

NORTH DAKOTA LEGISLATIVE COUNCIL

Minutes of the

TAXATION COMMITTEE

Tuesday, June 20, 2000
Roughrider Room, State Capitol
Bismarck, North Dakota

Senator Randel Christmann, Chairman, called the meeting to order at 9:00 a.m.

Members present: Senators Randel Christmann, Kenneth Kroepflin, Randy A. Schobinger, Bob Stenehjem, Vern Thompson, Steve Tomac, Herb Urlacher; Representatives Wesley R. Belter, C. B. Haas, Gil Herbel, Dennis J. Renner, Arlo E. Schmidt, Ray H. Wikenheiser

Members absent: Senator Meyer Kinnoin; Representatives Mick Grosz, Pam Gulleason, Stacey L. Mickelson, Ronald Nichols, Earl Rennerfeldt, Ben Tollefson, John M. Warner

Others present: See Appendix A

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

MOTOR FUELS TAX STUDY

Chairman Christmann called on Ms. Joan Galster, Supervisor, Motor Fuels Tax Section, Tax Department, for comments on fuels tax enforcement issues. Ms. Galster said she was requested at the previous committee meeting to provide information on the status of dyed fuels enforcement efforts and the percentage of dye contained in dyed diesel fuel.

Ms. Galster said one of the questions she was asked to address relates to the amount of dye that must be contained in fuel to constitute a violation subject to penalties under North Dakota law. Ms. Galster said the standard that will be applied is a content level of one part per million (ppm). She said the provision on dyed fuel is contained in North Dakota Century Code Section 57-43.2-41. She said this section provides penalties for use of dyed fuel in a licensed motor vehicle. She said this section provides that special fuel is considered dyed if the fuel contains traces of dye in an amount sufficient to be found in violation of federal laws and rules. She said the amount of dye that constitutes a violation under federal regulations is one ppm, and this is the standard that must be applied by the state statute for violations in North Dakota. She said Minnesota and South Dakota use the same standard of one ppm as is used in North Dakota and under federal regulations. She said Montana uses a standard of two ppm for dyed fuel use violations.

Senator Stenehjem asked what the dye content is in undiluted dyed fuel. Ms. Galster said she believes it is in the range of ten to twelve ppm.

Ms. Galster said since the last committee meeting, agreements have been entered with the chemistry laboratory of the State Department of Health for testing of dyed fuels in cases of suspected violations, with the Highway Patrol for enforcement, and with the Department of Transportation for possible funding assistance. She said the Highway Patrol hoped to begin testing of fuel in vehicle tanks this month (June 2000), but it now appears testing will begin in July. She said the Highway Patrol is training eight officers for testing for dyed fuels in licensed motor vehicles. She said the Highway Patrol had one officer trained by federal officials and that officer is providing training for others.

Senator Christmann asked how testing will be done by the Highway Patrol. Ms. Galster said the law on dyed fuel usage does not provide search and seizure authority for tanks of motor vehicles for dyed fuel content. She said she cannot provide a legal opinion, but her understanding is that if a vehicle is stopped for another cause, Highway Patrol officers will check the tank of that vehicle for dyed fuel usage in violation of the state law. She said her understanding of the process is that an amount of fuel will be drawn from the vehicle tank into a tube and visually inspected. She said if the visual inspection indicates the fuel has been dyed, the sample will be retained for testing and a citation will be issued. She said after the results of testing are received, the Tax Department will review the results and issue a notice of assessment if a violation appears probable.

Senator Urlacher asked whether the procedure described differs from the procedures in South Dakota. Ms. Galster said she believes South Dakota law provides search and seizure authority under the dyed fuel enforcement provisions to allow officers to stop and check tanks of vehicles without other probable cause for a stop.

In response to a question from Senator Stenehjem, Ms. Galster said she believes Highway Patrol officers have authority to check fuel tanks for dyed fuel content during stops at weigh stations and for safety checks.

Senator Stenehjem asked whether North Dakota will share information on dyed fuel test results with the Internal Revenue Service. Ms. Galster said no information will be shared and no agreement has been entered for sharing information.

Senator Christmann asked what costs will be involved with dyed fuel sample testing by the chemistry laboratory of the State Department of Health. Ms. Galster said testing costs will be approximately \$15 to \$20 per sample, which includes storage and preparation of a report for delivery to the Tax Department.

Chairman Christmann invited comments of committee members regarding future committee action under the motor fuels tax study. He said one area that has been discussed is search and seizure authority for fuels testing. He said he would not favor providing authority for random stops of vehicles to test for use of dyed fuel.

Senator Thompson said he would not favor search and seizure authority for random stops for dyed fuel testing. He said the committee study directive asks for monitoring of enforcement of the fuels tax laws after 1999 changes. He said no testing has been done at this point, so it is difficult for the committee to fulfill that directive. He said he hopes information will be available by the next meeting of the committee on public awareness of the new law prohibiting use of dyed fuels on the highways.

Committee members engaged in discussion of the part per million dye content for violations and how long it would take to bring the content in a fuel tank below the allowable level if dyed fuel has been used in the tank. Chairman Christmann said it appears it will be necessary to clarify the content of dye in fuel as it comes from the refinery and whether one ppm is detectable by visual inspection.

Mr. Gary Anderson, Director, Sales and Special Taxes Division, Tax Department, said he is not sure what experiences other states have had on dyed fuel testing and the level of dye content in violations of dyed fuel prohibitions.

Representative Haas asked whether no violation results if a test result indicates less than one ppm dye content in fuels. Mr. Anderson said the Highway Patrol will not know whether the dye content in fuel is above or below the one ppm amount. He said he believes if a Highway Patrol officer observes the presence of dye in fuel, testing must be done to determine whether the content is above or below the one ppm limit. He said if laboratory testing finds dye content to be less than one ppm, no violation would be the result.

Representative Renner asked if a trucker stops at his farm and is running out of fuel and he gives the trucker five gallons of dyed fuel to get him going, how long would the dye in the fuel system of the truck be in violation of the law? Mr. Anderson said he thinks discretion would be involved in enforcement, so

violations caused by necessity or for excusable circumstances would not be found to be violations. He said there will be much to learn in enforcement on this topic. He said the length of time it will take to reduce the dyed fuel content below the threshold amount will depend on how much dyed fuel remains when the tank is refilled, the capacity of the tank, and whether or not the tank is completely filled. He said it is difficult to provide guidance on this question, but the one ppm threshold is approximately 8 to 10 percent of the content of undiluted dyed fuel.

Senator Stenehjem suggested that at the next committee meeting someone from the chemistry laboratory of the State Department of Health should provide information to the committee on the questions of dyed fuel content and perhaps show samples of the appearance of undiluted dyed fuel and various concentrations of dye content to allow committee members a better understanding of the appearance of dyed fuel. He said it would also be helpful to have illustrations of the amount of undyed fuel it would take to dilute dyed fuel to a point below the one ppm threshold for violations.

FARM AND RANCH RETIREMENT STUDY AND AGRICULTURAL BUSINESS INVESTMENT STUDY

Chairman Christmann called on committee counsel to review resolutions on issues related to the agricultural studies.

Committee counsel reviewed a resolution urging Congress to reduce or eliminate the impediment of capital gains and estate taxes on passage of stewardship of family farms to succeeding generations. He said the resolution states that capital gains and estate taxes often require liquidation of family farm property and put families out of the farming business. He said this resolution and the other resolutions to be reviewed relate to issues of federal law over which states have little or no control.

Committee counsel reviewed a resolution urging Congress to provide a greater opportunity for farmers to participate in retirement investments by allowing withdrawals from individual retirement accounts and similar investments without penalty when necessary to support family farming operations. He said the resolution states that individual retirement accounts and similar retirement investments are not feasible for many farmers due to early withdrawal penalties. He said farmers must recognize they will have to draw upon savings in bad farming years, and this discourages use of retirement investments allowed under federal law because penalties exist for early withdrawal of money from these accounts.

Committee counsel reviewed a resolution urging Congress to reduce or eliminate capital gains taxes on inflationary valuation increases of farm and ranch property. He said the resolution states that imposition of capital gains taxes on inflation valuation increases

for farm and ranch property serves as an impediment to retirement for farmers and ranchers, further inflates the value of farm and ranch property, and makes acquisition of property much more difficult for the next generation of farmers and ranchers. He said a copy was distributed to committee members of information prepared by the National Center for Policy Analysis. The information distributed illustrates an example of a farm purchased for \$100,000 in 1975 and worked for twenty years. He said the farm in this example was sold in 1995 for \$300,000, making a \$200,000 taxable capital gain under federal law. He said under this example, capital gains taxes of \$56,000 would have been due to the federal government, but the consumer price index increased 183 percent over the years 1975 to 1995 and the property would have had to be sold for \$283,000 just to stay even with inflation. He said after inflation, the real gain on the sale of the property would have been only \$17,000, and if the capital gains tax had been indexed for inflation, the tax liability would only have been \$4,760.

Committee counsel reviewed a resolution urging Congress not to implement or allow implementation of the Kyoto Protocol because of the potentially disastrous impact on American agriculture. He said the 1997 Kyoto Protocol treaty on global warming called for reductions in emissions of carbon dioxide and for application of carbon permit fees for fuel users in industrial countries. He said farmers are forced to rely on use of fuels in farming operations, and the resolution states that fuel cost increases from implementing the Kyoto Protocol would aggravate the existing farm crisis.

Committee counsel reviewed a resolution urging Congress to enact legislation to allow farm and ranch risk management (FARRM) accounts and to consider limiting the size of the accounts rather than the time funds may be held in the accounts. He said Congress is considering legislation to allow FARRM accounts as a management tool for farmers and ranchers to defer income by setting it aside in tax-deferred accounts to be drawn upon as taxable income when needed in years of lower income. He said the resolution asks Congress to consider changing the five-year limit of time funds could be held in the accounts and that it may be more appropriate to limit the amount that may be held in the accounts, rather than the time funds may be held, so these accounts could be used for retirement planning and other long-range benefits for farmers and ranchers.

Committee counsel said at the previous meeting there was discussion of redrafting the two resolutions considered at that meeting into a format for faster communication to Congress. He said because three additional resolutions were drafted, they have not been drafted in an alternative format for communication. He said if the committee desires to approve the resolutions for immediate communication to Congress, changes could be made, and it would be

necessary to seek approval from the chairman of the Legislative Council because the rules governing Legislative Council interim committees require communications expressing policy to be approved by the chairman of the Legislative Council before they are disseminated.

Chairman Christmann said the committee will meet at least one more time and could act on these resolutions at the next committee meeting. He said committee members should give consideration to these resolutions and decide whether they support these resolutions and whether any changes are necessary. Senator Thompson said on the issue of speeding up communication of these requests to Congress, it may be important because if these resolutions are introduced in the 2001 Legislative Assembly, these opinions will not be forwarded to Congress until 8 to 10 months from now. Chairman Christmann said it might be important to have these resolutions considered by the full Legislative Assembly, and Congress is at a point before the fall elections when it might be unlikely that significant legislation will be enacted. Senator Thompson said that may be true, but at least with regard to the Kyoto Protocol issue, it appears to be regulatory rather than legislative action at the federal level that poses a threat to agriculture so it might be important on this issue to speed up communication of opposition to fuel cost increases for farmers.

Senator Urlacher said he thinks it would be appropriate to make these resolutions into resolutions of the committee and to seek approval from the chairman of the Legislative Council to communicate these opinions to Congress. He said these are important issues and opinions should be made known to the North Dakota Congressional Delegation. He said he does not believe it is necessary to act on these resolutions until the next committee meeting.

Chairman Christmann said he believes the committee could consider these resolutions at its next meeting. He asked committee counsel to consider language that would be necessary to change these resolutions into resolutions of the committee for consideration by the chairman of the Legislative Council.

Chairman Christmann called on Mr. Lance Gaebe, Executive Director, North Dakota Agricultural Products Utilization Commission, for testimony relating to grant programs administered by the Agricultural Products Utilization Commission. A copy of Mr. Gaebe's prepared testimony is attached as Appendix B. Mr. Gaebe also distributed and reviewed information on agricultural projects funded during the 1997-99 biennium, projects funded during the current biennium, and projects for which funding has not been approved.

Senator Urlacher asked who does the research for projects funded by grants from the Agricultural Products Utilization Commission. Mr. Gaebe said

research is available through several sources, and grant recipients who require research choose their own research methods and providers based upon their needs and the availability of expertise in the area being explored.

Chairman Christmann called on committee counsel to review reasons for many value-added agricultural projects choosing the cooperative as the preferred business structure for their organization. Committee counsel said the committee has a study directive to find ways to encourage private investment in agricultural projects in the state. He said at the previous committee meeting, it was observed that many of these enterprises are established as cooperatives, which limits opportunities for investment in the project by anyone other than an agricultural producer. He said the committee requested information on why the cooperative form of business organization seems to be preferred by many value-added agricultural enterprises.

Committee counsel said he discussed reasons for choosing the cooperative form of organization with Tax Department staff and Mr. Steve Noack, an attorney in Fargo, who has helped to establish several value-added agricultural projects. He said one of the reasons for choosing the cooperative form relates to tax considerations under federal law. He said corporations are subject to two levels of taxation on earnings, including the corporate income tax and income taxes paid by individuals on distributions from the corporation. He said earnings of a cooperative may be distributed as patronage dividends to members and avoid imposition of corporate income taxes. He said another consideration regarding earnings is that cooperatives are used as a way to keep earnings among those who are producers of the commodities used by the cooperative. He said another incentive exists under federal securities laws. He said an exemption provided by federal law allows organizers to avoid registration with the Securities and Exchange Commission for a tax-exempt cooperative. He said one requirement of cooperatives imposed under the securities laws is 85 percent minimum ownership by producers. He said Mr. Noack observed that in practice, it really is not possible to structure for less than 100 percent ownership by producers. He said another consideration under federal law is that a cooperative may be established to allow each member one vote in decisions of the cooperative. He said this differs from laws on most corporations in which ownership of shares determines the number of votes an individual has in corporate decisions. He said another consideration relates to control of the business. If the business is established as a corporation, a larger corporation could buy controlling interests in the venture once it has become profitable. He said Mr. Noack said there are other ways under current law to allow outside investment in value-added agricultural projects, but producers have

shown a preference for the cooperative form of organization for reasons that outweigh attracting outside investment under their present circumstances.

Chairman Christmann called on committee counsel to review a bill draft on establishing a farmers equity trust fund. Committee counsel said the bill draft was requested by the committee at the last meeting to be based on suggestions of Mr. Warren Enyart, Renewable Resources Research Institute, and Mr. Bill Patrie, Cooperative Development Center. Committee counsel said the bill draft is based on suggestions made by Mr. Enyart and Mr. Patrie, and the bonding provisions of the bill draft are patterned after provisions contained in 1999 Senate Bill No. 2425.

Committee counsel said the bill draft requires the Industrial Commission to establish the farmers equity trust fund at the Bank of North Dakota. He said the fund would be capitalized by sale of bonds by the Industrial Commission, through the Bank of North Dakota. He said the moneys in the farmers equity trust fund could be used by the Agricultural Products Utilization Commission on behalf of the fund to acquire ownership interests in value-added agricultural projects or for loans to value-added agricultural projects. He said the bill draft requires a loan to be secured by ownership interests in the project. He said the bill draft allows the Agricultural Products Utilization Commission to establish procedures for applicants to apply for investments and loans and to establish procedures to evaluate applications for investments or loans.

Committee counsel said the bill draft allows various tax incentives for purchasing bonds sold to capitalize the farmers equity trust fund. He said an individual or corporate income taxpayer would be entitled to a credit of 20 percent of the amount invested in bonds. He said the bill draft requires that the credit must be split between two taxable years, and any credit may not exceed 50 percent of the taxpayer's tax liability for the year. He said the bill draft requires bonds to be held for three years to claim the income tax credit to prevent taxpayers from purchasing and selling bonds just to acquire tax credits. He said the bill draft provides an individual long-form and short-form income tax credit for investments and a corporate income tax credit for investments. He said the bill draft also provides that interest income from the bonds is deductible on the corporate return and the individual long-form and short-form returns.

Committee counsel said the bill draft was not available for distribution prior to the meeting. He said the bill draft should be sent with a request for comments to the Bank of North Dakota, Tax Commissioner, Municipal Bond Bank, Agricultural Products Utilization Commission, agricultural organizations, and others who might have an opinion or expert advice on the concept. He said a fiscal note should also be requested from the Tax Department.

Chairman Christmann called on Mr. Warren Enyart, Chief Executive Officer, Renewable Resources Research Institute, for comments on the bill draft to establish the farmers equity trust fund. Mr. Enyart said income opportunities from traditional production agriculture are limited and subject to hardships of bad weather and market price fluctuations. He said it is necessary to establish opportunities for farmers to become involved in value-added agricultural projects to increase their income opportunities. He said establishing these projects is difficult, and one of the primary problems is accumulating equity capital to begin a project. He said assisting with attracting equity capital is the objective of the bill draft. He said the Taxation Committee was given a study directive to try to find a way to attract investment dollars to assist in value-added agricultural projects. He said cooperatives established for these projects do not allow outside investment in most cases, so he believes the concept in the bill draft is the best available means for the committee to meet its objective. He said investments in bonds to fund the farmers equity trust fund would allow an opportunity for investors to become involved in the success of value-added agricultural projects without acquiring direct ownership interests.

Chairman Christmann called on Mr. Bill Patrie, Cooperative Development Center, for comments on the bill draft to establish the farmers equity trust fund. Mr. Patrie said he has been involved in the establishment of approximately 34 agricultural enterprises now operating in North Dakota. He said his experience is that attracting capital necessary to launch these projects is a major part of getting projects established. He said the objective of the farmers equity trust fund concept is to provide a base for establishing these enterprises and to allow North Dakota investors an opportunity to buy bonds with proceeds that will go back to work in their communities.

Mr. Patrie said an example of how he envisions the project to work might be drawn from the current demand of Cloverdale Foods for hog production. He said there is an inadequate number of farmers raising

hogs to supply operations in Mandan and Minot, and the question is how to encourage raising hogs. He said raising hogs is an expensive endeavor and requires building hog barns for necessary operations. He said a group of producers wanting to build hog barns could join together and apply to this fund to acquire an ownership interest in their operations. He said over a period of time, these farmers would buy back the interest of the farmers equity trust fund, and the payments would be available to pay investments and interest back to bondholders. He said this approach could be used repeatedly in many value-added agricultural projects.

Representative Haas said over the years, lack of investment capital has been a big problem in trying to establish value-added agricultural projects. He said he thinks it is worthwhile to explore the concept in the bill draft.

Chairman Christmann said the Legislative Council staff should contact agencies, groups, and individuals with expertise or interests in the concept in the bill draft for comments at the next committee meeting. He said one issue of particular concern to him is whether bonds issued to capitalize the farmers equity trust fund under the bill draft would impact bond ratings of the State of North Dakota or the Bank of North Dakota. He said opinions should be sought on that issue.

The meeting was adjourned at 11:45 a.m. After adjournment, committee members joined Mandan-area legislators and representatives of the North Dakota Petroleum Council and Oil and Gas Division of the Industrial Commission for a tour and discussions at the BP Amoco Refinery in Mandan.

John Walstad
Code Revisor

ATTACH:2