STATE OF NORTH DAKOTA
OFFICE OF STATE TAX COMMISSIONER
Ryan Rauschenberger, Commissioner

TESTIMONY BEFORE THE ADMINISTRATIVE RULES COMMITTEE

March 11, 2014

Mr. Chairman, and members of the Administrative Rules Committee:

My name is Joseph Becker, and I am here today in response to Legislative Council's request that the Office of State Tax Commissioner provide testimony on the rules it recently promulgated. My testimony follows the subject matter outline set out in Legislative Council's request.

Item 1—Relationship to state statutory changes

The rules were promulgated by the Tax Commissioner as a result of statutory changes made by the 2013 North Dakota Legislative Assembly in Senate Bill 2325 (S.L. 2013, ch. 449). That legislation repealed the North Dakota financial institution tax (under N.D.C.C. ch. 57-35.3), which resulted in financial institutions becoming subject to North Dakota's income tax (under N.D.C.C. ch. 57-38).

Item 2—Relationship to federal statute or regulation

The rules do not relate to any federal statute or regulation.

Item 3—Description of rulemaking procedure

A full notice of the hearing on the proposed rule changes and a copy of the proposed rules were filed with the North Dakota Legislative Council on September 13, 2013. The full notice and the rules were sent to the following:

- Legislators who sponsored the underlying legislation, as well as the chairs of the Senate and House Finance and Taxation Committees.
- All financial institutions that filed a North Dakota return in 2012.
- North Dakota Association of Counties.
- North Dakota State Bankers Association.
- Independent Community Banks of North Dakota.
- National Bankers Association.
- Persons on the Tax Commissioner's permanent rules mailing list and other persons who requested a copy of the rules.

An abbreviated notice of the rules hearing was published in each official county newspaper in the state. The rules hearing was held October 15, 2013, at the North Dakota Office of State Tax Commissioner, with Donnita A. Wald, Special Assistant Attorney General, presiding as hearing officer. The hearing record was held open until October 25, 2013, to allow additional time for interested parties to provide comment on the proposed rule changes.

On December 9, 2013, the Tax Commissioner forwarded the rules to the North Dakota Attorney General for approval. On January 9, 2014, in a letter opinion, the Attorney General determined the rules to be in compliance with the North Dakota Administrative Agencies Practices Act (N.D.C.C. ch. 28-32) and approved them as to their legality.

The rules were forwarded to the Legislative Council on January 14, 2014, for publication.

Item 4—Public comment

Other than the written testimony provided by Tax Department staff at the public hearing, no written or oral comment indicating any concern, objection, or complaint regarding the rule changes was received.

Item 5—Cost of public notice, hearing, and agency work

The cost of publishing notice of the rules in the official county newspapers was $1,737.00. The cost for the professional reporter and transcript of the hearing was $91.00. The cost for developing and adopting the rules (not including staff time) was negligible.

Item 6—Reason for rule changes and description of the rules' subject matter

Reason for rule changes

When the North Dakota financial institution tax law was repealed in Senate Bill 2325, the apportionment and allocation provisions that applied to financial institutions operating on a multistate basis were also repealed.[1] Those provisions set out the manner in which a multistate financial institution determines the amount of income to report to North Dakota. They were specially adapted to how a financial institution conducts business and earns income. In particular, they contain detailed guidance on calculating the factors used in the 3-factor apportionment formula. The reason for promulgating the rules before you today is to formally restore that written guidance.

Rather than recodify the specially-adapted apportionment and allocation provisions for multistate financial institutions in the income tax law, the Tax Commissioner determined it more appropriate to place them in the Administrative Code.[2] For income tax purposes, the basic apportionment and allocation methodology required to be used by multistate businesses is set out in statutory law, but the detailed guidance on applying that methodology, including specially-adapted rules for particular industries, is set out in the Administrative Code.[3] The placement of the specially-adapted apportionment and allocation provisions for multistate

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[1] The financial institution tax law was contained in N.D.C.C. ch. 57-35.3, and the apportionment formula provisions were set out in sections 57-35.3-12 through 57-35.3-17 of that chapter.

[2] The 3-factor apportionment formula provisions were codified in the financial institution tax law because they were included in the legislation that created the financial institution tax in 1997, and the financial institution tax law was placed in a separate chapter of the Code. (S.L. 1997, ch. 490, creating N.D.C.C. ch. 57-35.3)

[3] The statutory provisions for the basic 3-factor apportionment formula for multistate businesses are contained in N.D.C.C. ch. 57-38.1 (Uniform Division Of Income For Tax Purposes Act). The detailed guidance on calculating each of the factors is contained in N.D. Admin. Code ch. 81-03-09 (Division of Income).

financial institutions in the Administrative Code is consistent with that income tax administrative practice.

Description of the rules' subject matter

(Page references in parentheses are to the April 2014 Quarterly Changes Supplement 352)

The rule changes consist of the amendment of an existing rule and the creation of five new rules.

(Pg. 533) 81-03-09.1-01. Special rules – Financial institutions—This rule is amended to remove obsolete language and add new language providing that a multistate financial institution shall apportion and allocate its income according to the new rules in this chapter. It also provides that the income tax apportionment and allocation provisions that apply to multistate businesses in general shall apply to financial institutions to the extent they are not inconsistent with the rules in this chapter.

(Pg. 534) 81-03-09.1-02. Definitions—This new rule provides definitions of terms used in the new rules in this chapter.

(Pg. 539) 81-03-09.1-03. Apportionment and allocation – Property factor—This new rule provides for the computation of the property factor component of the 3-factor apportionment formula to be used by a multistate financial institution. These provisions are the same as the provisions that apply to other multistate businesses, except that intangible property, such as loans and receivables, are included in the factor.

(Pg. 543) 81-03-09.1-04. Apportionment and allocation – Receipts factor—This new rule provides for the computation of the receipts factor component of the 3-factor apportionment formula to be used by a multistate financial institution. These provisions are the same as the sales factor provisions that apply to other multistate businesses, except that there are differences in the types of receipts included in the factor and in how those receipts are sourced to North Dakota.

(Pg. 549) 81-03-09.1-05. Apportionment and allocation – Payroll factor—This new rule provides for the computation of the payroll factor component of the 3-factor apportionment formula to be used by a multistate financial institution. These provisions are the same as the provisions that apply to other multistate businesses.

(Pg. 550) 81-03-09.1-06. Taxable years—This new rule provides that the new rules in this chapter apply to tax years beginning after December 31, 2012.

Items 7, 8, and 9—Regulatory analysis, impact on small entities, and fiscal effect

A regulatory analysis was prepared for the rules, a copy of which is attached. To summarize the analysis, the rule changes will have no fiscal impact on state revenues or small entities other than that attributable to the underlying legislation in Senate Bill 2325. In the fiscal note for Senate Bill 2325, no fiscal impact was attributed to the apportionment and allocation of a multistate financial institution's income because no change in that treatment was expected, and the proposed rule changes do not alter the analysis in that fiscal note.

Items 10 and 11—Constitutional takings assessment / Emergency rules

These rule changes do not require a constitutional takings assessment, nor are they adopted as emergency rules.

That concludes my testimony, Mr. Chairman. I would be glad to answer any questions the Committee may have.

Prepared by the
Tax Administration Division of the
Office of State Tax Commissioner

Rule Chapter 81-03-09.1 Division of Income For Financial Institutions

Regulatory Analysis for Large and Small Entities
N.D.C.C. §§ 28-32-08, 28-32-08.1(2) and 28-32-08.1(3)

The proposed rule affects all financial institutions, regardless of the size of the entity, doing business both within and outside North Dakota. The rule relates to the apportionment and allocation provisions used by multistate financial institutions in calculating North Dakota income tax and is consistent with the prior apportionment and allocation provisions previously codified in the now-repealed financial institution tax, N.D.C.C. ch. 57-35.3. (2013 Sess. Law 449, Senate Bill 2325) As the rule does not make any substantive changes to the previously applied apportionment and allocation provisions any change in impact on private persons, consumers, or the affected entities is not anticipated.

The fiscal impact (economic impact) of the proposed rule is estimated to be less than $50,000 on state revenues and small entities. The fiscal note on Senate Bill 2325 computed zero fiscal impact as it relates to the allocation and apportionment provisions proposed in the rule.

There are no probable costs to the agency of the implementation and enforcement of the proposed rule. Alternative methods for allocating and apportioning the income of multistate financial institutions were not considered because these provisions have been in effect used since the inception of the apportionment provisions in 1997.

The Office of State Tax Commissioner does not establish requirements for the filing of returns by taxpayers. Because all filing requirements and standards are set by the Legislature in statute, the Office of State Tax Commissioner does not have the authority to prescribe less stringent requirements for small entities.

Fiscal Note – Senate Bill 2325

The fiscal note attached to SB 2325 for which this proposed rule relates did not identify a tax impact for the allocation and apportionment provisions proposed in this rule.