



STATE OF NORTH DAKOTA
OFFICE OF STATE TAX COMMISSIONER
RYAN RAUSCHENBERGER, COMMISSIONER

Testimony—Interim Political Subdivision Taxation Committee

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Chairman Dockter and Members of the Committee:

Introduction

My name is Joseph Becker, and I am here on behalf of the North Dakota Office of State Tax Commissioner (Tax Department). When this Committee met last December, the Tax Department provided information about the income tax reciprocity agreement between North Dakota and Montana. We've been asked to appear before the Committee to provide additional information as follows:

1. Expand upon the data previously provided for the North Dakota-Montana reciprocity agreement to highlight the trend in the numbers.
2. Inform the Committee about any other tax agreement between North Dakota and Montana.
3. Provide a brief overview of the income tax reciprocity agreement with the State of Minnesota.

Overview of income tax reciprocity in general

Before I provide the additional information requested, I thought it would be helpful to take a couple of minutes to briefly go over a couple of basic individual income tax rules and how reciprocity affects them. This will not only provide a quick refresher, but it will address a number of questions that came up during and after the December meeting.

Basic individual income tax rules:

- Rule 1: A state may tax all of a resident's income, regardless of the income's source.
- Rule 2: A state may tax a nonresident's income that is sourced in the state.¹

The interaction of these two basic rules commonly results in an individual having to file a return and pay tax on the same income in two states—the state of residence and the state in which the income has its source. To avoid taxing the same income twice, the state of residence allows a credit to its residents for income tax paid to another state, which reduces the tax owed to the resident state.²

The income tax reciprocity agreements with Montana and Minnesota provide an exception to Rule 2 in the case of income from personal and professional services, which generally is limited to wages. The agreements provide that a state's residents do not have to file a return and pay tax on wages earned for work performed in the nonresident state, which means the wages are taxed only by the state of residence.

Attached to my testimony is a document that illustrates how the tax owed by residents of North Dakota, Montana, and Minnesota is affected by the reciprocity agreements.

Additional information requested by Committee

Now I would like to turn to the additional information requested by the Committee.

Item 1: Additional data on North Dakota-Montana reciprocity agreement

When this Committee met last December, the Tax Department provided information showing the number of Montana and North Dakota residents claiming reciprocity treatment for the 2013 tax year. We've been asked to expand the data to include additional tax years so the Committee can see the trend in the numbers.

¹ In general, income is sourced in a state if the income-producing employment or business activity is conducted in the state, or the income-producing property is located in the state.

² In general, the credit is limited to the lesser of (1) the tax paid to the nonresident state or (2) the tax owed to the resident state on the income subject to tax in both states.

Montana residents working in North Dakota. Table 1 expands upon the data previously provided to the Committee pertaining to Montana residents working in North Dakota who claimed reciprocity treatment.

Table 1				
Montana residents claiming exemption from North Dakota income tax				
Year	Column A		Column B	Column C
	Montana residents who filed North Dakota return to claim a refund under reciprocity			
	No. of returns	Amount refunded	Montana residents claiming exemption from North Dakota withholding	Total number of Montana residents claiming reciprocity treatment
2002	2,040	Not available	249	2,289
2003	2,194		265	2,459
2004	2,260		294	2,554
2005	2,151		209	2,360
2006	847	\$ 253,954	436	1,283
2007	804	\$ 304,924	321	1,125
2008	1,082	\$ 649,933	509	1,591
2009	930	\$ 398,971	416	1,346
2010	1,470	\$ 767,845	835	2,305
2011	2,726	\$ 1,663,039	1,479	4,205
2012	3,215	\$ 2,288,460	1,862	5,077
2013	3,117	\$ 1,952,628	1,871	4,988
2014	3,280	\$ 2,102,402	2,050	5,330

North Dakota residents working in Montana. For North Dakota residents working in Montana who claimed reciprocity treatment, we are not able to add much to the data previously provided to the Committee. Table 2 shows the limited data available from the Montana Department of Revenue.³

³ For tax years prior to 2013, the Montana income tax return did not contain any means to identify those returns filed by North Dakota residents under reciprocity.

Table 2				
North Dakota residents claiming exemption from Montana income tax				
Year	Column A North Dakota residents who filed Montana return to claim a refund under reciprocity		Column B North Dakota residents claiming exemption from Montana withholding	Column C Total number of North Dakota residents claiming reciprocity treatment
	No. of returns	Exempt wages*		
2008	Not available		190	Not available
2009			170	
2010			61	
2011			Not available	
2012			113	
2013	132	\$ 2,293,863	157	289
2014	145	\$ 5,005,514	217	362

*** Note:** The Montana Department of Revenue provided the amount of exempted wages instead of the amount refunded.

Item 2: Other tax agreements between North Dakota and Montana

The Tax Department was asked to provide information about any other tax agreements that North Dakota has with Montana. Other than the income tax reciprocity agreement, there are no other tax agreements between North Dakota and Montana.

Item 3: Overview of income tax reciprocity agreement with Minnesota

Lastly, the Tax Department was asked to provide an overview of the income tax reciprocity agreement between North Dakota and Minnesota.

The agreement with Minnesota was adopted in 1969—six years before the Montana income tax reciprocity agreement was adopted. The agreement with Minnesota is similar to the agreement with Montana, with the following two exceptions:

- **Exception 1:** The agreement with Minnesota contains an additional provision requiring an individual to maintain an abode in the state of residence to which he or she returns to at least once each month.
- **Exception 1:** While both agreements use the language “compensation from personal and professional services,” the application is broader in the Minnesota agreement:
 - Montana agreement—Limits to wages subject to federal income tax withholding.
 - Minnesota agreement—Covers wages and, under limited conditions, income from a sole proprietorship or partnership in which the profits are primarily generated by services personally rendered the individual or individuals who own the business.⁴

Minnesota residents working in North Dakota. Table 3 shows the available data for Minnesota residents working in North Dakota who claimed reciprocity treatment.

Table 3			
Minnesota residents claiming exemption from North Dakota income tax			
Year	Column A Minnesota residents who filed North Dakota return to claim a refund under reciprocity	Column B Minnesota residents claiming exemption from North Dakota withholding	Column C Total number of Minnesota residents claiming reciprocity treatment
2002	Not available	17,145	Not available
2003		16,503	
2004		17,175	
2005		17,176	
2006		20,691	
2007	4,093	18,704	22,797
2008	4,426	21,320	25,746
2009	3,846	17,924	21,770
2010	4,425	20,769	25,194
2011	5,532	21,598	27,130
2012	4,329	24,212	28,541
2013	6,161	24,612	30,773
2014	6,903	24,456	31,359

⁴ If the business sells goods or has any employees, the sale of goods and/or the services of the employees must be incidental to the generation of the business profits.

North Dakota residents working in Minnesota. As in the case with Montana, we are unable to provide much data on North Dakota residents working in Minnesota due to the limited data that could be obtained from the Minnesota Department of Revenue. Table 4 shows the data available at this time.

Table 4			
North Dakota residents claiming exemption from Minnesota income tax			
Year	Column A North Dakota residents who filed Minnesota return to claim a refund under reciprocity	Column B North Dakota residents claiming exemption from Minnesota withholding	Column C Total number of North Dakota residents claiming reciprocity treatment
2008	2,871		
2009	2,770	6,142	8,912
2010	2,741		
2011	3,950		
2012	3,133		
2013	3,611		
2014	3,881	6,898	10,779

Conclusion

That concludes my testimony, Mr. Chairman. If there are any questions from the Committee, I would be glad to address them.

Illustration of How Income Tax Reciprocity Affects the Tax Owed by Each State's Residents

Illustration 1 – Reciprocity's effect on North Dakota residents

North Dakota resident working in Montana or Minnesota	Tax without reciprocity (Basic rules)	Tax with reciprocity
Montana or Minnesota tax	\$ <u>2,000</u>	\$ <u>0</u>
North Dakota tax	\$ 400	\$ 400
Credit for tax paid to Montana or Minnesota	<u>(400)</u>	<u>0</u>
North Dakota tax after credit	\$ <u>0</u>	\$ <u>400</u>
Total tax for both states	\$ <u>2,000</u>	\$ <u>400</u>

Illustration 2 – Reciprocity's effect on Montana/Minnesota residents

Montana or Minnesota resident working in North Dakota	Tax without reciprocity (Basic rules)	Tax with reciprocity
North Dakota tax	\$ <u>400</u>	\$ <u>0</u>
Montana or Minnesota tax	\$ 2,000	\$ 2,000
Credit for tax paid to North Dakota	<u>(400)</u>	<u>0</u>
Montana or Minnesota tax after credit	\$ <u>1,600</u>	\$ <u>2,000</u>
Total tax for both states	\$ <u>2,000</u>	\$ <u>2,000</u>

Summary

- Without reciprocity...
 - The basic rules of individual income taxation apply: Each state's residents must file two returns to report the wage income to both their home state (residence rule) and the nonresident state (source rule).
 - The resident state allows a credit to offset the tax paid to the nonresident state on the wage income.
- With reciprocity...
 - The source rule is ignored and the nonresident state (in which the work was performed) foregoes taxing the wages.
 - Each state's residents file one return and pay tax on the wages to only their home state.
- North Dakota residents will pay a higher overall tax without reciprocity because of the higher tax rates in Montana and Minnesota.
- Montana and Minnesota residents will pay the same overall tax with or without reciprocity.