#### Minutes of the

# **TAXATION COMMITTEE**

Friday, March 23, 2012 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, Jim Dotzenrod, Lonnie J. Laffen, Ronald Sorvaag; Representatives Larry Bellew, Glen Froseth, Lyle Hanson, Patrick Hatlestad, Craig Headland, Richard Holman, Shirley Meyer, Mike Nathe, Marvin E. Nelson, Roscoe Streyle

**Members absent:** Senator Dave Oehlke; Representatives Wesley R. Belter, David Drovdal, Jim Kasper, Mark S. Owens

**Others present:** Representative Jerry Kelsh, member of the Legislative Management, was also in attendance.

See <u>Appendix A</u> for additional persons present.

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

#### **PROPERTY TAX STUDY**

Chairman Hogue called on Mr. Jerry Coleman, Department of Public Instruction, for presentation of information on the fiscal effect of property tax relief through allocations to school districts. Mr. Coleman said he was requested to provide information on the fiscal effect of providing 65 mills of property tax relief through allocations to school districts. He said he prepared two projections. He said the first projection (Appendix B) is a revised projection of the fiscal effect of 75 mills of property tax relief. He said these projections were revised based on new data on 2011 property valuations. He said the original projections used an estimated 7.7 percent increase. He said that estimate was based on an anticipated 20 percent increase in agricultural property values for 2012. He said the anticipated increase is now 23 percent for agricultural land values. He said as a result of that increase, the increase factor for 2013-14 is now 12.26 percent. He said the revised cost estimates are \$169.2 million for 2012-13, \$189.9 million for 2013-14, and \$205.6 million for 2014-15. He said the previous estimate was that total cost would be \$403.4 million for the entire 2013-15 biennium. He said the total cost estimate of the revised projections is that the total cost would be \$395.6 million for the 2013-15 biennium.

Senator Hogue asked if projections are becoming more accurate as the property tax relief allocation formula has been in place for some time now. Mr. Coleman said he believes that is the case and that better data is provided as updates become available.

In response to a question from Senator Dotzenrod, Mr. Coleman said the anticipated 23 percent increase in agricultural property values, when factored into all property values, results in an additional 4 percent increase in statewide average property values for all property. He said that will be a one-year effect from the change in agricultural property capitalization rates.

Representative Bellew asked what would the cost be for the state to buy down all school district property tax mills. Mr. Coleman said he has not run an estimate of that effect, but in ballpark numbers, the cost would probably be approximately \$300 million per year.

Representative Nathe asked if that estimated \$300 million per year would be in addition to the \$395 million property tax relief estimated in the projections. Mr. Coleman said yes, and he believes the combined amounts are reflected as property tax collections and mill levy reduction grants of school districts in the *School Finance Facts* publication of the Department of Public Instruction. Representative Nathe requested that copies of the page from the publication showing total property tax levies be distributed to committee members.

Mr. Coleman reviewed the information in the 65 mill levy cap projection (<u>Appendix C</u>) prepared at the request of the committee. He said current law contains a restriction so payments to a school district cannot be reduced from the previous year. He said this parameter is ignored for purposes of this projection. He said reducing the levy reduction to 65 mills would reduce the estimated cost of relief for the 2013-15 biennium to \$353.5 million. He said it would be anticipated that this approach would shift \$42 million from state sources to local property tax, which would mean school districts would need to have an additional 10 mills of property tax levy authority.

Copies were distributed to committee members of a letter (<u>Appendix D</u>) received from Mr. Scott Rising, Legislative Director, North Dakota Soybean Growers Association.

Chairman Hogue called on Ms. Marcy Dickerson, State Supervisor of Assessments, Tax Department, for presentation of testimony (<u>Appendix E</u>) providing information on questions raised by the committee regarding estimated statewide taxable valuation growth for property classifications, estimated shifting of tax burden and property tax relief, and effective tax rates for agricultural property.

Ms. Dickerson said statewide taxable value is estimated to increase 12.27 percent in 2012, largely because of an estimated 22.73 percent increase in agricultural land taxable value. She said 2013 statewide taxable valuation increase is estimated at 7.66 percent, and agricultural property is estimated to increase 6.24 percent in 2013.

Ms. Dickerson said she was requested to estimate the shift of tax burden among property classifications. She said agricultural taxable value would increase about 9.3 percent in its percentage share of the tax base for 2012 but is expected to decline as a percentage of total taxable valuation by 1.31 percent in 2013.

Ms. Dickerson said 2011 effective tax rates for agricultural land, using agricultural value, average 1.24 percent for 51 counties reporting agricultural property sales. She said effective tax rates for agricultural land, using market value, would average .46 percent.

Senator Cook asked if there are areas of the state where residential property values are increasing more than 10 percent per year. Ms. Dickerson said she is sure there are areas with increases of 10 percent or more in areas of greater demand. Senator Cook asked if agricultural property valuation increases are similar across the state. Ms. Dickerson said there is not as much variation among counties in terms of percentage valuation increases for agricultural property.

Representative Headland asked what would happen to agricultural property values if interest rates move toward historic averages. Ms. Dickerson said the formula uses 10 years of data so changes would be gradual but higher interest rates would tend to reduce agricultural property values.

Chairman Hogue called on Mr. Ryan Rauschenberger, Deputy Commissioner, Tax Department, for presentation of information relating to estimated fiscal impact of a residential property tax credit based on a bill draft considered by the committee. Mr. Rauschenberger said Ms. Kathy Strombeck prepared the fiscal estimates but is unable to attend this meeting so he is presenting the information. A copy of the information distributed by Mr. Rauschenberger is attached as Appendix F.

Mr. Rauschenberger said the information was compiled by conducting a residential property survey of seven representative counties which includes Cass, Grand Forks, Ward, Ramsey, McLean, Hettinger, and Divide Counties. He said this group of counties should provide a representative sample of residential property in the state. He said the estimates are made using the current property tax relief program, so the mill rates used in the estimates are lower than they would be without the current property tax relief program. He said the estimate also uses farm homes, which would be taxable under the bill draft and entitled to property tax relief. He said use of farm homes adds approximately 21,000 homes, which would have to be assessed.

Chairman Hogue asked what effect would occur if farm homes are left as tax-exempt property. Mr. Rauschenberger said he does not know the answer because that was not the basis of the estimates. He said the Tax Department could work on determining that answer.

Senator Laffen asked if being required to assess farm homes would be a struggle. Mr. Rauschenberger said that may be a better question to be addressed by the North Dakota Association of Counties, but he believes there would probably be a need for more assessment staff among counties to assess farm homes.

Senator Dotzenrod asked how estimates were determined on the number of farm homes. Mr. Rauschenberger said available sources were used, including the 2007 agricultural census and property tax statistics.

Representative Headland said he is concerned that 21,000 North Dakota farmers would see a tax increase on their homes to obtain this kind of relief.

Senator Hogue asked Mr. Rauschenberger if the Tax Commissioner would have a preference between the current method of providing property tax relief and the possibility of a residential property credit. Mr. Rauschenberger said Tax Department staff has discussed the administration of various property tax relief approaches, but the Tax Commissioner has not expressed a preference and would work with any approach the Legislative Assembly approves.

Senator Cook said if the estimates used for valuing farm homes are based on values of comparable city homes, the valuation in the estimates for farm homes may not be accurate. Mr. Rauschenberger said that may be true, and the Tax Department used values that are known. Senator Cook said perhaps more work should be done to refine those estimates.

Chairman Hogue called on committee counsel to review bill drafts for property tax relief. Committee counsel said there are three bill drafts for committee consideration, one [13.0018.01000] of which was reviewed at the January committee meeting to provide property tax relief on the basis that has been used for the years 2009 to 2013.

Committee counsel said а bill draft [13.0017.01000] that was reviewed at the January committee meeting would eliminate the farm residence property tax exemption and create a residential property tax credit. He said the bill draft contained blanks for the amount of reduction and appropriation required to fund the reduction. He said the estimates provided by Mr. Rauschenberger were based on this bill draft. He said a bill draft [13.0059.01000] was prepared for consideration at this committee meeting to allocate \$400 million per biennium in property tax relief through allocation to counties. He said this approach has some difficulties with timing because, in order to get property tax reductions on the property tax statement, it would be

necessary to use estimated taxes for the year. He said actual taxes for the year will not be known until some time after the new year begins and tax statements have been sent out. He said to use actual property tax payments would require full payment of taxes and some kind of refund program.

Committee counsel said there are advantages and disadvantages in the three approaches the committee has raised for consideration. He said the relief through allocations to school districts method is proven to work and deliver anticipated relief. He said the method has an element of equity, which some may describe as an element of inequity. He said the cost of the program is predictable, but the cost of the program will continue to grow substantially as valuation of property increases. He said another aspect of concern is that school districts are locked in at 2008 levy amounts which does not react to changing circumstances. He said this approach provides relief to all taxable property, which may be considered a plus or minus depending on objectives.

Committee counsel said the homestead credit approach involves unknowns. He said until a homestead credit approach for all property has been in place, estimated costs will be based on educated quesses. He said values of a homestead credit approach are not tailored to the home values of localities. He said a \$75,000 reduction for a home in Fargo or in a small town would not provide an equal level of relief. He said one aspect that is viewed as a positive aspect by some is that the relief provided by a homestead credit approach would be limited to North He said a homestead credit Dakota residents. approach should be easy to administer, but a learning curve will be involved for taxpayers because they will have to file a claim for the credit each year. He said the cost of a homestead credit relief approach would grow with home values, or mill rates, or both, depending on how it is structured.

Committee counsel said the approach providing allocations directly to counties for distribution to political subdivisions must be based on estimates to obtain reductions that can be applied to tax statements before they are distributed to taxpayers. He said there would not be any growth in the cost of a program unless the appropriation amount is adjusted. He said administration of allocation through counties should be easy and would provide relief to all taxable property.

Senator Dotzenrod said another aspect of the current method of property tax relief through allocations to school districts may involve the potential for lawsuits by school districts against the state for failure to provide adequate funding assistance for education.

### SALES TAX EXEMPTION STUDY

Chairman Hogue called on committee counsel for presentation of bill drafts to eliminate the Montana resident sales tax exemption and the Canadian resident sales tax refund. Committee counsel reviewed a bill draft [13.0048.01000] to eliminate the sales tax exemption for purchases by residents of an adjoining state that does not impose a retail sales tax. He reviewed a bill draft [13.0049.01000] to eliminate the sales tax refund available to Canadian residents.

Committee counsel distributed copies of a page (Appendix G) from the Tax Department Red Book publication estimating the fiscal effect of the Montana resident sales tax exemption at a loss of \$1 million to \$2 million per biennium and the fiscal effect of the refund for sales to residents of Canada at \$1 million to \$2 million per biennium. He said information should be reviewed on the effect of significant changes in retail sales in western North Dakota associated with oil and gas development. He said if the Montana resident exemption comes into play for purchases of goods for use in the oil industry, the exemption may provide a business advantage for Montana residents.

Senator Sorvaag said the Canadian resident sales tax exemption is an issue of concern for retailers in Fargo. He said these business owners request the committee to keep in mind that clothing is exempt from sales taxes in Minnesota and Canadian shoppers may be influenced to shop in Minnesota if the North Dakota refund provision is eliminated.

Representative Meyer asked for information about application of the Montana resident sales tax exemption. Mr. Myles Vosberg, Tax Department, said the statutory provision governing the exemption requires that the purchaser must be in the state of North Dakota specifically for the purpose of making a purchase before that purchase is exempt. He said the individual must furnish the North Dakota retailer a certificate claiming the exemption and stating that the purchase qualifies for the exemption.

Representative Nelson asked if North Dakota is able to track goods coming into the state to see if they are escaping sales tax. Mr. Vosberg said individual goods cannot be tracked, but sales tax audits would be the main way of finding goods that should be subject to tax.

Senator Cook asked what the tax status is for a Montana business buying goods for use in North Dakota. Mr. Vosberg said those goods would be taxable unless the purchaser signs an exemption certificate indicating that the goods will be taken outside North Dakota for use. Senator Cook asked what penalties would apply for false exemption claims. Mr. Vosberg said the penalty for nonpayment of a tax is a 5 percent penalty and an additional 1 percent per month as interest.

### PROPERTY TAX STUDY

Chairman Hogue called on committee counsel for presentation of a revised bill draft [13.0015.02000] relating to filing of informational reports on indebtedness incurred by a political subdivision or building authority. Committee counsel said the original bill draft only applied to building authorities. He said the bill draft was expanded to incorporate reporting by political subdivisions of issuance of bonds Taxation

or other evidences of indebtedness. He said the original bill draft required reporting filings with the Securities Commissioner but that was under the assumption that bond issues were required to be approved by the Securities Commissioner, which proved not to be the case. He said the Securities Commissioner expressed the opinion that these reports would be more appropriately filed with another agency. He said the bill draft contains a blank that must be completed to designate the filing entity. He said the bill draft also was revised in the application section to apply to indebtedness issued before August 1, 2013, if the debt has not been retired by that date.

Senator Sorvaag said the bill draft also was revised to require reporting before issuance of bonds. He said this may cause an additional problem for bond issues. Chairman Hogue asked that an opinion be obtained by bond counsel on the question of requiring reporting before or after issuance of bonds.

Senator Cook said this bill draft was intended to provide transparency and make available information that should be available to legislators and the public. He said the state has constitutional debt limitations that apply to political subdivisions, and there is no source of information on levels of political subdivision indebtedness.

Senator Hogue said the bill draft requires reporting by any "other entity" and asked if that could include higher education debt. Committee counsel said that was not intended but could be the interpretation.

Senator Cook said he does not see a problem with higher education debt being included in the reporting.

Representative Nathe said he thinks the bill draft should specify that higher education debt reporting is required.

Chairman Hogue called on committee counsel for presentation of a memorandum prepared by the Tax Department relating to State Board of Equalization authority regarding property tax exemptions granted by political subdivisions. Committee counsel said the memorandum (Appendix H) was prepared by Mr. Daniel Rouse, Legal Counsel, State Board of Equalization. He said Mr. Rouse was deployed for active military duty and unable to attend this meeting. He said the memorandum relates to an exemption granted by the Jamestown City Council to provide a partial property tax exemption and payments in lieu of taxes for the developer of an apartment complex. He said the conclusion of the memorandum is that the State Board of Equalization does not have express or implied authority to review decisions of local governing bodies on the question of whether to grant business incentive property tax exemptions.

Representative Headland said local property tax exemption decisions are a concern to many taxpayers. He said perhaps the committee should consider granting the State Board of Equalization authority to review these decisions.

Chairman Hogue called on committee counsel for presentation of a bill draft [13.0052.01000] allowing a

Committee counsel said the bill draft was prepared based on opinions from the Tax Department and the Jamestown city attorney that the State Board of Equalization has no authority to revoke an exemption granted by a city or county and that a city or county has no statutory authority to revoke an exemption that it has previously granted. He said the bill draft allows the city or county to revoke or reduce a property tax break if information from the project operator during the negotiation and deliberation of the tax break has proven to be inaccurate or untrue, use of the property by the operator does not comply with reasonable expectations of the governing body at the time the tax break was approved, the property has been improved to a substantially greater extent than the governing body reasonably anticipated at the time the tax break was approved, or there has been a change of ownership of the property. He said North Dakota Century Code Section 44-57.1-06 provides for reduced property tax breaks under certain circumstances. He said the section is poorly drafted. He said the first requirement is that a project operator must reapply if expansion of a project has increased the investment by more than 20 percent. He said only the project operator will know if the investment has been increased by that amount. He said reapplication is required if the operation is moved to a new business location, there is a change of ownership, or the use of the property is changed. He said the section also provides that relocation of the business will not affect an income tax exemption if the project operator satisfies the State Board of Equalization that the nature of the business and effect on competitors has not been changed.

Senator Cook said property tax exemptions have a poor perception among the public. He said some are effective, but some may be subject to abuse.

Senator Laffen said he agrees with the observation that there is poor public perception of property tax exemptions. He said the exemptions were created as business incentives to supply job growth, and in the current strong economic climate, perhaps we do not need some of these incentives.

Chairman Hogue requested committee counsel to seek opinions from the Department of Commerce and Greater North Dakota Chamber of Commerce and also ask representatives of those entities if contracts are used by local government to require compliance by recipients with certain conditions to obtain the exemption.

Representative Streyle said all of the gimmicks allowed for use by local government to exempt certain property from taxes should be examined.

Representative Headland said the state needs to make clear that local government has an obligation of fairness to all taxpayers. He said public perception is that cronyism may be involved in obtaining property tax exemptions. Chairman Hogue called on Ms. Clarice Liechty, Jamestown, for comments on the property tax exemption granted in Jamestown and reviewed by the committee at the January meeting. Ms. Liechty described the chain of events involved in the granting of the exemption and the resulting protest she made about the use of the exempt property.

Senator Hogue asked how long the Jamestown property in question was granted an exemption. Ms. Liechty said the property obtained a five-year property tax exemption and another five years of payments in lieu of taxes at a graduated rate. She said the exemption and payments in lieu of taxes applies to 20 of the 35 apartment units in the project.

Representative Headland said he would like the committee to consider a bill draft to eliminate all discretionary property tax exemptions.

Representative Meyer said she thinks property tax incentives should be used as appropriate, but in some areas of the state, local government may need this kind of authority to create jobs.

Representative Streyle said one of the problems with the property tax which has been expressed by supporters of initiated measure No. 2 is that there are huge amounts of exempt property in the state, and some cronyism is suspected. He said he would support considering eliminating discretionary property tax exemptions.

Senator Sorvaag said he believes it is appropriate to consider legislation to allow withdrawal of property tax exemptions if the project does not live up to expectations of the agreement. He said he also thinks we need to be careful about taking away local control because there have been benefits to local economies from use of exemptions.

Senator Laffen said in his business as an architect, he sees a lot of new building attributable to tax increment financing, renaissance zones, and property tax exemptions. He said there are benefits to these incentives, but he is not opposed to examining removal or restriction of exemptions. He said local governments will find ways to provide incentives to new and expanding businesses.

Representative Headland said the committee needs to seriously discuss these issues, and a bill draft to eliminate property tax exemption authority would begin that debate.

Committee counsel said discretionary property tax exemptions are allowed in several instances, including tax increment financing, renaissance zones, new businesses, new single-family and townhouse residential property, and perhaps other areas. He said more specific directions would be necessary about what should be included in a bill draft. Chairman Hogue said it would be necessary for committee members to refine the request for a bill draft.

Senator Cook said he believes the city of Mandan requires contractual agreements with recipients of property tax exemptions for new businesses. He said he thinks the committee needs to find out if there is a need for elimination of provisions or if practices of local government could be improved to set compliance standards.

Representative Headland said his concern would be to eliminate the authority to grant economic development property tax exemptions.

Senator Sorvaag said it would be necessary to develop very clear language on what constitutes economic development if that authority is to be removed.

Senator Cook said the committee should receive a memorandum reviewing the history of property tax exemptions allowed by state law.

Representative Froseth said there is a great variety of investors and opportunities in North Dakota. He said economic development has changed but smaller communities will still need economic development tools. He said he does not think he could support eliminating all property tax incentive authority for political subdivisions.

## **OIL TAX STUDY**

Chairman Hogue called on Mr. Rauschenberger for information on reports filed by oil-producing counties regarding revenues and expenditures from oil and gas production tax distributions and county infrastructure Mr. Rauschenberger distributed written funds. information (Appendix I) on a summary of infrastructure fund reports filed by counties. He said the information is for the calendar year 2011 and was required by 2011 legislation now contained in Section 57-51-15(7). He said the requirement is that the county must file with the Tax Commissioner a calendar year statement of revenues and expenditures and information on the amount available in the county infrastructure fund and information about use of the infrastructure fund. He said the summary provided shows the summary of information provided by each county. He said an additional report, contained in a ring binder with several hundred pages of statistical information, was filed with the Legislative Council and provided in an electronic format.

Senator Cook asked if the binder information shows all of the oil revenues and uses. Mr. Rauschenberger said the binder shows all of that information for each county that received oil tax revenues. Senator Cook said the committee needs this information to review in more detail. Senator Hogue asked committee counsel to send electronic copies of the revenue and expenditure reports to committee members. Committee counsel said the information would be sent by e-mail if it can be delivered without causing technological problems.

#### **COMMITTEE DISCUSSION**

Representative Bellew said a problem he hears in discussion of initiated measure No. 2 and other property tax issues is that the state has a ton of money and property tax relief could be greater than what is being provided. He said he believes the Legislative Assembly needs to look at a broader spectrum of tax relief.

Chairman Hogue said he would anticipate the next committee meeting to be in May. He asked committee members to let him know of conflicts to avoid during May.

Senator Cook said mobile home taxes in North Dakota often create administration issues in property tax relief and other areas. He asked if other states have different years for mobile home and residential property tax imposition. He said the committee should also obtain a briefing on streamlined sales tax developments at the national level from Mr. Vosberg.

Representative Meyer said the tobacco tax stamping facility tour that was scheduled for the meeting was canceled and asked if it would be rescheduled. Chairman Hogue said he will work with committee counsel to see if a tour can be rescheduled.

No further business appearing, Chairman Hogue adjourned the meeting at 12:05 p.m.

John Walstad Code Revisor

ATTACH:9