OPINION
73-547

November 5, 1973 (OPINION)

Mr. John A. Zuger
City Attorney
City of Bismarck
P.O. Box 1695
Bismarck, ND 58501

Dear Mr. Zuger:

This is in response to your letter of September 1973, in regard to the taxation of leaseholds under the Municipal Industrial Development Act of 1955, as amended.

You inform us that your city has pending applications by two groups of developers to use the MIDA.

You state that the Act classified the leasehold as personal property, with the intent, you believe, to subject it to taxation as the lessee's interest in the project except as an exemption might be granted to not exceed five years. The title to real estate which is taken in the City's name, you state, would appear to be exempt under Section 57-02-08.

You quote a part of subsection 25 of Section 57-02-08 of the North Dakota Century Code, relative to repeal of personal property tax.

You state that Section 40-57-17 allows exemption to not exceed five years. You state that Section 40-57-03(3) provides that the City shall have the power to lease as a rental necessary to pay principal, interest, and to provide for "the operation, maintenance, insurance on, and depreciation of such projects, and any taxes thereon".

You indicate that the applicants to the City to use the Act are willing to pay taxes on the leasehold. You indicate that the City is willing to use the Act, as intended, to promote commercial and industrial development. You state this is particularly true as to a whole downtown city block cleared under urban renewal.

You state that you ask our opinion if the City can under the Act provide a lease rental for the amount of taxes on the leasehold, and for the priority of such charge over other items payable from the rental.

You enclose a letter of comments and research resulting from a joint search and exchange of ideas with a specified attorney for what help it may be.

You state that if the lessee cannot be obligated to pay any rental for taxes on its interest in the leasehold, your city, or any other city, can ill afford to use MIDA for the purposes intended by the Act since it would suffer too great a loss in revenue.

We have had prior occasion to consider the type of problem your

letter sets out. We are enclosing herewith copies of our opinions of date 29 July 1968, August 1, 1969 and August 18 of 1969, in respect to same, with the thought in mind that they may be of some help to you in this regard. It may be of some interest to you, and the other attorney researching the question, that the language of the first sentence of Section 40-57-17 was changed from: "The leasehold granted by a municipality under this chapter hereby is classified as personal property" to "The leasehold granted by a municipality under this chapter is hereby classified as personal property for a period of five years from the granting of such leasehold and the execution of any instrument evidencing said grant", at the legislative session following the issuance of these opinions.

We would assume also that the "new" definition of real property for the purposes of taxation adopted at the 1971 Session of the North Dakota Legislature may be of interest to you in this regard.

We have some difficulty with your reasoning that the City would suffer too great a "loss" in revenue if the lessee cannot be obligated to pay any rental for taxes on itself, thus exempting same under 57-02-08, subsection 3, there would be some loss in revenue, generally speaking the improvements placed on land are what would put a much more substantial value on same. However, this is a new value as a result of the MIDA project, which is not gained, rather than an old value which is lost.

There are a number of approaches to the problem of taxation of both the land itself, the buildings, and equipment located thereon. We would tentatively assume that the provisions of Section 57-02-26 of the North Dakota Century Code would not apply to "cities" as the "state", or "religious, scientific or benevolent society or institution", though we are familiar with no judicial precedent answering this question. Perhaps if legislation is appropriate to solve your problem, you might consider an amendment of this statute.

There also might be possibilities of the city removing same from the exemption contained in subsection 3 of Section 57-02-08 by divesting itself of that part of the "real property" consisting of buildings (subsection 2 of Section 57-02-04) or of land (subsection 2 of Section 57-02-04) pursuant to the provisions of subsection 9 of Section 40-57-03 which might result in a considerable "devaluation" of the "leasehold" specified as personal property for the five year period, regardless of whether the chattel real leasehold were or were not considered to be personal property. Subsection 9 of Section 40-57-03 would in effect authorize conveyance by deed of the site and building to the "lessee" at any time. At such point, it would no longer be exempt under Section 57-02-08 as "city" owned property, or a part of the exempted leasehold under Section 40-57-17. It would simply be taxable as real property owned by the party designated in the Act as the "lessee". In practical effect it would not change possession - as the "lessee" rather than the city was intended to possess it anyway, and probably would not change the bondholder's security, as same would necessarily be subject to mortgage under Section 40-57-14, subsection 6, and foreclosure under subsection 5 of Section 40-57-16 in any case. It might have an effect on the salability of the bonds upon which we will not comment, as we do not claim to be experts on the bond market, though we are sure that the

associate counsel, whose letter you enclose, would be in contact with people familiar with the concepts of salability of this type of security.

We feel there is also the possibility of establishing a total waiver of the statutory tax exemption, and personal property classification on a contractual basis, or by the creation of an estoppel situation. We should mention, however, that same is not clearly established by specific statutory provisions or clear judicial precedent. If this is to be attempted we would suggest the following:

1. The project lessee should do so by an express provision in the lease that would provide for waiver of the exemption and for assessment and taxation of its leasehold interest in that part of the real property of the project that would be classified as real property under Section 57-02-04 and assessed to it if it, rather than the municipality, were the owner of the project.

2. Because Section 40-57-17 classifies the leasehold interest as personal property for the first five years of the lease term, we believe the assessment for the first five years and thereafter as a real property assessment for the remainder of the lease term.

3. If the taxes levied on the leasehold interest were not paid and it became necessary to enforce collection of them then any unpaid personal property taxes levied on the leasehold interest for the first five year could be collected through enforcement of any of the collection procedures provided in Chapter 57-22 N.D.C.C. After the first five years, when the classification of the leasehold interest or personal property under 40-57-17 would be terminated it would be assessed and taxed as real property, and the collection of any unpaid real property taxes levied on the leasehold interest could be enforced pursuant to Section 57-24-31 through either real estate tax sale proceedings or pursuant to Chapter 57-22 N.D.C.C. in the same way as collection of delinquent personal property taxes can be enforced.

Reasons for the above suggested procedure follow.

Prior to July 1, 1965, Section 40-57-17 provided that:

> "No project acquired by an municipality pursuant to the provisions of this chapter shall be exempt from the imposition and collection of taxes thereon."

Presumably the legislature did not intend to pass an unconstitutional act; presumably, also, the legislature knew that it was prohibited by the self-executing exemption provision in 176 of the State Constitution from taxing to a municipality property owned by it. It follows from this that the legislature by enacting 40-57-14 as quoted above intended at this time with respect to a MIDA project to tax whatever property it could constitutionally tax.

For reasons similar to those set out in the attached copy of the

Attorney General's opinion of July 17, 1973 to Divide County State's Attorney, Michel W. Stefonowicz, we believe a MIDA project lessee's leasehold interest in the real property part of the project would have been subject to assessment and taxation under the Code sections cited in that opinion even though 40-57-17 had not been enacted. As to the personal property part of such a project, we do not believe other Code sections authorized the assessment and taxation of a lessee's possessory interest in personal property owned by a municipality or other governmental unit. (See attached copies of the Tax Commissioner's letter of March 5, 1959, to the National Association of Tax Administration and of Mr. Kenneth Jakes' letter of May 28, 1962, to Mr. Robert Schempp, Minot City Assessor.)

Whether or not 40-57-17 as originally enacted and quoted above had the effect of providing that a MIDA project lessee's possessory interest in personal property of the project should be subject to assessment and taxation is a question that we do not believe has to be decided now; this is because of, first, the 1965 amendment to 40-57-17 which classified the leasehold in such a project as personal property for the entire lease term and exempted it from taxation for the first five years, and, second, because of the personal property tax repeal enacted by the 1969 legislature to be effective in 1970 which exempted nearly all personal property - see Section 1 of Chapter 528, S.L. 1969.

The 1969 legislature also amended Section 40-57-17 by adding to it the last sentence which reads as follows:

> "The project lessee may waive, in writing or by the act of making a payment, all or any portion of the tax exemption granted by this section."

See Chapter 384, S.L. 1969, and the attached copy of page 37 of the 1969 Legislative Research Committee Report. This 1969 enactment together with the 1969 personal property tax repeal had the effect, as held in the Attorney General's opinion of August 1, 1969, to Bruce L. Bartch, Director, Business and Industrial Development Department, of not only exempting the leasehold interest from assessment and taxation for the first five years but for the entire time of the lease. It now seems to use that the 1969 legislature by (1) enacting personal property tax repeal (subsection 25 of 57-02-08) and by (2) amending 40-57-17 to provide for waiver of the exemption of the leasehold interest that it had classified as personal property, thereby intended that the leasehold interest should be assessed and taxed (to the extent of the waiver of the exemption) regardless of the fact that 57-02-08(25) was enacted. This would be based on an interpretation that this leasehold interest in exempt real property would, in the absence of 40-57-17 be assessed and taxed as real property and that its classification as personal property by 40-57-17 created a "particular kind or class of personal property" within the meaning of that exemption in 57-02-08). You might consider in this regard, however, the August 1, 1969, Attorney General's opinion to Bruce Bartch in which it was held, as noted above, that the 1969 repeal of personal property taxation had the effect of exempting the leasehold interest not only from the first five years but for the entire term of the lease. We did not consider in that opinion the possibility that the classification of the leasehold interest or

personal property by 40-57-17 might be a "particular kind of class of personal property" within the meaning of the exemption in 57-02-08(25).

As already noted above, it was because of the August 1, 1969, opinion to Bruce Bartch that the 1971 legislature again amended 40-57-17, this time to provide that the leasehold granted by a municipality should be classified as personal property for only the first five years, after which it would be classified as real property for the remainder of the lease term and would then be subject to assessment and taxation; see Chapter 423, S.L. 1971, and the attached copy of page 59 of the 1971 Legislative Council Report.

In addition to the 1971 amendment of 40-57-17, the 1971 legislature also enacted Chapter 534, S.L. 1971, which amended Section 47-02-04, defining real property for the purpose of taxation. It seems to us that these two 1971 enactments should be interpreted together so as to conclude that the legislature intended that only part of the project lessee's leasehold interest in the project that is to be assessed and taxed after the five year exemption period would be the value of the lessee's leasehold interest in that part of the real property of the project that would be real property under Section 57-02-04, that is, the land itself, etc., as set out in subsection 1 of Section 57-02-04 and all structures and buildings on the land as set out in subsection 2 but not including the machinery or equipment that is set out in that subsection as not to be included as real property.

The 1969 legislature also amended Section 40-57-17 by adding to it, as already noted, the last sentence which reads as follows:

> "The project lessee may waive, in writing or by the act of making a payment, all or any portion of the tax exemption granted by this section."

See Chapter 384, S.L. 1969 and page 37 of the 1969 Legislative Research Committee Report.

Therefore, if the municipality and the project lessee intend that the project lessee should waive the property tax exemption provided for in that section, the project lessee presumably could do so in writing to the municipality and acknowledge that it should be assessed and taxed for the value of its leasehold interest in that part of the real property under 57-02-04 if the lessee rather than the municipality owned it. We believe, however, that the waiver might be better accomplished in incorporating it as a provision in the lease, as explained below.

Gripentrog v. City of Wahpeton 126 N.W.2nd. 230, upheld the constitutionality of Chapter 40-57, North Dakota Century Code. The court harmonized various provisions that were in apparent conflict and concluded that, since the municipality was prohibited from operating the project, the rent to be charged for the project need only be sufficient in amount to pay interest on and principal of the bonds promptly, and the lease may also provide for the operation, maintenance, insurance on, and depreciation of such project, and any taxes thereon." 126 N.W.2nd. 234. We find no specific authority for

the rental to include an item in lieu of taxes or to produce income to the city. We would thus suggest that the rent to be paid the municipality according to the terms of lease would not include any amount for property taxes, but that other provisions provide that the leasehold interest will be subject to assessment and taxation and that the lessee shall pay the taxes levied thereon to the county treasurer when due, and presumably such a lease provision could also require the lessee to establish a reserve for the payment of such taxes which would be credited monthly or on some other periodic basis in amounts that would be sufficient to pay such taxes when they became due each year. Such a provision could also be incorporated into the ordinance or resolution authorizing the bond issue that is provided for in 40-57-14, as held in Gripentrog page 234.

We hope the within and foregoing will be sufficient for your purposes.

Sincerely yours,

ALLEN I. OLSON

Attorney General