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10-16-03
Date

2003 SENATE FINANCE AND TAXATION

SB 2101

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10-16-03

Date

2003 SENATE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. SB2101

Senate Finance and Taxation Committee

Conference Committee

Hearing Date January 14, 2003

Tape Number	Side A	Side B	Meter #
1	X		4,465

Committee Clerk Signature *Michael Kuylenstierna*

Minutes:

Senator Urlacher opened the hearing on SB2101. All committee members were in attendance.

Joe Becker, Auditor III/Research Specialist, ND Office of State Tax Commissioner. Testified in support of SB2101. This bill relates to the 3-year income averaging method for farm income.

The changes made by this bill will not have any fiscal effect due to the administrative practices adopted. The Tax Commissioner urges a Do Pass on SB2101.

Senator Urlacher - Was there a noticeable impact?

Mr. Becker - No impact that we have seen.

Senator Urlacher - Any testimony opposing SB2101?

None. Hearing closed.

Senator Wardner motioned for a Do Pass. Second by Senator Tollefson. Roll call vote 6 yea, 0

nay, 0 absent. Carrier is Senator Syverson.

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FISCAL NOTE
 Requested by Legislative Council
 01/03/2003

Bill/Resolution No.: SB 2101

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.

	2001-2003 Biennium		2003-2005 Biennium		2005-2007 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues						
Expenditures						
Appropriations						

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

2001-2003 Biennium			2003-2005 Biennium			2005-2007 Biennium		
Counties	Cities	School Districts	Counties	Cities	School Districts	Counties	Cities	School Districts

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

SB 2101 will have no fiscal impact.

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:	Kathryn L. Strombeck	Agency:	Tax Department
Phone Number:	328-3402	Date Prepared:	01/07/2003

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Katherine L. Strombeck
 Operator's Signature

10-16-03
 Date

REPORT OF STANDING COMMITTEE (410)
January 14, 2003 11:46 a.m.

Module No: SR-06-0517
Carrier: Syverson
Insert LC: . Title: .

REPORT OF STANDING COMMITTEE

SB 2101: Finance and Taxation Committee (Sen. Uriacher, Chairman) recommends DO
PASS (6 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING). SB 2101 was placed on the
Eleventh order on the calendar.

(2) DESK, (3) COMM

Page No. 1

SR-00-0517

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2003 HOUSE FINANCE AND TAXATION

SB 2101

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10-16-03
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2003 HOUSE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. SB 2101

House Finance and Taxation Committee

Conference Committee

Hearing Date March 3, 2003

Tape Number	Side A	Side B	Meter #
1	X		6.5
			Recorder did not work
Committee Clerk Signature <i>Janice Stein</i>			

Minutes:

REP. WES BELTER, CHAIRMAN Called the hearing to order.

JOSEPH BECKER, ND OFFICE OF THE STATE TAX COMMISSIONER Testified in support of the bill. Gave the purpose of the bill which makes technical changes and clarifies the language. See attached written testimony.

REP. BELTER Asked whether this mirrors the federal tax.

JOSEPH BECKER Stated that was the whole idea. You have to do it for federal purposes first then you can do it for the state.

REP. GROSZ Asked whether you could elect the income averaging one year then go back to the other way the next.

JOSEPH BECKER Stated you can elect in and out on a year to year basis.

REP. KLEIN Asked what percentage of the taxpayers were using income averaging.

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Page 2
House Finance and Taxation Committee
Bill/Resolution Number SB 2101
Hearing Date March 3, 2003

JOSEPH BECKER Stated in 2001, 1,865 filers used the form. He stated there are 308,000 returns filed on the short form.

With no further testimony, the hearing was closed.

COMMITTEE ACTION

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

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

14 YES 0 NO 0 ABSENT

REP. HEADLAND Was given the floor assignment.

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Date: 3-3-03
Roll Call Vote #: 1

2003 HOUSE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. SB 2101

House FINANCE & TAXATION Committee

Check here for Conference Committee

Legislative Council Amendment Number _____

Action Taken Do Pass

Motion Made By Rep. Iverson Seconded By Rep. Clark

Representatives	Yes	No	Representatives	Yes	No
BELTER, CHAIRMAN	✓				
DROVDAL, VICE-CHAIR	✓				
CLARK	✓				
FROELICH	✓				
GROSZ	✓				
HEADLAND	✓				
IVERSON	✓				
KELSH	✓				
KLEIN	✓				
NICHOLAS	✓				
SCHMIDT	✓				
WEILER	✓				
WIKENHEISER	✓				
WINRICH	✓				

Total (Yes) 14 No 0

Absent 0

Floor Assignment Rep. Headland

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

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Operator's Signature Date

REPORT OF STANDING COMMITTEE (410)
March 3, 2003 1:00 p.m.

Module No: HR-37-3732
Carrier: Headland
Insert LC: . Title: .

REPORT OF STANDING COMMITTEE

SB 2101: Finance and Taxation Committee (Rep. Belter, Chairman) recommends **DO PASS** (14 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING). SB 2101 was placed on the Fourteenth order on the calendar.

(2) DESK, (3) COMM

Page No. 1

HR-37-3732

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2003 TESTIMONY

SB 2101

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10-16-03
Date

**Testimony before the Senate Finance and Taxation Committee
Senate Bill 2101**

January 14, 2003

Prepared by Joseph Becker, Auditor III/Research Specialist
North Dakota Office of State Tax Commissioner
Phone: 328-3451
E-mail: jjbecker@state.nd.us

Good morning, Chairman Urlacher, Members of the Committee:

For the record, my name is Joseph Becker, and I'm here on behalf of the North Dakota Office of State Tax Commissioner (Tax Department).

Senate Bill 2101 is an individual income tax bill that relates to the 3-year income averaging method for farm income. This method of calculating the tax is allowed only on Form ND-1, the main method of filing for individuals. (*It is not allowed on Form ND-2, the optional method.*)

Background

The 3-year income averaging method for farm income was adopted as part of the overhaul of what was known as the short-form individual income tax system (on Form 37-S) by the 2001 legislature. As you will recall, the main thrust of that overhaul was to change the starting point in calculating the individual income tax from the *federal income tax liability* to *federal taxable income* to avoid the revenue shortfall that would have been caused by the 2001 federal income tax rate cuts.

The 2001 legislature was also very concerned about maintaining neutrality not only in total revenues but also on an individual taxpayer basis. By disconnecting from the federal income tax liability as the starting point in calculating the tax, the state automatically disconnected from a number of special tax calculation features under federal income tax law that affected the federal income tax liability. The revenue neutrality would not have been maintained had the special federal features been ignored.

All of the special federal features were considered by the 2001 legislature, and changes were made to the overhaul legislation to address the major features. One of the major features addressed was the 3-year income averaging method for farm income.

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Reason for bill

The purpose of this bill is to follow-up on the legislative changes in 2001 to make some technical and clarifying changes, and to codify the administrative policies established to administer the 3-year income averaging method for 2001 and 2002. The changes proposed by this bill will not change the administration of the 3-year income averaging provisions.

Bill's provisions

On page 1, lines 7 through 10, the language is revised to clarify that, in order to be eligible to use the 3-year income averaging method for state purposes, the taxpayer must use the 3-year income averaging method for federal income tax purposes. This was the intent in addressing this particular federal feature in the 2001 overhaul legislation, and it keeps with the purpose of maintaining revenue neutrality.

Also on page 1, lines 18 through 21, new language is added to provide that if a taxpayer uses Form ND-2, the optional method for individuals, for any of the three base years in the averaging calculation, the taxpayer must recalculate the tax for the base year using Form ND-2. The 2001 legislation addressed this situation, but only with respect to the 1998 through 2000 tax years. This change extends the treatment for base years after 2000.

Finally, on page 2, lines 4 through 5, new language is added to address the situation where a taxpayer has a net long-term capital gain that is included in farm income for income averaging purposes. In this situation, an adjustment must be made to account for the state's 30% exclusion allowed on the capital gain; otherwise, North Dakota taxable income and the related tax will be understated for the year in which the income averaging method is used. *(The income understatement equals the 30% exclusion amount. It results from subtracting both the entire net long-term capital gain before the exclusion and the 30% net long-term capital gain from North Dakota taxable income for the year in which the income averaging method is used.)* Administratively, this adjustment has been provided for in the instructions to the 2001 and 2002 tax returns. This bill would codify the administrative treatment.

The changes made by this bill will not have any fiscal effect due to the administrative practices adopted. The Tax Commissioner urges a DO PASS on Senate Bill 2101. If the committee has any questions, Mr. Chairman, I would be happy to respond to them at this time.

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10-16-03
Date

**Testimony before the House Finance and Taxation Committee
Senate Bill 2101**

March 3, 2003

Prepared by Joseph Becker, Auditor III/Research Specialist
North Dakota Office of State Tax Commissioner
Phone: 328-3451
E-mail: jjbecker@state.nd.us

Good morning, Chairman Belter and Members of the Committee:

Introduction

For the record, my name is Joseph Becker, and I'm here on behalf of the North Dakota Office of State Tax Commissioner (Tax Department).

Senate Bill 2101, which was introduced at the Tax Commissioner's request, is an individual income tax bill that relates to the 3-year income averaging method for farm income. This method of calculating the tax is allowed only on Form ND-1, the main method of filing for individuals. (*In other words, it is not allowed on Form ND-2, the optional method.*)

Background

First, I'd like to provide some background information to put this bill into perspective for you. The 3-year income averaging method for farm income was adopted as part of the 2001 legislature's overhaul of what was known as the short-form individual income tax system (on Form 37-S). The purpose of the overhaul was to avoid the state income tax revenue shortfall that would have resulted from the effect of the 2001 federal income tax rate cuts on the short-form system's federal income tax liability starting point.

The main elements of the overhaul were to (1) change the starting point in calculating the individual income tax from the *federal income tax liability* to *federal taxable income* and (2) set up a new tax rate structure that would produce the same amount of income tax as the former short-form system.

The 2001 legislature was also concerned about maintaining, as much as possible, revenue neutrality not only in total revenues but also at the taxpayer level. Disconnecting from the federal

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income tax liability as the starting point in the tax calculation, though, meant that the state would automatically disconnect from a number of special federal tax calculation features that were built into the federal income tax liability. Revenue neutrality at the taxpayer level would have been a problem had the special features been ignored.

All of the special federal tax calculation features were considered by the 2001 legislature, and the major ones were addressed in the 2001 legislation. One of the major features addressed was the federal 3-year income averaging method for farm income, which could be used by farmers to reduce their federal income tax. This feature was addressed by adopting a state 3-year income averaging method for farm income that is available to individuals using Form ND-1, the main method of filing for individuals.

Purpose of bill

The purpose of this bill is to follow-up on the legislative changes in 2001 to make some technical and clarifying changes, and to codify the administrative policies adopted to administer the 3-year income averaging method for its first two years (2001 and 2002).

Bill's provisions

On page 1, lines 7 through 10, the language is revised to clarify that, in order to be eligible to use the state 3-year income averaging method, the taxpayer must use the 3-year income averaging method for federal income tax purposes. This application was the intended one because it maintained the revenue neutrality goals that guided the drafting of the 2001 legislation.

On page 1, lines 18 through 21, new language is added to provide that if a taxpayer uses Form ND-2 (the optional method for individuals) for any of the three base years in the averaging calculation, the taxpayer must recalculate the tax for that base year using Form ND-2. (The three base years are the three tax years preceding the tax year for which the income averaging method is used.) The 2001 legislation did address this situation, but inadvertently made it applicable for only the 1998 through 2000 tax years. This change provides for the same treatment for tax years after 2000.

Finally, on page 2, lines 4 through 5, new language is added to codify an administrative policy established to prevent a double deduction. The double deduction occurs in the situation

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10-16-03
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where farm income for averaging purposes includes a net long-term capital gain from the sale or exchange of property (other than land) used in the farming operation. (*For example, a gain from the sale of breeding stock or equipment.*)

The double deduction results from the interaction of two items: First, under the 3-year income averaging method, the amount of farm income that a taxpayer elects to include in the averaging calculation is deducted from the current year's taxable income. (*Elected farm income may, as explained above, include a net long-term capital gain.*) Second, the law allows a deduction equal to 30% of a net long-term capital gain. Thus, if elected farm income includes a net long-term capital gain, a double deduction equal to the amount of the 30% capital gain deduction will occur.

As a matter of administrative policy established to prevent the double deduction, a taxpayer in this situation has been required to reduce elected farm income by the amount of the capital gain exclusion. The policy is reflected in the instructions to the 2001 and 2002 tax returns. This bill would codify that administrative policy.

Closing

The major changes made by this bill will not affect the current administration of the 3-year income averaging method for farm income. They only codify the existing administrative practices that have been set out in the instructions to the tax return since 2001.

The Tax Commissioner requests the Committee's recommendation of a DO PASS on Senate Bill 2101. If the committee has any questions, Mr. Chairman, I would be happy to respond to them at this time.

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