

NORTH DAKOTA LEGISLATIVE COUNCIL

Minutes of the

TAXATION COMMITTEE

Thursday, November 4, 1999
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, Meyer Kinnoin, Kenneth Kroepelin, Randy A. Schobinger, Bob Stenehjem, Vern Thompson, Herb Urlacher; Representatives Wesley R. Belter, Mick Grosz, C. B. Haas, Gil Herbel, Earl Rennerfeldt, Arlo E. Schmidt, Ben Tollefson, John M. Warner, Ray H. Wikenheiser

Members absent: Senator Steve Tomac; Representatives Pam Gulleason, Stacey L. Mickelson, Ronald Nichols, Dennis J. Renner

Others present: See Appendix A

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

LIGNITE INDUSTRY STUDY

Chairman Christmann called on Mr. Jim Deutsch, Public Service Commission, for testimony regarding reclamation laws and rules more stringent than corresponding federal requirements. A copy of Mr. Deutsch's prepared testimony is attached as Appendix B.

In response to a question from Senator Christmann, Mr. Deutsch said the biggest changes resulting from 1975 legislation were probably the requirements for a detailed soil survey prior to mining to identify topsoil and subsoil materials and that topsoil and subsoil to a depth of five feet must be saved and used for reclamation purposes. He said the five-foot depth requirement is no longer imposed.

Senator Christmann asked whether there is anything in the reclamation laws or rules that strikes Mr. Deutsch as having outlived its usefulness. Mr. Deutsch said he is not aware of any provisions that are no longer necessary, and he believes what is contained in the rules is necessary for reclamation purposes.

Senator Thompson asked whether the areas where differences exist between federal and state requirements are primarily the result of state statute. Mr. Deutsch said that is correct and there are very few things in Public Service Commission rules that are stricter than corresponding federal requirements, unless required by state statute.

Senator Thompson asked what happens to mined lands if the lignite industry in North Dakota becomes economically unviable. Mr. Deutsch said for disturbed lands there is a performance bond that is available to assure reclamation. He said these bonds are determined to be adequate to cover reclamation costs if the mining company goes out of business and the state would have to hire private concerns to do the reclamation work.

Representative Warner asked whether the water delivery systems referred to in the prepared testimony are manmade or natural water delivery systems. Mr. Deutsch said these systems are mostly manmade wells, but these requirements could also apply to natural springs.

Chairman Christmann called on Mr. Murray G. Sagsveen, State Health Officer, State Department of Health, for testimony on environmental laws and rules that may be more strict than corresponding federal requirements. A copy of Mr. Sagsveen's prepared testimony is attached as Appendix C.

Senator Thompson inquired about emissions of pollutants from Canadian electrical generating facilities near the North Dakota border. Mr. Dana Mount, State Department of Health, said a single generating plant in Canada emitted about 100 million tons of particulate per year as compared to approximately five million tons for all generating facilities in North Dakota. He said this is certainly a concern to North Dakota because it affects air quality in North Dakota, which may be attributed to North Dakota facilities under federal law. He said efforts have been made by the state and by the United States and Canadian governments to clean up emissions from the facility. Mr. Sagsveen said he has always been offended by the apparent callous disregard of air quality in the operation of the Canadian facility. He said the State Department of Health has instigated more aggressive monitoring of air quality near the Canadian border and will continue to press for improvements.

Senator Christmann asked what the chemical and mineral contents of emissions were and what qualifies as special waste that is subject to special rules for disposal. Mr. Neil Knatterud, State Department of Health, said special waste is defined to include nonhazardous waste generated from conversion facilities and surface mining. He said this would

include sludge, ash, and other items consistent with federal law which would not be subject to federal hazardous waste laws and rules. He said hazardous waste requirements are much more stringent than the requirements for handling special waste. He said special waste includes materials collected in air-filtering equipment and ash from generating facilities and may include dissolved solids that could contaminate surface and ground water.

Senator Christmann said federal regulations limit regional haze and he asked whether recent grass and hay fires in the state affect the state's air quality rating under federal regional haze regulations. Mr. Mount said federal rules did not address long-range drift of smoke from fires. He said new federal rules require that each state develop a plan to restore air quality in defined areas within 60 years. He said North Dakota will be required to develop such a plan by the year 2006. He said Governor Schafer has directed that North Dakota join with regional states to work on such a plan. He said Canadian generating facilities degrade the air in North Dakota, and the federal rules allow recognition of the impact of foreign air pollution. He said the federal rules also allow recognition of smoke from fires so the state would not have to over-compensate for smoke or foreign air pollution or other factors that are beyond the control of the state.

Chairman Christmann called on committee counsel, who said the Tax Department staff prepared fiscal estimates on coal severance tax rate reductions at various levels. He said the preparer was unable to be present for the meeting, and he distributed copies of the fiscal estimates prepared by the Tax Department. A copy of the fiscal estimates is attached as Appendix D.

Chairman Christmann called on Ms. Carmen Miller, Special Assistant Attorney General, Attorney General's office, for comments on a legal challenge to the 1999 legislation imposing a sales tax on coal from out-of-state sources. Ms. Miller said the committee inquired after its July meeting about whether legal challenges were expected on the 1999 legislation imposing sales taxes on imported coal. Ms. Miller said the state of North Dakota has been sued by Kennecott Energy Company and Spring Creek Coal Company in a suit filed in September 1999. Ms. Miller said it would not be appropriate to comment on the merits of the pending litigation. She distributed a copy of the answer filed by the state in this action.

Chairman Christmann called on former Governor Arthur A. Link for comments on the coal industry study. Mr. Link said when he was Governor, many of the regulations on reclamation for the coal industry were established at the state level. He said the state laws were enacted before federal regulations. He said the state was on the forefront in reclamation issues, protection of air and water, and disposal of waste from the industry. He said he thinks the state did well in its efforts in establishing workable

regulations for the benefit of the state and the coal industry. He said he urges the committee in its deliberations to not go so far as to jeopardize the concept that total reclamation of the land surface must be accomplished. He said examples of what results when reclamation is not done properly can be seen by looking at areas of Canada. He said subsoil consideration in surveys and reclamation efforts is important because the subsoil is as important to plant growth as topsoil because it supports plant roots.

Mr. Link said he compliments the lignite industry on tours of reclaimed areas and the job the industry has done in reclaiming property. He said viewing reclaimed areas gives no indication that mining has occurred because the property looks as good as unmined property. He said North Dakota can be proud of the laws and rules in place and the job that has been done by the lignite industry. He said the state should not relax reclamation requirements for short-term benefits of reducing mining costs.

Chairman Christmann called on Mr. John Dwyer, President, Lignite Energy Council, for comments on the committee study. Mr. Dwyer said the big battleground for the lignite industry he perceives in the next 10 years will be with Environmental Protection Agency rules. He described lawsuits against enforcement of Environmental Protection Agency rules in which the industry has been successful thus far, but he said the battle is not over. He said regional haze regulations are probably now the number one issue for the lignite industry. He said enforcement of existing regional haze regulations would jeopardize the ongoing operation of the Leland-Olds, Milton R. Young, and Stanton power plants. He said he believes the committee should look with particular concern at air quality rules.

Senator Urlacher said he questions whether it relates to the lignite industry study, but issues have arisen over identifying what is gravel. He said questions and lawsuits have arisen regarding this issue, and he asked whether this could be examined in this study. Chairman Christmann said he would consult with the Legislative Council staff on this question.

Chairman Christmann said he will consider which direction future inquiry of the committee should go on the lignite industry study.

AGRICULTURAL BUSINESS INVESTMENT AND FARM RETIREMENT STUDIES

Chairman Christmann called on Mr. Warren Enyart, Chief Executive Officer, Renewable Resources Research Institute, for comments on the study of means to encourage investment in agricultural businesses. Mr. Enyart said the goal of the Renewable Resources Research Institute is to develop technologies to benefit the agricultural industry. He said as part of this mission, the institute works with rural development efforts.

Mr. Enyart said the primary concern in establishing agricultural businesses is an inability to raise capital. He said the process of establishing a successful agricultural product value-added business involves assembling a puzzle composed of several pieces. He said the first piece of the puzzle generally consists of a producer's closed cooperative. He said this would consist of farmer members providing a supply of agricultural raw materials, technology, and equity capital. He said equity capital is the least available of these items for producers. He said another portion of the puzzle consists of finding a strategic partner with market connections and equity capital. He said market connections could consist of a brand name or an existing place in the market. He said another piece of the puzzle could involve a second strategic partner to bring machinery, processing expertise, and equity capital into the enterprise. He said the fourth portion of the puzzle is very important and consists of other investors to provide equity capital. He said it is in this area that capacity must be developed to support the establishment of agricultural product value-added businesses.

Mr. Enyart proposed establishment of a farmers' equity trust to establish a \$30 million fund for equity investments in feasible value-added enterprises on behalf of eligible farmers. He said the objective is to aid investment after groundwork for a project has been done. He said management of the trust would be in a board of trustees controlled by farmers. He said any individual, including nonfarmers, could invest in the trust. He said investors should be given income tax credits for investments. He said the trust would establish a nominal interest rate and conditions for repayment based on the success of the company receiving a loan. He said the trust could make investments in companies in the name of the trust and the individual farmer participating in the company. He said the participating farmer could buy back the shares sold to nonfarmer investors over time, through patronage with the enterprise. He said trust shares could be transferred to other eligible participating farmers at current market value if the trust and the company agreed to the transfer. He said trust investors would obtain a tax credit up front and would receive interest over time while offsetting any losses with the appreciating value of investments. He said equity in the trust could be used to leverage other strategic partners to join the company.

Mr. Enyart said he would make four recommendations to the committee in pursuit of its study objective. He said the four recommendations are:

1. Strengthen support for technology development and use by farmer-owned enterprises.
2. Provide readily accessible sources of loans for producers' equity participation in ag-based value-added enterprises.

3. Provide incentives for "strategic partners" investment in ag-based value-added enterprises.

4. Establish a Farmers' Equity Trust to enable and encourage North Dakota residents to invest in ag-based value-added enterprises.

Senator Christmann asked where the \$30 million to establish the Farmers' Equity Trust would be obtained. Mr. Enyart said it is hoped that the trust could be established with investor dollars. He said he would contemplate that investments would not only come from producers but would include some nonfarmers' investment dollars that might otherwise go to mutual funds, stocks, or other investments outside the state. He said he believes it was the objective of the study resolution to make available investment opportunities for some of these investments.

Representative Belter asked where the operating funds are obtained for the Renewable Resources Research Institute. Mr. Enyart said funding for the institute comes partially from checkoffs of commodity groups and from federal grant moneys.

Senator Christmann asked whether corporate farming laws create legal problems for the kind of fund described by Mr. Enyart. Mr. Enyart said he does not think the trust would conflict with the corporate farming laws, but Mr. Steven Noack, Attorney, Fargo, would be more able to address legal issues of this nature.

In response to a question from Representative Haas, Mr. Enyart said the Agricultural Products Utilization Commission is one resource for higher risk business establishment. He said the state needs to strengthen funding in this area to encourage innovation.

Representative Rennerfeldt asked whether, if he invested in the Farmers' Equity Trust, his stock would be freely marketable. Mr. Enyart said that depends on how the trust is established. He said limits could be placed on approval of sales of stock to other investors.

Mr. Enyart distributed copies of an article from *American News* relating to a Federal Reserve System center for the study of rural America and efforts to improve the economy of rural areas. He also distributed a copy of written testimony prepared by Mr. Noack on the agricultural business study.

Chairman Christmann called on committee counsel for comments on the farmer retirement study. Committee counsel said he has called this issue to the attention of several attorneys and accountants in the state. He said Mr. Jon Strinden, Attorney, Fargo, suggested one feasible approach might be to eliminate penalties for withdrawing funds from an individual retirement account (IRA) if the funds are put into an agricultural operation. He said the rationale for the suggestion is that it is very difficult for farmers to put money into retirement vehicles available under

federal law because withdrawals of those moneys before retirement age is subject to substantial penalties. He said the nature of farming is that in bad years it will be necessary to draw investment money into support of the farming operation, and this discourages placement of investment dollars in retirement funds where penalties would apply to withdrawal of the funds. He said Mr. Strinden suggested that Congress might be urged to provide an exception to allow IRA moneys to be withdrawn in the limited instance in which the money goes into support of a farming operation. Committee counsel said it would probably be necessary to establish limitations on what uses could be made of withdrawn funds to qualify for such an exception.

Chairman Christmann called on Mr. James M. Moench, Commission on the Future of Agriculture, for comments on the committee study. Mr. Moench said the commission has no suggestions to offer at this time, other than those contained in the correspondence submitted to the committee at its previous meeting.

MOTOR FUELS TAX STUDY

Chairman Christmann called on Ms. Joan Galster, Motor Fuels Tax Section Supervisor, State Tax Department, for comments on dyed fuel enforcement efforts. Ms. Galster said the Tax Department has found that it takes time to implement enforcement of dyed fuel provisions. She said during the legislative session she informed committees considering House Bill No. 1462 that it would probably take several months to implement the program and that has proven to be true. She said the bill originally had an effective date of January 1, 2000, but the date was advanced to July 1, 1999. She said the original effective date of January 1, 2000, was more realistic for an implementation of enforcement timetable. She said she has checked with other states and it has taken several months to implement similar programs, including eight months to implement the program in South Dakota.

Ms. Galster said at the previous committee meeting she informed the committee that she believed that the Internal Revenue Service would do testing of dyed fuels for North Dakota. She said a new document from the Internal Revenue Service has revealed a problem that was previously unknown. She said it has come to light that if the Internal Revenue Service does training for state personnel, the state would be obligated to take fuel samples for the Internal Revenue Service. She said the Tax Department does not like that aspect of Internal Revenue Service testing. She said that three or four years ago the North Dakota Highway Patrol participated in the Internal Revenue Service testing program and some officers received training at that time. She said the Tax Department is looking into using the experience of

those officers as a basis for a state enforcement program.

Senator Christmann asked what training is necessary for testing for the presence of dyed fuels. Ms. Galster said protective clothing, gloves, and equipment would have to be specially designed for testing. She said the South Dakota Highway Patrol tests fuel in trucks when trucks are pulled over for other reasons. She said the South Dakota Highway Patrol officers "suit up" to do testing.

Senator Stenehjem said fuel station operators do not "suit up" in protective clothing when dispensing diesel fuel. He said he does not see the need for extensive precautions by officers. He said he does not see the need for extensive training because Highway Patrol officers know chain of custody issues from blood, drug, and alcohol testing and enforcement. Ms. Galster said she is uncertain why extensive training is necessary but believes it is a federal requirement.

Senator Urlacher asked what federal agency requires these training levels. Ms. Galster said she is not certain what agency requires these training requirements, but it could be the Internal Revenue Service, Environmental Protection Agency, or another federal agency.

Senator Urlacher requested more information on why and where these requirements originated. Ms. Galster said she could provide that information at the next committee meeting. Senator Stenehjem said that information would be desirable.

Representative Schmidt said he did not expect in considering the 1999 legislation that extensive testing would be necessary. He said he assumed that presence of red dye in fuel would be easy to detect. Ms. Galster said for court actions, it is necessary to have chemical analysis of the fuel. She said visual observation of red dye in diesel fuel is not enough for evidentiary use in court actions.

Senator Stenehjem said in some cases a driver may admit the use of red fuel, and he asked whether testing could be avoided in those situations. Ms. Galster said the Tax Department is looking at that possibility to reduce the need for testing in some cases.

Representative Grosz said the testing requirements being considered seem much more complicated than necessary. He said visual observation should be adequate to determine the existence of red dye in fuel. He said the existence of sulfur in fuel is an Environmental Protection Agency concern because sulfur content is not permitted in fuel used for highway purposes. He said if fuel contains red dye, it violates our state law and should not require extensive chemical analysis.

Senator Urlacher said he was under the impression that this was a fairly simple provision in the law enacted in 1999. He said he also thought visual testing of red dye in fuel would be adequate. He

asked whether we could get back to that concept. Ms. Galster said the system will basically work as contemplated, but training of enforcement personnel is necessary. She said if red dye is present in fuel, it will not require testing unless an assessment of a fee is challenged in court. She said there can be red dye present in fuel from legal uses or a concentration of red dye below prohibited levels, so testing is necessary to overcome court challenges or defenses offered by defendants.

Representative Grosz said it would be disappointing if the Tax Department enforcement efforts brought the Internal Revenue Service and Environmental Protection Agency into the state enforcement.

Ms. Galster said the Tax Department intends to meet with the State Highway Patrol on proposed training and to meet with the State Laboratories division regarding testing of fuels. She said the Tax Commissioner wants the committee to know that he has not decided on any enforcement options at this time and is examining all options available.

Senator Christmann inquired about the fiscal note on the 1999 legislation and whether the delay in enforcement is affecting anticipated revenues. Ms. Galster said the fiscal note for the 1999 legislation estimated a revenue gain of \$1.95 million for the biennium from a combination of changes, one of which was the dyed fuels enforcement provisions. She said, of the amount in the fiscal note, only approximately \$150,000 per year was anticipated revenue enhancement from dyed fuel enforcement. She said she believes that estimate may have been optimistic, and the fiscal effect really cannot be estimated. She said she believes the provision is being followed and that fuel users are buying and using undyed fuel for highway purposes.

Senator Christmann asked whether there have been any developments on the reduced shrinkage allowance for fuel dealers now that fuel tax reports have been completed under the new law. Ms. Galster said there have been very few problems with the new law, but a small number of individuals have complained that the reduction in the shrinkage allowance is unfair to them.

Chairman Christmann called on Captain Neil Johnson, Highway Patrol, to address questions from committee members. Senator Christmann asked whether there would be search and seizure legal issues involved in testing for dyed fuel in vehicles. Captain Johnson said he does not believe there

would be search and seizure issues beyond those that normally attach to Highway Patrol enforcement. He said testing could be done if the officer has an articulable suspicion of a violation.

In response to a question from Senator Christmann, Captain Johnson said the Highway Patrol did testing for the presence of dyed fuels for the Internal Revenue Service in 1995 and 1996. He said officers were required to put on coveralls and gloves for testing, so it does not present a big problem.

Senator Kinnoin asked whether the Highway Patrol may stop vehicles at random for fuel testing. Captain Johnson said that is a question for legal counsel, but in his experience, anytime the word "random" is associated with searches there is a potential legal problem. Captain Johnson said there is normally a requirement that a reason must exist to stop a vehicle for another cause before a check is authorized.

Senator Christmann said when the 1999 legislation was being considered, he envisioned that testing would be performed when vehicles were stopped for reasons other than testing for dyed fuel. Captain Johnson said that was also his impression.

Chairman Christmann said the committee will continue to monitor development of the enforcement efforts for the dyed fuel provisions of the 1999 legislation. He asked whether committee members would like other information under the fuels tax study.

Representative Grosz said during consideration of 1999 House Bill No. 1462, legislative committees were told that it takes a great deal of administration by fuel dealers to track fuels taxes, do accounting operations, and comply with the law. He said it was suggested that several accountants are necessary to handle administration. He said he would like to have someone explain why it is so expensive for fuel dealers to comply with the tax administration provisions. He requested that the Petroleum Marketers Association be invited to have someone walk through the process with the committee and explain why the compliance costs are such a concern.

The meeting was adjourned at 2:00 p.m.

John Walstad
Code Revisor

ATTACH:4