment would be considered to be of the same status as a property tax. Mr. Hasti said generally a special assessment is not considered a tax because it is a payment for a capital improvement. Representative Tollefson asked whether tax-exempt properties are subject to special assessments. Mr. Hasti said exempt property is subject to special assessments with the possible exception of some federal property.

Representative Kilzer said he believes this bill draft would change the focus of property tax exemption decisions to focus on the mission of the organization. He said he believes it has long been assumed that organizations eligible for the charitable organization exemption were entitled to exemptions for any activities conducted under the name of the organization. He said he believes some hospital organizations have become involved in operations that are not essential to operating a hospital and that these peripheral endeavors should not be eligible for property tax exemptions.

Representative Belter asked Mr. Hasti whether hospitals are required under current law to document any giving of charitable aid. Mr. Hasti said court decisions indicated that charitable organizations are not required to operate only in the red. He said for the most part nonprofit hospitals are required only to meet the criteria of providing services to patients without regard to the ability to pay. He said it appears that over time there have become fewer services provided by hospitals for which payment is not received because funding has been made available from government sources and insurance so there is probably less charity provided by hospitals in the form of uncompensated services than was provided in earlier times.

Senator Kinnoin asked how assessment officials draw the line on what is a charitable operation. Mr. Hasti said the two criteria for determining the exemption are ownership and use of the facility. He said this requires examination of whether the organization is charitable in nature and whether the facility is charitable in its operation. He said this does not require that the organization must lose money.

Chairman Belter called on Mr. Hushka for comments on the charitable property tax exemption. Mr. Hushka said determination of what is a charitable use in parts of buildings may be difficult. He said a clinic in Fargo was acquired by a hospital. He said the clinic was taxable prior to the acquisition and was to remain taxable after being acquired by the hospital. He said the difficulty is that sharing of facilities between the hospital and clinic has taken place and it has become difficult to determine which portions of the facilities would be taxable. He said the assessor's office in Fargo has worked for more than a year with hospital officials to agree on which portions of the facilities would be taxable. He said these decisions in practice are sometimes very difficult, and these problems could arise under the approach in the bill draft.

Representative Belter asked which portions of the facilities create problems for assessors. Mr. Hushka said it is the areas in which functions are shared or the use is blended between a hospital and clinic that create uncertainty in application of exemptions.

Representative Kilzer said he likes use of the word “primarily” in the bill draft and that the primary use of a facility or portion of a facility would determine whether it is exempt. He said many professionals function primarily in a hospital setting. He said he thinks it is appropriate to examine primary use to determine whether the provision of inpatient services is the predominant use of property. He said for clinics it might become necessary to consider prorating assessments based on usage.

Representative Brown said it seems inappropriate to him that charitable hospitals are advertising for business. He said this competitive practice seems not suited to charitable activities. He asked whether advertising for business by hospitals could be used as a criteria to decide charitable status. Mr. Hushka said that would be a question of degree because there are various levels of advertisement. He said it seems to him the approach taken in the Pennsylvania law would be more useful because fairly specific criteria are established for use by assessment officials.

In response to a question from Representative Tollefson, Mr. Hushka said there is one hospital in Fargo that is a for-profit venture and subject to property taxes. Representative Tollefson said the former St. Joseph's Hospital in Minot has recently been sold to a for-profit corporation, and he believes the tax bill for the facility will now be approximately $500,000 per year. He said that level of property tax will open some eyes in Minot to the potential for adding these properties to tax rolls.

Ms. Clarice Liechty, Jamestown, said her residential property is subject to property taxes and suggested hospital property should also be subject to property taxes. She said hospitals could be allowed to reduce property tax liability by the dollar amount of charitable care they provide. She said clinics and facilities in smaller towns would perhaps have to remain subject to exemptions so they could continue to operate.

Senator Kinnoin said an incident occurred with the Stanley hospital that made him skeptical of whether hospitals perform a charitable function. He said a transient person became ill in the Stanley area and was taken to the hospital. He said the individual was transported to Minot for treatment where he was refused admission because he was indigent and had to be returned for treatment to the Stanley hospital. He said the cost of treatment for this individual almost broke the Stanley hospital. He said he sees the refusal to treat those unable to pay as evidence that the hospital is not a charitable organization. He said he believes the Minot facility is not charitable in nature because it refused treatment to the individual in question.

Senator Urlacher said another aspect of hospital operation he believes indicates hospitals are becoming noncharitable in nature is the evidence of larger facilities coming into smaller communities to compete for business.

Chairman Belter called on committee counsel to review a bill draft to limit the acreage of property a nonprofit organization may own in the state and the Governor’s veto message on 1997 Senate Bill No. 2385. Committee counsel said the bill draft is identical to the provisions of 1997 Senate Bill No. 2385, which was passed by the Legislative Assembly but vetoed by the Governor. He said existing law limits only the North Dakota Wetlands Trust and imposes a limitation of 12,000 acres of land in the state for ownership by the North Dakota Wetlands Trust. He said the bill draft amends existing law to make the limitation apply to any nonprofit organization and to increase the limitation to 16,000 acres of agricultural property in the state.

Committee counsel said the Governor’s veto message for 1997 Senate Bill No. 2385 stated that the Governor believes the present acquisition approval process has worked well. He said the Governor’s message stated that the bill seeks to address a valid public policy concern of how much land should be owned by nonprofit corporations in North Dakota. He said the Governor also stated that it must be determined how ownership of land by nonprofit organizations affects tax bases, economic vitality of the local area, and the state as a whole. The Governor described an initiative he had undertaken to inventory ownership by nonprofit organizations and to develop consensus among involved agencies and organizations on how much property is enough in ownership by nontaxable entities. Committee counsel said the Governor’s office had been invited to comment on the bill draft but had declined the invitation.

Chairman Belter called on Mr. Joe Satrom, State Director, The Nature Conservancy, for comments on the committee bill draft limiting ownership of agricultural land by nonprofit corporations. A copy of Mr. Satrom's testimony is attached as Appendix C.

Mr. Satrom said he wants to make sure there are no misunderstandings among committee members about The Nature Conservancy and its ownership of property in the state. He said The Nature Conservancy is a private landowner that throughout its existence has paid property taxes on its land holdings in North Dakota. He said the organization plans to continue to pay property taxes on its property. Attached to his commentary is a chart showing property taxes and exemptions on property in North Dakota and South Dakota.

Mr. Satrom said he also wishes to clear up the concept that The Nature Conservancy has deep pockets and outbids farmers and ranchers to acquire property. He said the North Dakota and South Dakota chapters of The Nature Conservancy are two of the smallest chapters in the nation and have limited resources to acquire property. He said only a small percentage of land offered to The Nature Conservancy is even considered for purchase. He said The Nature Conservancy also turns down considerable amounts of property offered as gifts. He said if The Nature Conservancy does buy land, highly regarded appraisers are used and the organization is limited to paying appraised value or less for the property.

Mr. Satrom said it was suggested at the previous committee meeting that lands purchased by The Nature Conservancy are permanently removed from production. He said nearly all grasslands owned by The Nature Conservancy are under active grazing and much is done through private grazing or haying leases.

Representative Brown asked whether the acquisition of the Brown Ranch is still in the works. Mr. Satrom said The Nature Conservancy expects to complete this acquisition although there are some obstacles remaining.

In response to questions from Senator Urlacher, Mr. Satrom said grazing use of The Nature Conservancy property is on a competitive basis and rates are quite high in comparison to other property owners and The Nature Conservancy is managing its property in an effort to control weeds.

In response to a question from Senator Christmann, Mr. Satrom said there are summaries of how many cattle per acre are grazed on properties of The Nature Conservancy. He said he will send that information to committee members. He said grazing use of The Nature Conservancy property is sometimes handled under bidding processes and sometimes by prior commitments such as when a farm operator was grazing the land before its acquisition. He said grazing rates in cases of prior commitments are based on county averages.

Representative Rennerfeldt asked what percentage of funding for The Nature Conservancy comes from out-of-state sources. Mr. Satrom said funding in property acquisitions is variable. He said most acquisitions have been largely funded from contributions of North Dakota members of The Nature Conservancy, but in some cases a portion of funding has been obtained from foundations and similar sources that are not North Dakota organizations.

Representative Brown asked if Mr. Satrom could provide copies of a mission statement for The Nature Conservancy to committee members. Mr. Satrom said he would do so.

Representative Belter said properties being acquired by The Nature Conservancy have been preserved under private ownership for several generations. He asked why property needs to be acquired by organizations like The Nature Conservancy for preservation if private ownership would accomplish the same goals. Mr. Satrom said some sellers or donors of property do not think current land management practices will preserve the character of their land. He said these persons have sought to have property acquired by The Nature Conservancy because they want the land to continue to be preserved as they have preserved it.

Senator Christmann asked how The Nature Conservancy deals with use of herbicides to control weeds. Mr. Satrom said that is a problem and The Nature Conservancy does not like to use powerful herbicides. He said The Nature Conservancy uses goats, beetles, and has tried other methods in attempts to control weeds. He said this is an area in which The Nature Conservancy continues to try to improve its management of property.

In response to a question from Representative Kilzer, Mr. Satrom said The Nature Conservancy is exempt from property taxes by law but voluntarily pays because the organization believes it is an important part of its responsibilities in this state.

Senator Urlacher asked whether The Nature Conservancy would support a requirement that a trust be established to pay taxes at the time of acquisition of property. Mr. Satrom said the organization pays property taxes in the same manner as other taxpayers and would prefer to carry on that way and have local managers of property participate in local government functions the same way other citizens do.

In response to a question from Representative Brown, Mr. Satrom said The Nature Conservancy would agree to have it placed in law that The Nature Conservancy would be subject to payment of property taxes on its property.

Chairman Belter called on committee counsel for presentation of a memorandum entitled *Constitutional Considerations Relating to Limitations on the Amount of Property That May Be Acquired by a Tax-Exempt Organization*. Committee counsel said the right to acquire property is protected by the United States Constitution in the due process clause of the 14th Amendment. He said corporations are entitled to this due process protection regarding property rights.

He said the constitutional right of property is not absolute and is subject to reasonable restraint under exercise of the police power. He said exercise of the police power would not be reviewed by courts to substitute their judgment for that of the legislature unless it clearly appears that the legislature has no foundation in reason or necessity for its action. He said it can be argued that limitation of the amount of acreage that may be owned by an organization in North Dakota should pass constitutional muster because the state has a legitimate reason for protecting its property tax base and the economic vitality of communities and the limitation in the bill draft does not appear to unduly restrict any organization.

Representative Brown and Representative Gorder requested that a bill draft be prepared patterned after the Pennsylvania law restricting the charitable property tax exemption for hospitals.

PROPERTY TAX RELIEF STUDY

Chairman Belter called on committee counsel for presentation of a memorandum entitled *Comparison of Property Taxes Levied, Per Student Payments, Per Capita Personal Income, and State Aid to Political Subdivisions 1986-97*. Committee counsel said the information presented in the memorandum was gathered from various sources in an attempt to allow comparison of available data in selected categories.

In response to a question from Representative Brown, committee counsel said the information on North Dakota per capita personal income was drawn from United States Department of Commerce data, which is on a statewide basis and is not available for regions of the state. Representative Brown said the per capita income data indicates increases he believes would not be representative of all parts of the state. He said he believes regions of the state have personal income figures substantially below the statewide average.

Committee counsel said a copy of a research paper from the Connecticut Office of Legislative Research was distributed to committee members. He said the paper is a summary of recent property tax initiatives in other states distributed for background information of committee members.

Representative Tollefson said he believes special assessments could be applied to certain properties that are exempt from property taxes to allow for contribution to the cost of police and fire protection and certain infrastructure costs for properties that currently pay nothing toward these services that benefit their property. He said he would like the committee to consider a bill draft that would allow a city or county to establish a special assessment charge for exempt property. He said this would represent property tax relief to other taxpayers. He said he has been discussing this issue with the Legislative Council staff since the previous meeting. Chairman Belter said Representative Tollefson should continue working with the Legislative Council staff to develop a bill draft on this concept.

Senator Christmann said he would like to see a comparison of property taxes paid among the classifications of property to see whether shifting has occurred from agricultural, residential, commercial, and centrally assessed properties.

Senator Urlacher said the ability to pay taxes is difficult to assess, and he believes it would be important to have regional income information. Mr. Tony Clark, Tax Department, said some analysis has been done of income on a zip code basis. He said he is unsure whether this could be refined to provide regional income information. Chairman Belter asked Mr. Clark to work on developing regional income information for the committee's information. Senator Thompson said Job Service North Dakota might be able to help with statistical information on a regional basis.

FARM BUILDINGS PROPERTY TAX EXEMPTION STUDY

Chairman Belter called on Mr. Charles Krueger, Deputy State Supervisor of Assessments, Tax Department, for presentation of information on the net income standard applied for farmers under the farm residence exemption. A copy of Mr. Krueger's testimony is attached as Appendix D.

Mr. Krueger said the Tax Department takes the position that net income from farming or ranching includes income from producing products of the soil, poultry, or livestock or from dairy farming in an unmanufactured state. He said this would include taxable farm income for income tax purposes and exclude income from custom work. He said interest expense is deducted from income if it was incurred in the farm or ranch operation and was deducted in computing taxable income. He said net income from farming or ranching does not include cash rent, mineral leases or royalties, wages or salaries, interest income from contract for deed payments on sale of farmland, or any other income not specifically included in farm income for federal income tax purposes.

Mr. Krueger said depreciation of farm equipment under federal income tax law is treated like other farming expenses and is deducted from gross revenues to determine net income from farming activities.

Mr. Krueger said obtaining and verifying net farm income information can be difficult. He said in certain cases when income is in question, assessment officials ask for federal income tax returns from farmers to document income levels. He said farmers are not required to furnish this information, but there would be incentive to furnish the information to obtain the exemption. He said in limited cases inquiries to the Tax Department have been made and property tax personnel have reviewed income tax records and reported back to local assessment officials whether the individual in question met the income requirements.

Mr. Krueger said court decisions conclude the burden of documenting the qualification for a tax exemption is on the person claiming the exemption. He said if an owner does not provide documentation of income qualification, the exemption would not be available to that individual.

Chairman Belter called on committee counsel for presentation of a bill draft relating to eligibility of beginning farmers for the farm buildings exemption. Committee counsel said the bill draft was prepared pursuant to discussion at previous committee meetings indicating that current law technically would exclude beginning farmers from qualifying for the property tax exemption for a farm residence because they would not have a history of farm income, which is required by current law to qualify for the exemption. He said the bill draft creates an exception to allow a beginning farmer to qualify for the property tax exemption for a period of three years. He said after the initial three years, the farmer would have to meet the income requirements that otherwise apply to all farmers.

Chairman Belter called on committee counsel for presentation of a bill draft to repeal provisions requiring assessment of all exempt real property. Committee counsel said the bill draft was requested at the previous committee meeting to resolve a problem that arises when a 1997 amendment to North Dakota Century Code (NDCC) Section 57-15-01.1 is compared to the provisions of NDCC Section 57-02-14. He said Section 57-02-14 was enacted in 1897 to require assessment officials to establish a valuation for all exempt property that is not governmental property. He said the problem that arises is that 1997 legislation required assessment of specific kinds of exempt property, not including farm buildings. He said in Towner County a difficulty of interpretation arose because the county director of tax equalization assumed that farm buildings were to be assessed under the 1997 legislation, and the State Supervisor of Assessments is not able to advise assessment officials that there is no duty to assess farm buildings because the 1897 law requires such valuations to be established. He said the 1897 law has been in existence for many years but has not been strictly applied. He said the bill draft would repeal the 1897 law to leave the requirements of the 1997 law that valuations be established for property exempted at the discretion of local government and charitable organization property.

Representative Tollefson said he believes the Legislative Assembly has a need for establishing values on exempt properties. He said he does not favor repeal of the older law.

Representative Belter asked Mr. Hasti whether there is a way to eliminate confusion about valuation of farm buildings but retain the requirement that valuations should be established for exempt properties other than farm buildings. Mr. Hasti said perhaps Section 57-02-14 should be amended to say that only property within city limits or nonagricultural property must be assessed. Chairman Belter said it appears there is a consensus among committee members that this would be appropriate and requested the Legislative Council staff to amend the bill draft to accomplish the changes suggested by Mr. Hasti.

Chairman Belter called on committee counsel for presentation of a bill draft regarding application of the property tax exemption for farm buildings and the criteria established by the North Dakota Supreme Court for applying the exemption. Committee counsel said the bill draft amends existing law to provide that factors announced by the North Dakota Supreme Court in the *Butts* decision would not be considered in applying the exemption for farm buildings. He said the bill draft specifically excludes consideration of whether the farmer grows or purchases feed for animals raised on the farm, whether the farmer owns the animals being raised on the farm, whether replacement animals are produced on the farm, and whether the farmer is engaged in contract feeding of animals. He said the bill draft also incorporates language intended to implement the suggestion of members of the Ag Coalition that processing of agricultural products should not qualify as farming under the exemption. He said the bill draft attempts to do this by providing that business other than farming would include processing to produce a value-added physical or chemical change in an agricultural commodity beyond the ordinary handling of that commodity by a farmer prior to sale. He said the language is intended to allow flexibility of interpretation by assessment officials to recognize ordinary farm practices but to exclude processing that goes beyond ordinary handling. He said establishing a definition of what is included in processing is extremely difficult because of the range of activities that may be involved in handling and processing of agricultural commodities. He said the phrase "agricultural commodity" as used in this provision is intended to apply to the same products described in the Tax Department interpretation of net income from products that are required to be in an unmanufactured state. He said the other significant change in the bill draft is inserting the word "primarily" in regard to the usage of a structure. He said existing law requires exclusive usage for agricultural purposes, which would mean that the exemption would be lost with even an incidental usage of a building for other purposes.

Chairman Belter called on Mr. Terry Traynor, North Dakota Association of Counties, for comments on the farm buildings property tax exemption study. Mr. Traynor said some county officials are concerned about application of the provisions of the bill draft regarding beginning farmer qualification for the farmer residence exemption. He said if a person declares that he is a beginning farmer and actually never qualifies as a farmer, there would be an issue of whether there would be a way to recoup the taxes that should have been paid by the person. Mr. Hasti said the Tax Department has developed a form that is used by many counties, and some counties have developed their own forms for claiming the exemption for farm residences and buildings. He said the form requires the claimant to state whether the claimant meets certain requirements of the exemption. He said the change in the bill draft would still require that the individual who is a beginning farmer must devote 50 percent or more of time to farming activities and the individual would have to certify qualification under this requirement. He said this would allow recouping exempted taxes if fraudulent claims are made.

Chairman Belter called on Ms. Liechty, who said she is concerned about the requirement in the beginning farmer bill draft that the beginning farmer must own the residence for which the exemption is claimed. She said if she would lease a farm residence to a beginning farmer, that person would not qualify under this provision. Chairman Belter said it appears that the consensus of committee members is that ownership should not be required for beginning farmers to qualify for the exemption and requested the Legislative Council staff to amend the bill draft to eliminate the requirement of ownership for a beginning farmer.

Chairman Belter called on Mr. Wade Moser, North Dakota Stockmen's Association, for comments on the bill draft relating to factors to be considered in application of the farm buildings exemption. Mr. Moser said the Stockmen's Association would support this approach. He said the Ag Coalition had suggested limiting the exemption to agricultural activities not including processing and the language of the bill draft has not been reviewed by the Ag Coalition members but appears intended to accomplish that goal and he will ask for Ag Coalition members' comments on the language in the bill draft.

Chairman Belter called on Ms. Patti Brown, North Dakota Farm Bureau, who said the bill draft on application of the farm buildings exemption looks favorable. She said the Farm Bureau legislative committee has not reviewed the bill, but she will ask for review by the committee and report to the Taxation Committee.

AGRICULTURAL PROPERTY ASSESSMENT STUDY

Chairman Belter called on Mr. Dwight Aakre, North Dakota State University Extension Service, for testimony regarding analysis of changing the agricultural property valuation formula by including a cost index for farmers. A copy of Mr. Aakre's prepared testimony is attached as Appendix E.

Mr. Aakre said he completed analysis of this issue by establishing a base index of prices paid by farmers and then comparing that index to actual indexes to prices paid for years 1989 through 1997 and assuming for years 1998 and thereafter that the index would increase two points per year. He said using these figures, and assuming all other factors in the model remain constant, would result in a drop in agricultural property valuations in the year 2010 of 25 percent as compared to values without indexing. He said this is a rather substantial effect of cost indexing. He said the effect for 1998 shows valuation declines of approximately two percent, which does not seem too large. He said as this change becomes cumulative over several years, it will have a substantial impact and will result in a substantial reduction in valuations.

Senator Christmann said it appears that changes in interest rates and effects on the capitalization rate in the formula have a heavy influence on valuation of agricultural property under the formula. He asked whether Mr. Aakre believes the formula overemphasizes the importance of interest rates. Mr. Aakre said the effect of interest accounts for approximately half of the impact of the data that is used to determine the valuations under the formula. He said he does not know if that is right or wrong, but the impact is substantial.

Chairman Belter called on committee counsel for presentation of a bill draft to establish a classification of unproductive agricultural land for assessment purposes. Committee counsel said copies were distributed to committee members of the bill draft reviewed at the previous committee meeting on including a production cost factor in the agricultural property valuation formula. He said copies were also distributed of a newspaper article describing concerns of counties in the Devils Lake Basin with mandated valuation increases for agricultural property. Committee counsel said the bill draft to establish unproductive agricultural land as a classification was reviewed at the previous committee meeting and has been revised to provide that unproductive agricultural land consists only of property inundated to an extent making it unsuitable to grow crops or graze animals for a full growing season or more. He said the bill draft requires that classification of a parcel of property as unproductive must be approved by the county board of equalization for each taxable year. He said the valuation of unproductive agricultural lands is an unspecified percentage of the average agricultural value of noncropland for the county as otherwise determined. He said the bill draft provides that valuation of individual parcels of unproductive agricultural land may recognize the probability that the property will be suitable for production in the future. He said the bill draft contains a blank for the unspecified percentage of valuation under the formula which must be filled in before the bill draft could be recommended.

Senator Christmann asked how classifying property as unproductive agricultural land would differ from granting of an abatement on property. Mr. Hasti said under present law a value is established for cropland and noncropland for each county. He said when abatements are granted, all remaining taxable land in the county must have a valuation increase to allow the county average agricultural value to be met. He said if a category of unproductive agricultural property is used, valuations can be reduced for inundated lands without requiring an increase in valuation for other agricultural property. Senator Thompson said classification as unproductive agricultural land would be a tool for local officials faced with problems that are being encountered in the Devils Lake Basin.

Chairman Belter called on Mr. Lonnie Olson, Ramsey County State's Attorney, who said he is representing the Ramsey County Commission at this meeting because they are unable to attend since it is county commission meeting day. He said Mr. Hasti is correct in describing the need for the bill draft. He said the problem encountered in Ramsey County is that granting abatements to property that has been inundated by rising waters of Devils Lake means an increase in taxes will be necessary for other farmers whose property is not affected by the rising water. He said Ramsey County is facing a major crisis in regard to these tax issues and this bill draft will not solve all of these problems but will provide one tool to deal with the problems. He asked the assistance of the committee in providing Ramsey County with the tools it needs to conquer the problems presented by the rising waters of Devils Lake.

In response to a question from Representative Belter, Mr. Olson said Ramsey County has done what it can to deal with the problem being presented. He said county offices have reduced budgets substantially in recognition of the strain being placed on the budget by inundated lands. He said the county will continue to maintain very tight budgets, but there will still be pressure for mill rate increases to provide necessary funds for county operations.

Mr. Hasti said the bill draft creates a category of unproductive agricultural land and the bill draft has been amended to apply only to inundated lands. He said perhaps the bill draft should be revised so that the category is called inundated land rather than unproductive land. Chairman Belter said it appears the committee consensus is to make the change and requested the Legislative Council staff to change the references in the bill draft from unproductive agricultural land to inundated land.

Chairman Belter called on committee counsel to review a bill draft prepared at the request of Representative Schmidt to limit the changes in the capitalization rate under the agricultural property valuation formula. Committee counsel said the agricultural property valuation formula contains a capitalization rate that uses the Federal Land Bank mortgage interest rates for North Dakota, discards the highest and lowest years' interest rates for the most recent 12 years, and averages the remaining amounts. He said the bill draft would add an additional requirement that the capitalization rate determined by this averaging method could not result in a rate less than 10 percent nor more than 11 percent.

Representative Belter asked Mr. Aakre what effect he thinks the bill draft would have on valuations. Mr. Aakre said the capitalization rate is currently 10.14 percent, and he believes the next computation will drop the capitalization rate below 10 percent so this bill draft would probably have an immediate effect. He said long-range effects are difficult to predict since we do not know what will happen to interest rates. He said the capitalization rate peaked at approximately 11.4 percent in 1993-94 and has steadily decreased since then to 10.14 percent.

Chairman Belter called on Representative Schmidt, who said during his first year in the Legislative Assembly he heard many complaints from landowners about property taxes. He said the question constantly asked of him by landowners is why taxes on agricultural property keep increasing while income from agricultural property keeps decreasing. He said he had undertaken study on this issue with farmers and taxing officials and the factor that appears most responsible for recent valuation increases for agricultural lands is the capitalization rate. He said the bill draft is an attempt to soften the impact of interest rate fluctuation on property tax bills of farmers.

Representative Schmidt said he has a resolution of support from 10 counties that has been signed by county commissioners stating that an increase in taxation for agricultural property is absolutely unacceptable in view of the current farming climate. He delivered a copy of the resolution to the chairman. Chairman Belter said the resolution would be included in the committee record. Representative Schmidt said the resolution is an indication of the strong feeling of county officials in the Devils Lake Basin that agricultural property valuations should be decreasing rather than increasing because of poor growing conditions in recent years and the inundation of tremendous amounts of agricultural property in the Devils Lake Basin.

Chairman Belter asked Representative Schmidt why the cap rates were chosen to be set at a low of 10 percent and a high of 11 percent. Representative Schmidt said he has discussed different interest rate amounts with concerned people and 10 percent and 11 percent seemed to be the consensus as appropriate limitation amounts.

Senator Christmann said he understands the need for the 10 percent limit on the low end of interest rates but does not believe there is a need to limit the interest rate increase on the high end. He asked why the 11 percent limitation should be included and said he thinks there would be no opposition to eliminating this limitation on the high end.

Chairman Belter called on Ms. Liechty, who said she questions how much unproductive agricultural land has to be inundated to qualify. She said she has reviewed statistics on her property taxes. She said she believes much of the impetus for increased property taxes comes from funding of education. She said she believes there is too much reliance on property taxes to fund education, which means rural taxpayers pay more than their share of the cost of education. She said a greater share of funding for education from the state would reduce property tax burdens of rural taxpayers.

Senator Christmann said he believes the committee should remove the 11 percent limitation in the bill draft on the high side of the capitalization rate. He said a cap on the high end of the formula is not relevant in current conditions and would become a matter of opposition when it does become relevant.

Representative Belter said he is somewhat concerned that excessive tinkering to achieve short-term results under the agricultural property valuation formula could destroy the validity of the formula.

Representative Renner asked if the committee could get an analysis of the impact of the bill draft to limit changes in the capitalization rate. Committee counsel said determining the potential effect would be difficult because it would require assumptions about what will happen to interest rates in the future. Mr. Aakre said that is correct and that analysis could be done if assumptions are allowed in the computation.

Senator Thompson said tax equalization directors from counties in the Devils Lake Basin could support some of the bill drafts being considered by the committee. He said he would invite the Taxation Committee to meet in the Devils Lake Basin region to allow input from county officials. He said the last two meetings of the committee were held on days of county commission meetings, which prevented attendance of local officials. He said county officials in the region would like the opportunity to address the committee and would appreciate having the committee in the area to see the magnitude of the problem they are facing.

Representative Olson said she shares concerns of Representative Belter about tinkering with the agricultural property valuation formula. She said she was a member of the Legislative Assembly in 1981 when the formula was established and the concept was not without opposition. She said if the formula is adjusted to achieve valuations that are acceptable under certain conditions, the formula becomes less justifiable over time.

Chairman Belter said he anticipates the next meeting of the committee to be held in mid-September. He said he anticipates the next meeting will be the last meeting of the committee unless unusual circumstances arise. He said at the next committee meeting he would anticipate receiving very little testimony and the meeting would consist mostly of committee discussion and final action on bill drafts and recommendations.

It was moved by Representative Grosz, seconded by Representative Renner, and carried that the meeting be adjourned subject to the call of the chairman. The meeting was adjourned at 4:15 p.m.

John Walstad
Committee Counsel

ATTACH:5