

MICROFILM DIVIDER

OMB/RECORDS MANAGEMENT DIVISION

SFN 2053 (2/85) 5M



ROLL NUMBER

DESCRIPTION

1251

2001 HOUSE FINANCE AND TAXATION

HB 1251

2001 HOUSE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. HB1251

House Finance and Taxation Committee

Conference Committee

Hearing Date January 23, 2001

Tape Number	Side A	Side B	Meter #
1	X		3,035
Committee Clerk Signature <i>Ganice Klein</i>			

Minutes:

REP. AL CARLSON, CHAIRMAN, Opened the hearing.

REP. GEORGE KEISER, DIST. 47, BISMARCK, Introduced the bill. He stated this is a simple bill, but an important bill. This bill comes from the accountant throughout the state who, along with the practice of their industry and with their customers, have a frustration that exists in our current law. This is something that is very anti-business. He stated, a few years ago we started a few opportunities for businesses in our state. We created a limited liability company, a limited liability partnership, and now we have limited liability on top of limited liability, it seems. All of those measures that we passed, were designed to help the businesses within the state of North Dakota. When we did this, we created a limited liability company, and in so doing, we followed the federal guidelines, with exception of one, and that one exception, is relative to unemployment compensation. In this bill, if one fourth of the ownership of the company is controlled by the manager, the manager's parent, child, spouse, or combination of

those, this bill provides for an additional exclusion to subsection 18, which identifies employment, does not include. We are saying, if you are a limited liability company, and you meet this criteria, you are not considered to be an employee of the firm, but you are to be treated as an owner of the firm.

PAUL WOHNOUTKA, CPA, EIDE BAILLY, Testified in support of the bill. See attached written testimony and a copy of the North Dakota Century Code Tax Law 52-01-01. Mr. Wahnoutka gave an example of a client's situation and explained the mechanics of the bill.

REP. CARLSON Asked, in existing law, limited liability partners are already exempt?

PAUL WOHNOUTKA Yes.

REP. CARLSON This bill says an LLC, that is taxed as a partnership, will not have to pay the job service tax?

PAUL WOHNOUTKA That is right.

REP. KROEBER Asked Mr. Wahnoutka to explain the statement, "what would prevent making all one hundred or one thousand employees of the LLC owners, so they are all exempt from job service.

PAUL WOHNOUTKA It won't happen, but it is possible in theory. The point that needs to be made is if somebody really wanted to create an entity like that, for the purpose of avoiding job service tax, they wouldn't create an LLC. They would form an LLP and they have that exemption currently.

REP. KROEBER Is it clear to the employees then that they are exempt from unemployment and they can take and sue the partners if something occurs in the job?

PAUL WOHNOUTKA Only the owners are exempt, the employees are not exempt.

BOB OLSON, NORTH DAKOTA JOB SERVICE, Testified in a neutral position. He testified in place of Ray Gudajtes, see written testimony from Ray Gudajtes.

REP. LLOYD You mentioned, they would no longer be allowed to have the tax, in other words, they couldn't request it.

BOB OLSON The bill as it is written, would exempt them from the definition of employment.

REP. CARLSON Is that a good thing for those people or a bad thing?

BOB OLSON I think, as Mr. Wounoutka says, it probably isn't a big deal. The only question is, if there were a lot of people, maybe small owners, who would try to avoid the taxation, I don't know if that would happen or not.

REP. CARLSON When they avoid the taxation, they also avoid the benefits?

BOB OLSON Our concern is not the taxation, it would be the coverage for the worker.

REP. WINRICH It was pointed out that under certain circumstances a limited liability partnership, could be organized and gain this same sort of thing. if these same things could occur in either kind of company, why have two different forms?

BOB OLSON Stated he didn't know why they needed different forms.

With no further testimony, the hearing was closed.

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House Finance and Taxation Committee
Bill/Resolution Number HB 1251
Hearing Date January 23, 2001

COMMITTEE ACTION 2-06-01, TAPE #2, SIDE A, METER #3938

REP. GROSZ Gave an update on the research he did on the bill regarding to limited liability corporations and partnerships, etc. This bill gives them a choice to opt out of the unemployment compensation or pay it.

REP. GROSZ Made a motion for a **DO PASS**

REP. RENNER Second the motion. **MOTION FAILED.**

REP. WINRICH Made a motion for a **DO NOT PASS.**

REP. CLARK Second the motion. **MOTION CARRIED**

8 YES 6 NO 1 ABSENT

REP. WINRICH Was given the floor assignment.

FISCAL NOTE
 Requested by Legislative Council
 03/26/2001

Bill/Resolution No.:

Amendment to: HB 1251

1A. State fiscal effect: *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

	1999-2001 Biennium		2001-2003 Biennium		2003-2005 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues	\$0	\$0	\$0	\$0	\$0	\$0
Expenditures	\$0	\$0	\$0	\$0	\$0	\$0
Appropriations	\$0	\$0	\$0	\$0	\$0	\$0

1B. County, city, and school district fiscal effect: *Identify the fiscal effect on the appropriate political subdivision.*

1999-2001 Biennium			2001-2003 Biennium			2003-2005 Biennium		
Counties	Cities	School Districts	Counties	Cities	School Districts	Counties	Cities	School Districts
\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0

2. Narrative: *Identify the aspects of the measure which cause fiscal impact and include any comments relevant to your analysis.*

This bill will exempt from unemployment coverage all limited liability company managers whose companies do not treat themselves as a corporation for purposes of federal income taxation. Currently, approximately 360 unemployment insurance tax accounts are limited liability companies. Current law provides managers with 25% or more ownership opportunity to exempt themselves from coverage.

Data is not available to identify which of the 360 accounts treat themselves as corporations for purposes of federal income taxation; nor is there data available to identify which if any employees reported by these accounts are managers. Consequently, we are unable to determine fiscal impact on the State Unemployment Insurance Trust Fund from exempting all limited liability company managers except those whose company treat themselves as a corporation for federal income taxation.

There will be some reduction of income and benefit payments, which we cannot estimate.

3. State fiscal effect detail: *For information shown under state fiscal effect in 1A, please:*

A. Revenues: *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*

B. Expenditures: *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*

C. Appropriations: *Explain the appropriation amounts. Provide detail, when appropriate, of the effect on the biennial appropriation for each agency and fund affected and any amounts included in the executive budget. Indicate the relationship between the amounts shown for expenditures and appropriations.*

Name:	Wayne Kindem	Agency:	Job Service North Dakota
Phone Number:	328-3033	Date Prepared:	03/27/2001

FISCAL NOTE
 Requested by Legislative Council
 01/15/2001

Bill/Resolution No.: HB 1251

Amendment to:

1A. State fiscal effect: *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

	1999-2001 Biennium		2001-2003 Biennium		2003-2005 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues	\$0	\$0	\$0	\$0	\$0	\$0
Expenditures	\$0	\$0	\$0	\$0	\$0	\$0
Appropriations	\$0	\$0	\$0	\$0	\$0	\$0

1B. County, city, and school district fiscal effect: *Identify the fiscal effect on the appropriate political subdivision.*

1999-2001 Biennium			2001-2003 Biennium			2003-2005 Biennium		
Counties	Cities	School Districts	Counties	Cities	School Districts	Counties	Cities	School Districts
\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0

2. Narrative: *Identify the aspects of the measure which cause fiscal impact and include any comments relevant to your analysis.*

This bill will exempt from unemployment coverage all limited liability company managers whose companies do not treat themselves as a corporation for purposes of federal income taxation. Currently, approximately 360 unemployment insurance tax accounts are limited liability companies. Current law provides managers with 25% or more ownership opportunity to exempt themselves from coverage.

Data is not available to identify which of the 360 accounts treat themselves as corporations for purposes of federal income taxation; nor is there data available to identify which if any employees reported by these accounts are managers. Consequently, we are unable to determine fiscal impact on the State Unemployment Insurance Trust Fund from exempting all limited liability company managers except those whose company treat themselves as a corporation for federal income taxation.

There will be some reduction of income and benefit payments, which we cannot estimate.

3. State fiscal effect detail: *For information shown under state fiscal effect in 1A, please:*

A. Revenues: *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*

B. Expenditures: *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*

C. Appropriations: *Explain the appropriation amounts. Provide detail, when appropriate, of the effect on the biennial appropriation for each agency and fund affected and any amounts included in the executive budget. Indicate the relationship between the amounts shown for expenditures and appropriations.*

Name:	Wayne Kindem	Agency:	Job Service North Dakota
Phone Number:	328-3033	Date Prepared:	01/19/2001

Date: _____
Roll Call Vote #: _____

2001 HOUSE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. HB 1251

House FINANCE & TAXATION Committee

Subcommittee on _____
or
 Conference Committee

Failed

Legislative Council Amendment Number _____

Action Taken 100 100

Motion Made By Rep Grosz Seconded By Rep L...

Representatives	Yes	No	Representatives	Yes	No
CARLSON, AL, CHAIRMAN	✓		NICHOLAS, EUGENE	✓	
DROVDAL, DAVID, V-CHAIR		✓	RENNER, DENNIS	✓	
BRANDENBURG, MICHAEL	✓		RENNERFELDT, EARL	✓	
CLARK, BYRON		✓	SCHMIDT, ARLO	✓	
GROSZ, MICHAEL	✓		WIKENHEISER, RAY		
HERBEL, GIL		✓	WINRICH, LONNY		✓
KELSH, SCOT					
KROEBER, JOE					
LLOYD, EDWARD		✓			

Total (Yes) 6 No 8

Absent _____

Floor Assignment Rep

If the vote is on an amendment, briefly indicate intent:

Date: 2-6-01
 Roll Call Vote #: 2

2001 HOUSE STANDING COMMITTEE ROLL CALL VOTES
 BILL/RESOLUTION NO. HB 1251

House FINANCE & TAXATION Committee

Subcommittee on _____
 or
 Conference Committee

Legislative Council Amendment Number _____

Action Taken Do Not Pass

Motion Made By Rep. Winrich Seconded By Rep. Clark

Representatives	Yes	No	Representatives	Yes	No
CARLSON, AL, CHAIRMAN		✓	NICHOLAS, EUGENE	A	
DROVDAL, DAVID, V-CHAIR	✓		RENNER, DENNIS		✓
BRANDENBURG, MICHAEL		✓	RENNERFELDT, EARL		✓
CLARK, BYRON	✓		SCHMIDT, ARLO		✓
GROSZ, MICHAEL		✓	WIKENHEISER, RAY	✓	
HERBEL, GIL	✓		WINRICH, LONNY	✓	
KELSH, SCOT	✓				
KROEBER, JOE	✓				
LLOYD, EDWARD	✓				

Total (Yes) 8 No 6

Absent 1

Floor Assignment Rep. Winrich

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE (410)
February 7, 2001 11:31 a.m.

Module No: HR-22-2571
Carrier: Winrich
Insert LC: . Title: .

REPORT OF STANDING COMMITTEE

HB 1251: Finance and Taxation Committee (Rep. Carlson, Chairman) recommends DO NOT PASS (8 YEAS, 6 NAYS, 1 ABSENT AND NOT VOTING). HB 1251 was placed on the Eleventh order on the calendar.

2001 SENATE INDUSTRY, BUSINESS AND LABOR

HB 1251

2001 SENATE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. HB 1251

Senate Industry, Business and Labor Committee

Conference Committee

Hearing Date February 21, 2001.

Tape Number	Side A	Side B	Meter #
1		x	9.0 to 22.5
2	x		11.0 to 12.2
(March 20/01) 1	x		0 to 14.3
Committee Clerk Signature			

Minutes:

The meeting was called to order. All committee members present. Hearing was opened on HB 1251 relating to unemployment compensation coverage of managers of limited liability companies.

Representative George Keiser, District 47, sponsor. When the legislation regarding limited liability companies was enacted the issue of how to treat them in terms of unemployment compensation insurance for managerial employees was not addressed. According to the law regardless of when the company was formed they can opt out on January 1st of the following year. This creates a problem for individuals and also for their accounting firms because when created they have to opt in and the following January they have to come back and opt out. Most of them opt out.

Senator Mathern: What was the problem the House members saw with this bill? I know it didn't pass by a very high margin.

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Senate Industry, Business and Labor Committee

Bill/Resolution Number HB 1251

Hearing Date February 21, 2001.

Rep. Kelser: In committee they said, you mean you can form a company with a lot of managers and thereby circumvent entirely the law. They were fearful this was a loophole. Manager has to agree to it, that was already in the law and does not change. LLC's with many managers would be committing business suicide. We have provided not a loophole but an opt out option.

Senator Mutch: At time when they opt out, do they get their money back?

Rep. Kelser: No

Paul J. Wohnoutka, Partner Eide Bailly LLP, request you pass this bill. Written testimony Attached, including copy of part of the NDCC. We are talking solely about managers that are also owners. Bill makes ND rules consistent with the federal rules regarding LLC's' unemployment compensation coverage.

No opposing testimony. Hearing closed.

Tape 2-A-11 to 2-A 12.2

Discussion held. **Senator Krebsbach:** Motion: do pass. **Senator Tollefson:** Second.

Roll call vote: 7 yes; 0 no. Motion carried. Floor assignment: **Senator Krebsbach.**

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Senate Industry, Business and Labor Committee

Bill/Resolution Number HB 1251

Hearing Date February 21, 2001.

March 20, 2001. Tape 1-A- 0 to 14.3

Committee reconvened. All members present.

Ray Gudajtes, ND Job Service, Will address this bill and HB 1319, both have basically the same issues. Intent of the amendment is to bring conformity with the Federal Unemployment Insurance Tax Act. Written testimony and proposed amendment attached.

Discussion held.

Senator Krebsbach: Motion to reconsider. **Senator Tollefson**: Second.

Roll call vote: 7 yes; 0 no.

Senator Krebsbach: Motion: Adopt amendment. **Senator Klein**: Second.

Roll call vote: 7 yes; 0 no.

Senator Krebsbach: Motion: Do pass as amended. **Senator Tollefson**: Second.

Roll call vote: 7 yes; 0 no. Floor assignment: **Senator Krebsbach**.

Date: Feb 21/01
Roll Call Vote #: 1

2001 SENATE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. 1251

Senate Industry, Business and Labor Committee

- Subcommittee on _____
or
 Conference Committee

Legislative Council Amendment Number _____

Action Taken Do Pass

Motion Made By Sen Krebsbach Seconded By Sen Tollefson

Senators	Yes	No	Senators	Yes	No
Senator Mutch - Chairman	✓		Senator Every	✓	
Senator Klein - Vice Chairman	✓		Senator Mathern	✓	
Senator Epegard	✓				
Senator Krebsbach	✓				
Senator Tollefson	✓				

Total (Yes) 7 No 0

Absent 0

Floor Assignment Sen Krebsbach

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE (410)
February 21, 2001 1:41 p.m.

Module No: SR-32-4223
Carrier: Krebsbach
Insert LC: . Title: .

REPORT OF STANDING COMMITTEE

HB 1251: Industry, Business and Labor Committee (Sen. Mutch, Chairman) recommends DO PASS (7 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING). HB 1251 was placed on the Fourteenth order on the calendar.

Date: 3/20/01
Roll Call Vote #: 1

2001 SENATE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. 1261

Senate Industry, Business and Labor Committee

- Subcommittee on _____
- or
- Conference Committee

Legislative Council Amendment Number _____

Action Taken Motion to reconsider

Motion Made By Sen Krebsbach Seconded By Sen Tollefson

Senators	Yes	No	Senators	Yes	No
Senator Mutch - Chairman	✓		Senator Every	✓	
Senator Klein - Vice Chairman	✓		Senator Mathern	✓	
Senator Espegard	✓				
Senator Krebsbach	✓				
Senator Tollefson	✓				

Total (Yes) 7 No 0

Absent 0

Floor Assignment _____

If the vote is on an amendment, briefly indicate intent:

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1251

Page 1, line 14, after taxation insert "or a manager of a limited liability company who is not a member

Page 1, line 19, remove that is treated as a corporation for purposes of

Page 1, line 20, remove federal income taxation

Page 2, line 3, after the period insert "This exclusion from employment does not apply to any limited liability company which is wholly owned by or operates as an Indian tribe, state or local government, or nonprofit organization regarding services performed for those entities which are required to be covered under the North Dakota Unemployment Compensation Law by federal law."

Renumber accordingly

REPORT OF STANDING COMMITTEE

HB 1251: Industry, Business and Labor Committee (Sen. Mutch, Chairman) recommends AMENDMENTS AS FOLLOWS and when so amended, recommends **DO PASS** (7 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING). HB 1251 was placed on the Sixth order on the calendar.

Page 1, line 14, after "taxation" insert "or a manager of a limited liability company who is not a member"

Page 1, line 19, remove "that is treated as a corporation for purposes of"

Page 1, line 20, remove "federal income taxation"

Page 2, line 3, after the period insert "This exclusion from employment does not apply to any limited liability company that is wholly owned by or operates as an Indian tribe, state or local government, or nonprofit organization with respect to services performed for those entities which are required by federal law to be covered under the North Dakota unemployment compensation law."

Renumber accordingly

2001 TESTIMONY

HB 1251



Consultants • Certified Public Accountants

January 23, 2001

House Taxation Committee
ND House of Representatives
600 E Boulevard Ave
Bismarck, ND 58505

RE: House Bill 1251-Job Service & LLCs

Dear Committee Members:

House Bill 1251 was introduced by Representative Keiser at my request. The meat of this Bill is that limited liability companies are almost always treated as a partnership for federal income tax purposes and all federal payroll taxes including unemployment taxes. In North Dakota those same LLCs are treated as partnerships for income tax purposes and income tax withholding purposes. However, for North Dakota Job Service tax, they are treated like corporations.

As a bit of background, LLCs came about as part of a quest for an entity that would be taxed for income tax purposes as a partnership but yet provide liability protection for the owners similar to that provided to owners of corporations. Depending on how the state statute was drafted, there was still a chance that the LLC could be classified as a corporation by IRS. North Dakota's LLC law was carefully drafted so that a person would have to screw up royally to cause an LLC formed in North Dakota to be taxed as a corporation.

At the time the LLC law was adopted in North Dakota, someone put in a separate Bill treating them like corporations for Job Service purposes.

Later, IRS gave in on the prior criteria they had been using for determining whether an entity would be taxed as a partnership or as a corporation. The result is what is referred to as "check the box". What that means is that an entity formed as a general partnership, limited partnership, limited liability partnership, limited liability partnership, or limited liability company will be treated as a partnership for all federal taxes unless the entity files a one-page form with the Internal Revenue Service checking a box that they want to be taxed as a corporation.

As such, LLCs are almost always taxed as partnerships. If someone wanted to be taxed as a corporation they would almost always form the entity as a corporation not as a LLC. However, it is possible to have an LLC being taxed as a corporation. One other piece of background information is that an LLC can be formed by just one person. A one owner

LLC is taxed as a sole proprietorship unless they send a form in to the Internal Revenue Service checking the box that they want to be taxed as a corporation. Again, if their intent were to be taxed as a corporation they normally would have formed their entity as a corporation not as an LLC. It is our understanding that ND Job Service treats one owner LLCs like corporations subject to tax on the owner unless they filed the January exemption form.

General partnerships, limited partnerships, limited liability partnerships and limited liability partnerships do not have to pay Job Service tax on their owners because that is the way that Job Service always has and continues to treat partners and partnerships.

In contrast, a limited liability company that is otherwise taxed as a partnership is required to pay a Job Service tax on its owners unless:

1. The owner has the title of "manager" within the limited liability company, and
2. The owner owns at least 25% of the entity; and
3. A form is filed with Job Service in January signed by the owner and by the LLC requesting exemption of that owner from Job Service tax.

The same situation is true for the one owner LLC. While they are treated as a sole proprietorship for income tax purposes, Job Service will assess them tax unless they file an exemption in January.

If the LLC is formed in any month other than January, they have to wait until the subsequent January in order to file a request for exemption.

Let me give you an example of just one of the problems we have seen because of the current law. In the middle of 1999, two individuals decided to go together and form a joint venture that they anticipated would generate a profit to them over a period of years. They went to an attorney to form an entity that would be taxed as a partnership and would provide them liability protection. The attorney could have chosen a limited liability company or a limited liability partnership. The attorney not knowing about the issue with North Dakota Job Service and LLCs, formed the entity as an LLC. This LLC had no employees. The people doing all the work were the two owners who would be taking the profits out as distributions to owners.

In January 2000, I pulled out the exemption form regarding Job Service tax, completed it and had the owners sign it individually and sign it on behalf of the LLC. Where it asked about employees, I made it very clear that there were no employees and that the owners were providing the services to the entity. Shortly after the return was filed, the LLC received a telephone call from Job Service suggesting that they withdraw their request to

be exempted. There were two reasons given. One was that they were just going to pay in that much additional in Federal unemployment taxes (which is incorrect because they're exempt from Federal unemployment taxes on the owners). The other reason giving was that they did not have an account with Job Service as an employer (because they weren't paying salaries to anyone). The client called me. I, in turn, call Job Service. While again encouraged to withdraw the application for exemption, I declined to do so. The reason I refused was because I knew from past history that when the LLC made a profit and distributed profit to the owners, Job Service would reclassify those distributions of profits as salaries to the owners and assess the LLC Job Service tax.

This scenario is not at all untypical with Job Service attempting to enforce the law as it is currently on the books. It is a strange law for an entity taxed like a partnership or as a sole proprietorship.

What this Bill does, is to treat all owners of an LLC exactly the same as owners of a general partnership, limited partnership, limited liability partnership and limited liability partnership. Under this Bill, the only time an LLC would be treated like a corporation for Job Service purposes would be where the LLC sent the one page form to the Internal Revenue Service and checked the box that they wanted to be treated as a corporation.

The Bill itself may be a little confusing as to exactly what it does without looking at additional paragraphs under NDCC 52-01-01 which is the definitions and general provisions under Title 52 titled "SOCIAL SECURITY" of the North Dakota Century Code.

Lines 10 through 14 of the Bill relate to paragraph 14 which defines an employee. It changes that paragraph from specifying that all managers of LLCs are employees to specifying that managers of LLCs that are treated as corporations for federal income tax purposes will be considered employees.

To assist with what lines 15 through 24 on page 1 and lines 1 through 3 of page 2 does, I have attached part of paragraph 17 of NDCC 52-01-01 that comes before subparagraph 2. Subsection 17 defines employment. Paragraph a.(1) (which is not being amended) specifies that salary to an officer of a corporation will be taxed unless a form is filed in January requesting exemption and the officer owns at least $\frac{1}{4}$ of the corporation. Paragraph 2 is basically identical to paragraph 1 except that it substitutes manager of an LLC for officer of a corporation. This Bill amends paragraph a.(2) so that it would be limited to managers where the LLC is treated as a corporation for federal income tax purposes.

House Taxation Committee
January 22, 2001
Page 4

Lines 4 through 9 of page 2 of this Bill is to make it clear in statute that entities taxed as partnerships, including LLCs will not have Job Service tax on the owners. Likewise, one owner LLCs taxed as sole proprietorships would not be subject to Job Service tax.

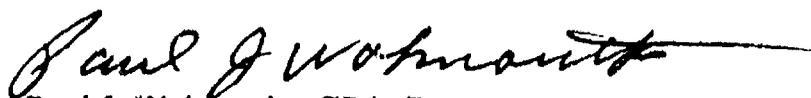
One may ask, what would prevent someone from making all 100 or 1,000 employees of an LLC owners so they are all exempt from ND Job Service. The answer is nothing. However, if the intent was solely to form an entity to get out of Job Service tax, they would form a limited liability partnership under existing law.

In summation, the current provisions in NDCC relating to Job Service and LLCs is antiquated, is a hassle for practitioners, a hassle for owners of LLCs and is a trap for the unwary. It is respectfully requested that you pass House Bill 1251.

I'm available to answer any questions that you may have at this time or at any subsequent time. I can be reached at 701-255-8443 or by email at pwohnoutka@eidebailly.com.

Sincerely,

EIDE BAILLY LLP


Paul J. Wohnoutka, CPA, Partner

PJW/bp

engaged solely in performing such work, except that each such contractor or subcontractor who is an employer by reason of subsection 15 is liable alone for the employer's contributions measured by wages to individuals in the person's service; and

- c. Each individual employed to perform or to assist in performing the work of any person in the service of an employing unit must be deemed to be engaged by such employing unit for all the purposes of the North Dakota Unemployment Compensation Law whether such individual was hired or paid directly by such employing unit or by such person, if the employing unit had actual or constructive knowledge of the employment.

→ 17. "Employment" means:

- a. Any service performed prior to January 1, 1972, which was employment as defined in this subsection prior to such date, and subject to the other provisions of this subsection, service performed after December 31, 1971, including service in interstate commerce, by:

→ (1) Any officer of a corporation. If a corporate officer is employed by a corporation in which one-fourth or more of the ownership interest, however designated, is owned or controlled by the officer or by the officer's parent, child, or spouse, or by any combination of them, the corporation with the concurrence of the officer may exclude that officer's service from employment as of the first day of January of any calendar year if, during January of that year, the corporation files a written application to exclude the officer's service from employment.

→ (2) Any manager of a limited liability company. If a limited liability company manager is employed by the limited liability company in which one-fourth or more of the ownership interest, however designated, is owned or controlled by the manager or by the manager's parent, child, spouse, or by any combination of them, the limited liability company with the concurrence of the manager may exclude that manager's service from employment as of the first day of January of any calendar year if, during January of that year, the limited liability company files a written application to exclude the manager's service from employment.

(3) Any individual who, under the provisions of subdivision e, has the status of an employee.

(4) Any individual other than an individual who is an employee under paragraph 1, 2, or 3 who performs services for remuneration for any person:

(a) As an agent-driver or commission-driver engaged in distributing meat products, vegetable products, fruit products, bakery products, beverages (other than milk), or laundry or drycleaning services, for the person's principal.

HOUSE BILL 1251

Testimony Before the House Committee On
Finance and Tax
Representative Al Carlson, Chairperson
January 23, 2001

Mr. Chairman and members of the committee, I am Ray Gudajtes of Job Service North Dakota. I am not speaking in favor or against the proposed legislation. I would like to provide information on how House Bill 1251 may impact the employer group and their employees.

Currently, all Limited Liability Company (LLC) managers are covered under the Unemployment Insurance program. House Bill 1251 will provide unemployment insurance coverage to only LLC managers whose LLC is treated as a corporation for federal income taxation purposes.

This bill also provides the LLC managers whose LLC is treated as a corporation for federal income taxation purposes and who have one-fourth or more ownership in the LLC the option to exclude their services from coverage. Currently, LLC managers who have one-fourth or more ownership in the LLC have this option available to them.

The bill further excludes services performed by an owner of a general partnership, limited liability partnership, limited liability limited partnership, or a limited liability company, unless the organization is treated as a corporation for purposes of federal income taxation. Currently, no owner in a partnership is being considered an employee for unemployment insurance purposes. The language in the bill will reinforce the current application.

The difference between HB 1251 and current law is:

- 1) LLC managers or owners who have less than 25 percent ownership would no longer be considered employees for unemployment insurance purposes nor allowed coverage under the program.
- 2) LLC managers or owners with 25 percent or more ownership in an LLC that is not treated as a corporation for federal income tax purposes would no longer have the option to be covered under the unemployment insurance coverage.

Mr. Chairman, this concludes my testimony. Thank you.



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February 21, 2001

Senate IBL Committee
ND House of Representatives
600 E Boulevard Ave
Bismarck, ND 58505

RE: HB 1251-Job Service & LLC's

Dear Committee Members:

HB 1251 was introduced by Representative Keiser at my request. The meat of this Bill is that limited liability companies are almost always treated as partnerships for federal income tax purposes and **all** federal payroll taxes. In North Dakota those same LLCs are treated as partnerships for income tax purposes and income tax withholding purposes. However, for North Dakota Job Service tax, the owners of an LLC are subject to unemployment tax even though they are **not** subject to federal unemployment tax.

HB 1251 would make the North Dakota Job Service tax rules for LLC owners the same as they are for federal unemployment tax purposes. This includes one owner LLCs taxed as sole proprietorships and two or more owner LLCs taxed as partnerships.

HB 1251 further provides that if an LLC makes an election with the IRS to be treated as a corporation, then the ND Job Service tax rules would treat LLC owners like corporate owners.

Currently general partnerships, limited partnerships and limited liability partnerships do not pay Job Service tax on their owners. In contrast, a limited liability company which is taxed as a partnership is required to pay a Job Service tax on its owners unless:

1. The owner has the title of "manager" within the limited liability company, and
2. The owner owns at least 25% of the entity; and
3. Someone remembers to file a form with Job Service in January requesting exemption of that owner from Job Service tax.

The same January form is required for the one owner LLC even though they are treated as a sole proprietorship for income tax purposes.

Unfortunately, many attorneys drafting LLC agreements and most owners of LLC are not aware that the current Job Service laws are different for LLC owners than they are for LLP owners.

Let me give you an example of just **one** of the problems we have seen because of the current law. In the middle of 1999, two individuals decided to go together and form a joint venture that they anticipated would generate a profit to them over a period of years. They went to an attorney to form an entity that would be taxed as a partnership and would provide them liability protection. The attorney could have chosen a limited liability company or a limited liability partnership. The attorney not knowing about the issue with North Dakota Job Service and LLCs, formed the entity as an LLC. This LLC had no employees. The people doing all the work were the two owners who would be taking the profits out as distributions to owners.

In January 2000, I completed the form regarding Job Service tax, had the owners sign it individually and sign it on behalf of the LLC. Where it asked about employees, I made it very clear that there were no employees and that the owners were providing the services to the entity. Shortly after the return was filed, the LLC received a telephone call from Job Service suggesting they withdraw their request to be exempted. There were two reasons given. One was that they were just going to pay in that much additional in Federal unemployment taxes (which is incorrect because the owners are exempt from Federal unemployment taxes). The other reason giving was that they did not have an account with Job Service as an employer (because they weren't paying salaries to anyone). The client called me. I, in turn, call Job Service. While again encouraged to withdraw the application for exemption, I declined to do so. The reason was because I knew from past history that when the LLC distributed profits to the owners, Job Service would reclassify those distributions as salaries and assess Job Service tax on the profit distributions.

This scenario is not at all untypical with Job Service attempting to enforce the law as it is currently on the books. It is a strange law for an entity taxed like a partnership or as a sole proprietorship for all other purposes.

The Bill itself may be a little confusing as to exactly what it does without looking at additional paragraphs under NDCC 52-01-01 which is the definitions and general provisions under Title 52 titled "SOCIAL SECURITY" of the North Dakota Century Code.

Lines 10 through 14 of the Bill relate to paragraph 14 which defines an employee. It changes that paragraph **from** specifying that an employee includes all managers of LLCs, **to** specifying that it includes managers of LLCs where the LLC is treated as a corporation for federal income tax purposes. Please note, this is an **inclusion** paragraph, not an exclusion paragraph.

Senate IBL Committee
February 21, 2001
Page 3

To assist with what lines 15 through 24 on page 1 and lines 1 through 3 of page 2 do, I have attached part of paragraph 17 of NDCC 52-01-01 that comes before subparagraph a.(2). Subsection 17 defines employment. Paragraph a.(1) (which is not being amended) specifies that salary to an officer of a corporation will be taxed unless a form is filed in January requesting exemption and the officer owns at least $\frac{1}{4}$ of the corporation. Paragraph 2 is basically identical to paragraph 1 except that it substitutes manager of an LLC for officer of a corporation. This Bill amends paragraph a.(2) so that it would apply only when the LLC is treated as a corporation for federal income tax purposes.

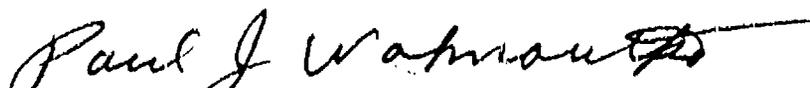
There is no place in NDCC 52-01-01 that specifies owners of partnerships are exempt from Job Service tax. Being they aren't included, they have always been excluded. Lines 4 through 9 of page 2 of this Bill makes it clear that entities taxed as partnerships, including LLCs will not have Job Service tax on the owners. Likewise, one owner LLCs taxed as sole proprietorships would not be subject to Job Service tax.

In summation, the current provisions in NDCC relating to Job Service and LLCs is antiquated, is a hassle for practitioners, a hassle for owners of LLCs and is a trap for the unwary. It is respectfully requested that you pass House Bill 1251.

I'm available to answer any questions that you may have at this time or at any subsequent time. I can be reached at 701-255-8443 or by email at pwohnoutka@eidebailly.com.

Sincerely,

EIDE BAILLY LLP


Paul J. Wahnoutka, Partner

HOUSE BILL 1251 and 1319
Testimony Before the Senate Committee On
Industry, Business and Labor
Senator Duane Mutch, Chairperson
March 20, 2001

Mr. Chairman and members of the committee, I am Ray Gudajtes of Job Service North Dakota. House Bill 1251 excludes from unemployment insurance coverage all managers of Limited Liability Companies (LLC) except those that are managers of LLC's that treat themselves as corporations for purpose of federal income taxation. Of those managers that will be excluded, some may not be members (owners) of the LLC.

The bill further allows the LLC to exclude those managers that are covered if the manager or certain relatives or a combination of them have 25 percent or more ownership in the LLC.

The US Department of Labor (DOL) indicates that this raises a conformity issue with the Federal Unemployment Insurance Tax Act (FUTA). FUTA requires services to be covered under State law if they are excluded from the FUTA definition of employment solely on the basis that they are performed for government entities, for 501(c)(3) nonprofit organizations, or American Indian tribes.

If an LLC exists within or is wholly owned by a State or local government, a nonprofit organization and/or an American Indian Tribe, then HB 1251 would be inconsistent with that requirement of FUTA.

We are submitting amendments to HB 1251 to address the FUTA conformity issue and to provide consistent application of exclusions to those managers that are covered.

Page 1, line 14 – a US DOL representative has indicated this amendment is necessary to assure conformity with FUTA. HB 1251 does not address those managers that are not members (owners) of a LLC that is treated as a partnership for federal income taxation. An LLC wholly owned by a State or local government, 501(c)(3) non-profit organization, or American Indian Tribe would have a situation were a manager would not be an owner and consequently the State is required to provide unemployment insurance coverage.

Page 2, line 3 – this amendment is specifically addressed in correspondence from the US DOL

Page 1, lines 19 and 20 – now with the inclusion as employee those managers who are not owners, this amendment would provide the same opportunity for these managers to request exclusion from coverage as is provided in the original bill.

These amendments will address conformity with FUTA and still support the original intent of the bill.

House Bill 1319 provides an additional time period for a corporation or LLC to exclude a corporate officer or limited liability company manager, respectively, that has 25% or more ownership.

The US DOL addressed the same issues with the exclusions in HB 1319 as they addressed in HB 1251 regarding coverage for government entities, for 501(c)(3) nonprofit organizations, or American Indian tribes. According to the US DOL the proposed amendment will remove the conformity issue.

Mr. Chairman, this concludes my testimony. Thank you.

SECTION 1.

Subsection 14 of section 52-01-01

14. "Employee" means every individual, whether ~~male, female~~, citizen, alien, or minor, who performs services for an employer in an employment subject to the North Dakota Unemployment Compensation Law and includes an officer of a corporation and a manager of a limited liability company that is treated as a corporation for purposes of federal income taxation or a manager of limited liability company who is not a member.

SECTION 2.

Paragraph 2 of subdivision a of subsection 17 of section 52-01-01

- (2) ~~Any manager~~ Certain managers of a limited liability company ~~companies.~~ If a limited liability company manager is employed by the a limited liability company [REDACTED] in which one-fourth or more of the ownership interest, however designated, is owned or controlled by the manager or by the manager's parent, child, spouse, or by any combination of them, the limited liability company with the concurrence of the manager may exclude that manager's service from employment as of the first day of January of any calendar year if, during January of that year, the limited liability company files a written application to exclude the manager's service from employment. This exclusion from employment does not apply to any limited liability company which is wholly owned by or operates as an Indian tribe, state or local government, or nonprofit organization regarding services performed for those entities which are required to be covered under the North Dakota Unemployment Compensation Law by federal law.

SECTION 3. A new subdivision to subsection 18 of section 52-01-01 of the North Dakota Century Code is created and enacted as follows:

Service performed by an owner of a general partnership, limited partnership, limited liability partnership, limited liability limited partnership, or a limited liability company, unless the organization is treated as a corporation for purposes of federal income taxation.