

1999 HOUSE FINANCE AND TAXATION

HB 1113

1999 HOUSE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. HB 1113

House Finance and Taxation Committee

Conference Committee

Hearing Date January 12, 1999

Tape Number	Side A	Side B	Meter #
1	x		10 - 18
Committee Clerk Signature <i>Jamie Stein</i>			

Minutes:

REP. BELTER Opened the hearing.

JOSEPH BECKER, AUDITOR III/RESEARCH SPECIALIST, NORTH DAKOTA OFFICE OF THE STATE TAX COMMISSIONER, Testified in support of the bill. See attached written testimony. Also attached is a cross-reference of current language with new language in the bill, plus an analysis of the bill with components of federal income tax liability & changes to current law. An amendment was also submitted.

With no further testimony, the hearing was closed.

COMMITTEE ACTION

REP. CLARK Made a motion to adopt the amendments as presented by Joseph Becker.

REP. GRANDE Second the motion. MOTION CARRIED BY VOICE VOTE.

Page 2

House Finance and Taxation Committee

Bill/Resolution Number Hb 1113

Hearing Date January 12, 1999

The bill will be acted on at a later date.

COMMITTEE ACTION Tape #2, Side A, Meter #18.6

REP. WINRICH Made a motion for a DO PASS AS AMENDED.

REP. GROSZ Second the motion. MOTION CARRIED.

15 Yes 0 No 0 Absent

REP. CLARK Was given the floor assignment.

FISCAL NOTE

Turn original and 10 copies)

Bill/Resolution No.: HB 1113

Amendment to: _____

Requested by Legislative Council

Date of Request: 12-29-98

1. Please estimate the fiscal impact (in dollar amounts) of the above measure for state general or special funds, counties, cities, and school districts. Please provide breakdowns, if appropriate, showing salaries and wages, operating expenses, equipment, or other details to assist in the budget process. In a word processing format, add lines or space as needed or attach a supplemental sheet to adequately address the fiscal impact of the measure.

Narrative: HB 1113 primarily clarifies language. It will have a fiscal impact of less than \$5,000 in the 1999-2001 biennium.

2. **State** fiscal effect in dollar amounts:

	1997-99 Biennium		1999-2001 Biennium		2001-03 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues						
Expenditures						

3. What, if any, is the effect of this measure on the budget for your agency or department:

- a. For rest of 1997-99 biennium:

(Indicate the portion of this amount included in the 1999-2001 executive budget:)

- b. For the 1999-2001 biennium:

(Indicate the portion of this amount included in the 1999-2001 executive budget:)

- c. For the 2001-03 biennium:

4. **County, city, and school district** fiscal effect in dollar amounts:

1997-99 Biennium			1999-2001 Biennium			2001-03 Biennium		
Counties	Cities	School Districts	Counties	Cities	School Districts	Counties	Cities	School Districts

If additional space is needed
attach a supplemental sheet.

Signed: Kathryn L. Strombeck

Typed Name: Kathryn L. Strombeck

Department: Tax

Date Prepared: 1-5-99

Phone Number: 328-3402

Please type or use black pen to complete

Date 1-12-99

Roll call vote # 1

1999 HOUSE STANDING COMMITTEE ROLL CALL VOTES

BILL/RESOLUTION NO. HB 1113

House HOUSE FINANCE & TAX Committee

Subcommittee on _____

Conference Committee

} Identify or check where appropriate

Legislative Council Amendment Number _____

Action Taken Do Pass as amended

Motion Made By Rep. Winrich Seconded By Rep. Grosz

Representatives	Yes	No	Representatives	Yes	No
BELTER	✓		WINRICH	✓	
RENNERFELDT	✓				
CLARK	✓				
FROELICH	✓				
GRANDE	✓				
GROSZ	✓				
HERBEL	✓				
KROEBER	✓				
MICKELSON	✓				
NICHOLAS	✓				
RENNER	✓				
SCHMIDT	✓				
WARNER	✓				
WIKENHEISER	✓				

Total 15 0
(Yes) (No)

Absent 0

Floor Assignment Rep. Clark

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

DO NOT USE HIGHLIGHTER ON ANY FORMS

REPORT OF STANDING COMMITTEE (410)
January 14, 1999 11:50 a.m.

Module No: HR-08-0612
Carrier: Clark
Insert LC: 98165.0101 Title: .0200

REPORT OF STANDING COMMITTEE

HB 1113: Finance and Taxation Committee (Rep. Belter, Chairman) recommends **AMENDMENTS AS FOLLOWS** and when so amended, recommends **DO PASS** (15 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING). HB 1113 was placed on the Sixth order on the calendar.

Page 2, line 4, after the underscored comma insert "including calculation and tax rate modifications prescribed under other provisions of the Internal Revenue Code,"

Page 2, line 21, replace "4793(a)" with "4973(a)"

Renumber accordingly

1999 SENATE FINANCE AND TAXATION

HB 1113

1999 SENATE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. HB 1113

Senate Finance and Taxation Committee

Conference Committee

Hearing Date 2-9-99

Tape Number	Side A	Side B	Meter #
HB 1113	X		1890-3584
Committee Clerk Signature <i>Sheila Wald</i>			

Minutes:

Sen Urlacher opened the hearing on 1113, A BILL RELATING TO DEFINITIONS OF FEDERAL INCOME LIABILITY FOR SHORT FORM INCOME TAX RETURN PURPOSES.

Joe Becker - Tax Dept. Testimony submitted & attached.

Sen Stenehjem - The tax on lump sum distribution, add an exception, did we not have that before?

Joe Becker - That is correct. We have allowed non - resident to be left out of the starting point of the discrimination Constitutional issues that I have mentioned. Practical matter has not been included for those individuals. Because non resident, preempted by Fed Law to tax that income in the first place. So Administrative point of view, we have advised them not to include it in the starting point, so we can get around that problem.

Page 2

Senate Finance and Taxation Committee

Bill/Resolution Number Hb 1113

Hearing Date *Click here to type Hearing Date*

Sen Stenehjem - Another area here, contributions to IRA, and medical saving accounts, not collecting tax from out of State residents, and this just meets the law in the way you are operating?

Joe Becker - Some of these items are very obscure, and rarely run into. Excess contributions in to these items, they are probably catching you on an audit and they you put too much in and now they are charge you a 6% tax on the excess. Not very often do you encounter this situation. It is included in, but it is a rarity that we run in to.

Sen Urlacher closed hearing on Bill 1113.

DISCUSSION 2-10-99 TAPE B 735 -3900 SEN WARDNER MADE A MOTION TO DO PASS AND SECONDED BY SEN. CHRISTMANN. VOTE TAKE 7 Y 0 N. CARRIER WILL BE SEN WARDNER.

Date: 2-10-99
Roll Call Vote #: 1

1999 SENATE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. 1113

Senate Senate Finance and Taxation Committee

Subcommittee on _____
or
 Conference Committee

Legislative Council Amendment Number _____

Action Taken No Pass

Motion Made By Sen. Wardner Seconded By Sen. Christmann

Senators	Yes	No	Senators	Yes	No
SENATOR URLACHER	✓				
SENATOR CHRISTMANN	✓				
SENATOR SCHOBINGER	✓				
SENATOR STENEHJEM	✓				
SENATOR WARDNER	✓				
SENATOR KINNOIN	✓				
SENATOR KROEPLIN	✓				

Total (Yes) 7 No 0

Absent _____

Floor Assignment Sen. Wardner

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

REPORT OF STANDING COMMITTEE (410)
February 25, 1999 3:48 p.m.

Module No: SR-34-3627
Carrier: Wardner
Insert LC: . Title: .

REPORT OF STANDING COMMITTEE

HB 1113, as engrossed: Finance and Taxation Committee (Sen. Urlacher, Chairman)
recommends **DO PASS** (7 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING).
Engrossed HB 1113 was placed on the Fourteenth order on the calendar.

**1999 TESTIMONY
HB 1113**

Testimony before the House Finance and Taxation Committee

House Bill 1113

January 12, 1999

Prepared by Joseph Becker, Auditor III/Research Specialist
North Dakota Office of State Tax Commissioner

Mr. Chairman, and Members of the House Finance and Taxation Committee, my name is Joseph Becker. I'm an individual income tax auditor with the North Dakota Office of State Tax Commissioner. I am here today on behalf of the Tax Commissioner to testify in support of House Bill 1113 which was introduced at the Tax Commissioner's request.

This is an income tax bill relating to the North Dakota short form method of filing for individuals. This method is implemented on North Dakota Form 37-S.¹ The primary purpose of this bill is to rewrite the provision that defines the terminology "federal income tax liability" which is the starting point in calculating the tax under this method. A secondary purpose is to propose a couple of changes to the definition to address legal concerns that have come to the Tax Commissioner's attention.

Rewrite of definition of "federal income tax liability"

The purpose of the rewrite is to clarify what makes up the federal income tax liability for short form purposes. Since its enactment in 1981, there have been a number of changes to federal tax law and federal tax forms that are not adequately addressed in the current language. Also, the current language is not clear with respect to certain federal tax items, such as the special capital gain tax rates, the new income averaging rules for farmers, and the new income tax credits enacted in the last couple of years. The rewrite also simplifies the content and structure of the provision. This rewrite does not alter the amount of tax that an individual pays under the short form method.

Proposed changes to definition of "federal income tax liability"

The Tax Commissioner also is proposing a couple of changes to the definition to address legal concerns that have come to the Tax Commissioner's attention.

One change involves the federal alternative minimum tax which is one of the main

¹The testimony makes reference only to individuals, but these changes also affect estates and trusts that use the short form method of filing on North Dakota Form 38.

components of the federal income tax liability for short form purposes. In 1985, the North Dakota Legislature added language to this provision to allow the federal alternative minimum tax to be reduced by the amount of any federal investment tax credit allowed for the same tax year. The purpose of the 1985 law change was to remove an inequity in the law.² This inequity no longer exists due to a change in federal income tax law. Therefore, the investment credit language added in 1985 has been removed in the rewrite.

Another change being proposed by the Tax Commissioner involves three of the other federal taxes that are components of the federal income tax liability for short form purposes—namely, the tax on a lump-sum distribution, the tax on excess contributions to an IRA, and the tax on excess accumulations in certain retirement accounts. The change is proposed to address legal questions that arise in the case of a nonresident who incurs any of these taxes.

The legal questions relate to the method prescribed for determining the amount of a nonresident's federal income tax liability that is subject to the short form tax rate of 14%.³ Under the prescribed method, the nonresident's federal income tax liability must be multiplied by the ratio of North Dakota adjusted gross income to federal adjusted gross income.⁴ The problem is that while all three of the federal taxes in question are included in the federal income tax liability, the amounts on which these taxes are based are not included in federal adjusted gross income. This lack of income representation in the nonresident ratio calculation results in an unfair apportionment of the federal income tax liability by skewing it in favor of North Dakota, raising discrimination and constitutional questions. Given the nature of the three federal taxes in question—that is, all of them involve a separate tax calculation on an amount that is not included in federal adjusted gross income—the Tax Commissioner proposes to exclude the three taxes from the federal income tax liability in the case of a nonresident. Given the nature of these taxes

²See S.L. 1985, ch. 635. The inequity was that a taxpayer with both an alternative minimum tax and an investment tax credit paid more North Dakota income tax than another taxpayer with an identical tax situation except that the other taxpayer had no investment tax credit. This problem was attributable to how the investment tax credit was handled in the calculation of the alternative minimum tax.

³The starting point under the short form method of filing is the total federal income tax liability as defined under N.D.C.C. § 57-38-30.3(5). However, the total federal income tax liability must be adjusted to account for any income that is not subject to North Dakota income tax under federal or North Dakota law.

⁴For example, if a nonresident's federal income tax liability on all income is \$1,000, and if the nonresident has a federal adjusted gross income of \$20,000 of which \$5,000 is taxable by North Dakota, the amount of the total federal income tax liability to which the 14% tax rate is applied is \$250 $[(\$5,000 + \$20,000) \times \$1,000]$.

and that the problem only affects nonresident filers, the fiscal effect is considered negligible.⁵

Amendment to bill as introduced

The Tax Commissioner finds it necessary to offer an amendment to the bill as introduced to correct two drafting errors. One error is on page 2, line 4, which involves the omission of language necessary to take into account special provisions affecting the federal income tax computation that Congress chooses to place in sections of the U.S. Internal Revenue Code other than sections 1 and 3.⁶ The second error is on page 2, line 21. The reference to "4793(a)" should read "4973(a)." The clerk should have the Department's amendment.

Conclusion

For reference, I am providing the Committee with copies of two tables that I prepared. Table 1 provides a cross-reference of the current language of the statute with the language in the proposed rewrite. The purpose of this table is to show that all federal items referenced in the current statute are accounted for in the proposed rewrite. Table 2 provides a breakdown of the provisions of the bill (and the amendment) and describes each of the components making up the federal income tax liability for short form purposes. Table 2 also shows the Tax Commissioner's proposed changes to the current language. The Tax Commissioner asks for the Committee's favorable consideration of House Bill 1113. If the Committee has any questions, I would be happy to respond to them.

⁵Due to the nature of all three of the federal taxes in question, they are not frequently encountered. In addition, the 5- and 10-year income averaging rules for lump-sum distributions under federal income tax law are being phased out: (1) The 5-year rules expire after 1999; and, (2) Except for individuals born before 1936, the 10-year rules were repealed for distributions after 1986.

⁶Examples of this include I.R.C. §§ 641(c), 1341, and 1301. All three of these provisions affect the computation of the federal income tax under I.R.C. § 1. Section 641(c) provides for a special income tax computation on income that a trust receives from stock in a Subchapter S corporation. Section 1341 (sometimes referred to as the "claim-of-right" provision) also provides for a special income tax calculation for taxpayers who are required to pay back income in a year following the year in which the taxpayer paid tax on the income. Section 1301, recently created by Congress, provides for the new 3-year income averaging method for farmers.

Table 1

Federal references in N.D.C.C. § 57-38-30.3(5):

Cross-reference of current language with new language in House Bill 1113

Prepared by Joseph Becker, Auditor/Research Specialist
 North Dakota Office of State Tax Commissioner
 January 1999

Reference in current language	Corresponding reference in proposed rewrite	
	Internal Revenue Code §	N.D.C.C. § 57-38-30.3(5)
1. Tax tables and tax rate schedules	I.R.C. §§ 1 and 3	Subsection 5 generally
2. Form 8615 (Tax For Children Under Age 14 Who Have Investment Income Of More Than \$1,400)	I.R.C. §§ 1 and 3	Subsection 5 generally
3. Form 4970 (Tax On Accumulation Distribution Of Trusts)	I.R.C. § 667(a)(2)	Subsection 5(c)
4. Form 4972 (Tax On Lump-Sum Distributions)	I.R.C. § 402(d)(1)	Subsection 5(b)
5. Section 72(m)(5) penalty tax	I.R.C. § 72(m)(5)	Subsection 5(d)
6. Form 5329 [Additional Taxes Attributable To Qualified Retirement Plans (Including IRAs), Annuities, Modified Endowment Contracts, And MSAs]	I.R.C. § 72(q)(1) I.R.C. § 72(t)(1) I.R.C. § 4973(a) I.R.C. § 4974(a) I.R.C. § 4980A	Subsection 5(e) Subsection 5(f) Subsection 5(g) Subsection 5(h) Subsection 5(i)
7. Form 6251 (Alternative Minimum Tax—Individuals)	I.R.C. § 55	Subsection 5(a)
8. Form 8656 (Alternative Minimum Tax—Fiduciaries) Note: This form is no longer used—now calculated on Schedule I, Form 1041.	I.R.C. § 55	Subsection 5(a)
9. Credit for prior year minimum tax (form 8801)	I.R.C. § 53	Subsection 5(j)
10. Credit for the elderly or the disabled (schedule R)	<p>These items do not have to be referenced in the rewrite of subsection 5 of section 57-38-30.3. The rewrite simplifies the content and structure of the subsection by specifically referencing only the federal taxes that are to be included in the federal income tax liability for purposes of the short form method.</p> <p>In addition, with respect to any federal tax credit, the rewrite specifically excludes all federal tax credits not specifically provided for in subsection 5 of section 57-38-30.3.</p>	
11. Credit for child and dependent care expenses (form 2441)		
12. Investment credit (form 3468)		
13. Foreign tax credit (form 1116)		
14. General business credit (form 3800)		
15. Jobs credit (form 5884)		
16. Credit for alcohol used as fuel (form 6478)		
17. Credit for increasing research activities (form 6765)		
18. Low income housing credit (form 8586)		
19. Nonconventional fuel credit Note: There is no special form for this credit.		
20. Federal income tax withheld		
21. Estimated tax payments		
22. Earned income credit		
23. Amount paid with Form 4868		
24. Excess social security tax withheld		
25. Excess federal Railroad Retirement Tax Act tax withheld		
26. Credit for federal tax on gasoline and special fuels (form 4136)		
27. Regulated investment company credits (form 2439)		
28. Self-employment tax		
29. Social security tax and railroad retirement tax on tips		

Table 2

Analysis of House Bill 1113: Components of federal income tax liability and changes to current law

Prepared by Joseph J. Becker, Auditor III/Research Specialist, North Dakota Office of State Tax Commissioner

January 1999

Bill provisions		Description of federal provisions cited in bill			Change from current law
Page and line reference	N.D.C.C. § citation	I.R.C. § citation	Description of federal tax provision	Applicable federal form (1998)	
Page 2, lines 2–4	Subsection 5 (in general)	Section 1 Subsection a Subsection b Subsection c Subsection d Subsection e Subsection f Subsection g Subsection h	Individual income tax rates: Married filing joint and qualifying widow(er) Head of household Single Married filing separate Estate or trust income tax rates Indexing of tax rates Tax on unearned income of child under age 14— Income reported on child's return Income reported on parent's return Maximum capital gain tax rates— Individuals Estate or trust	An individual uses one of the following forms: Form 1040EZ (line 10) Form 1040A (line 25) Form 1040 (line 40) Schedule G (Form 1041) Form 8615 (Form 1040/1040A) Form 8814 (Form 1040) Schedule D (Form 1040) Schedule D (Form 1041)	No change; rewrite only.
Page 2, lines 2–4	Subsection 5 (in general)	Section 3	Alternate tax tables (individuals only)	Not applicable	No change; rewrite only.
Page 2, lines 5–6	Subdivision a of subsection 5	Section 55	Alternative minimum tax (AMT)— Individuals Estate or trust	Form 6251 (Form 1040) Schedule I (Form 1041)	Proposed change: Remove the adjustment for the investment tax credit allowed under current law.
Page 2, lines 7–10	Subdivision b of subsection 5	Section 402	Tax on a lump-sum distribution	Form 4972 (Form 1040/1041)	Proposed change: Add an exception to the inclusion of this tax in the case of a nonresident individual, estate or trust.
Page 2, lines 11–12	Subdivision c of subsection 5	Section 667	Tax on an accumulation distribution of a trust— Individuals Estate or trust	Form 4970 (Form 1040) Schedule G (Form 1041)	No change; rewrite only.
Page 2, lines 13–16	Subdivision d of subsection 5	Section 72(m)(5)	10% tax on excess benefits received from a qualified retirement plan or an annuity	No special form is provided— individuals include this tax on line 56, Form 1040.	No change; rewrite only.

Bill provisions		Description of federal provisions cited in bill			Change from current law
Page and line reference	N.D.C.C. § citation	I.R.C. § citation	Description of federal tax provision	Applicable federal form (1998)	
Page 2, lines 17–18	Subdivision e of subsection 5	Section 72(q)(1)	10% tax on an early distribution from an annuity contract	Form 5329, Part 1 (Form 1040)	No change; rewrite only.
Page 2, lines 19–20	Subdivision f of subsection 5	Section 72(t)(1)	10%* tax on an early distribution from a qualified retirement plan, individual retirement account (IRA), or I.R.C. § 457 plan *25% in the case of a SIMPLE IRA	Form 5329, Part 1 (Form 1040)	No change; rewrite only.
Page 2, lines 21–25	Subdivision g of subsection 5	Section 4973(a)	6% tax on excess contributions to an individual retirement account (IRA), medical savings account (MSA), individual retirement annuity under I.R.C. § 408(b), a custodial account treated as an annuity contract under I.R.C. § 403(b)(7)(A) (relating to custodial accounts for regulated investment company stock), and an education individual retirement account under I.R.C. § 530	Form 5329, Part 2 (Form 1040)	Proposed change: Add an exception to the inclusion of this tax in the case of a nonresident individual, estate or trust.
Page 2, lines 26–28	Subdivision h of subsection 5	Section 4974(a)	50% tax on excess accumulations in an individual retirement account (IRA), qualified retirement plan, or Section 457 plan	Form 5329, Part 4 (Form 1040/1041)	Proposed change: Add an exception to the inclusion of this tax in the case of a nonresident individual, estate or trust.
Page 2, lines 29–30	Subdivision i of subsection 5	Section 4980A	15% tax on excess distributions from a qualified retirement plan	Not applicable for 1998; repealed by the '97 Taxpayer Relief Act. Formerly calculated and reported on Form 5329, Part 4 (Form 1040).	No change; rewrite only.
Page 3, lines 1–2	Subdivision j of subsection 5	Section 53	Credit for prior year minimum tax	Form 8801 (Form 1040/1041)	No change; rewrite only.
Page 3, lines 3–4	Subsection 5 (in general)	N/A	N/A	N/A	No change; rewrite only.
Amendment to bill as introduced The amendment to the bill as introduced adds new language to account for any modifications to the calculation method or tax rates prescribed under I.R.C. §§ 1 and 3 that Congress chooses to place in other sections of the Internal Revenue Code. Notable examples include the modifications to the I.R.C. § 1 calculations and tax rates provided under I.R.C. §§ 641(c), 1341, and 1301. <ul style="list-style-type: none"> • I.R.C. § 641(c) provides for a special income tax computation on income that a trust receives from stock in a Subchapter S corporation. • I.R.C. § 1341 (sometimes referred to as the "claim-of-right" provision) provides for a special income tax calculation for taxpayers who are required to pay back income in a year following the year in which the taxpayer paid tax on the income. • I.R.C. § 1301, added by the Taxpayer Relief Act of 1997, provides for the new 3-year income averaging method for farmers. 					No change; rewrite only.

Testimony before the Senate Finance and Taxation Committee House Bill 1113 (First Engrossment)

February 9, 1999

Prepared by Joseph Becker, Auditor III/Research Specialist
North Dakota Office of State Tax Commissioner

Mr. Chairman, and Members of the Senate Finance and Taxation Committee, my name is Joseph Becker. I'm an individual income tax auditor with the North Dakota Office of State Tax Commissioner. I am here today on behalf of the Tax Commissioner to testify in support of House Bill 1113 which was introduced at the Tax Commissioner's request.

This is an income tax bill relating to the North Dakota short form method of filing for individuals, estates and trusts.¹ This is largely a housecleaning bill. Its primary purpose is to rewrite the provision that defines the terminology "federal income tax liability" which is the starting point in calculating the tax under this method. A secondary purpose is to propose a couple of changes to the definition to address legal concerns that have come to the Tax Commissioner's attention.

Rewrite of definition of "federal income tax liability"

The rewrite simplifies the content and structure of the provision and clarifies what makes up the federal income tax liability for short form purposes. In addition, since its enactment in 1981, there have been a number of changes to federal tax law and federal tax forms that are not adequately addressed in the current language. For example, the current provision does not clearly address the special capital gain tax rates, the new income averaging rules for farmers, and the new income tax credits enacted in the last couple of years. This rewrite does not alter the amount of tax that must be paid under the short form method. 2106

Proposed changes to definition of "federal income tax liability"

The proposed changes to the definition address legal concerns that have come to the Tax Commissioner's attention.

¹The short form method of filing is implemented on North Dakota Form 37-S for individuals and on Form 38 (Short Method) for estates and trusts.

One change involves the federal alternative minimum tax which is one of the components of the federal income tax liability for short form purposes. In 1985, the North Dakota Legislature added language to this provision to allow the federal alternative minimum tax to be reduced by the amount of any federal investment tax credit allowed for the same tax year. The purpose of the 1985 law change was to remove an inequity in the law.² This inequity no longer exists due to a change in federal income tax law. Therefore, the investment credit language added in 1985 has been removed in the rewrite.

Another change being proposed by the Tax Commissioner involves three of the other federal taxes that are components of the federal income tax liability for short form purposes—namely, the tax on a lump-sum distribution, the tax on excess contributions to an IRA, and the tax on excess accumulations in certain retirement accounts. The change is proposed to address legal questions that arise in the case of a nonresident filer who incurs any of these taxes.

The legal questions relate to the method prescribed for apportioning the federal income tax liability in the case of a nonresident filer.³ The problem is that while all three of the federal taxes in question are included in the federal income tax liability, the amounts on which they are based are not included in federal adjusted gross income, and therefore are not taken into account in the apportionment calculations. This lack of income representation in the nonresident apportionment calculations results in an unfair apportionment of the federal income tax liability by skewing it in favor of North Dakota. This raises discrimination and constitutional questions.

To address these legal questions, the Tax Commissioner proposes to exclude these three taxes from the federal income tax liability in the case of a nonresident filer. Because of the very

²See S.L. 1985, ch. 635. The inequity was that a taxpayer with both an alternative minimum tax and an investment tax credit paid more North Dakota income tax than another taxpayer with an identical tax situation except that the other taxpayer had no investment tax credit. This problem was attributable to how the investment tax credit was handled in the calculation of the alternative minimum tax.

³The starting point under the short form method of filing is the total federal income tax liability as defined under N.D.C.C. § 57-38-30.3(5). However, the total federal income tax liability must be adjusted to account for any income that is not subject to North Dakota income tax under federal or North Dakota law. Under current law, the prescribed method is to multiply the nonresident's federal income tax liability by the ratio of North Dakota income to total federal income. For example, if a nonresident's federal income tax liability on all income is \$1,000, and if the nonresident's total federal income is \$20,000 of which \$5,000 is taxable by North Dakota, the amount of the total federal income tax liability apportioned to North Dakota is \$250 $[(\$5,000 \div \$20,000) \times \$1,000]$.

limited application of these taxes and that the problem occurs only in the case of a nonresident filer, the fiscal impact of the proposed changes is considered negligible.⁴

Conclusion

For your information, the amendment of this bill by the House was made at the Tax Commissioner's request to correct two drafting errors.⁵

In addition to my written testimony, I am providing the Committee with copies of two tables that I prepared for its reference. Table 1 provides a cross-reference of the current language of the statute with the language in the proposed rewrite. The purpose of this table is to show that all federal items referenced in the current statute are accounted for in the proposed rewrite. Table 2 provides a breakdown of the provisions of the bill and describes each of the components making up the federal income tax liability for short form purposes. Table 2 also shows where the proposed changes occur.

The Tax Commissioner asks for the Committee's favorable consideration of House Bill 1113. If the Committee has any questions, I would be happy to respond to them.

⁴Due to the nature of all three of the federal taxes in question, they are not frequently encountered. In addition, the 5- and 10-year income averaging rules for lump-sum distributions under federal income tax law are being phased out: (1) The 5-year rules expire after 1999; and, (2) Except for individuals born before 1936, the 10-year rules were repealed for distributions after 1986.

⁵ One error involved the omission of language necessary to take into account special provisions affecting the federal income tax computation that Congress chooses to place in sections of the U.S. Internal Revenue Code other than sections 1 and 3. The second error involved a transposition of numbers in a federal code reference.

Table 1**Federal references in N.D.C.C. § 57-38-30.3(5):****Cross-reference of current language with new language in House Bill 1113
(First Engrossment)**

Prepared by Joseph Becker, Auditor/Research Specialist
 North Dakota Office of State Tax Commissioner
 January 1999

Reference in current language	Corresponding reference in proposed rewrite	
	Internal Revenue Code §	N.D.C.C. § 57-38-30.3(5)
1. Tax tables and tax rate schedules	I.R.C. §§ 1 and 3	Subsection 5 generally
2. Form 8615 (Tax For Children Under Age 14 Who Have Investment Income Of More Than \$1,400)	I.R.C. §§ 1 and 3	Subsection 5 generally
3. Form 4970 (Tax On Accumulation Distribution Of Trusts)	I.R.C. § 667(a)(2)	Subsection 5(c)
4. Form 4972 (Tax On Lump-Sum Distributions)	I.R.C. § 402(d)(1)	Subsection 5(b)
5. Section 72(m)(5) penalty tax	I.R.C. § 72(m)(5)	Subsection 5(d)
6. Form 5329 [Additional Taxes Attributable To Qualified Retirement Plans (Including IRAs), Annuities, Modified Endowment Contracts, And MSAs]	I.R.C. § 72(q)(1) I.R.C. § 72(t)(1) I.R.C. § 4973(a) I.R.C. § 4974(a) I.R.C. § 4980A	Subsection 5(e) Subsection 5(f) Subsection 5(g) Subsection 5(h) Subsection 5(i)
7. Form 6251 (Alternative Minimum Tax—Individuals)	I.R.C. § 55	Subsection 5(a)
8. Form 8656 (Alternative Minimum Tax—Fiduciaries) Note: This form is no longer used—now calculated on Schedule I, Form 1041.	I.R.C. § 55	Subsection 5(a)
9. Credit for prior year minimum tax (form 8801)	I.R.C. § 53	Subsection 5(j)
10. Credit for the elderly or the disabled (schedule R)	<p>These items do not have to be referenced in the rewrite of subsection 5 of section 57-38-30.3. The rewrite simplifies the content and structure of the subsection by specifically referencing only the federal taxes that are to be included in the federal income tax liability for purposes of the short form method.</p> <p>In addition, with respect to any federal tax credit, the rewrite specifically excludes all federal tax credits not specifically provided for in subsection 5 of section 57-38-30.3.</p>	
11. Credit for child and dependent care expenses (form 2441)		
12. Investment credit (form 3468)		
13. Foreign tax credit (form 1116)		
14. General business credit (form 3800)		
15. Jobs credit (form 5884)		
16. Credit for alcohol used as fuel (form 6478)		
17. Credit for increasing research activities (form 6765)		
18. Low income housing credit (form 8586)		
19. Nonconventional fuel credit Note: There is no special form for this credit.		
20. Federal income tax withheld		
21. Estimated tax payments		
22. Earned income credit		
23. Amount paid with Form 4868		
24. Excess social security tax withheld		
25. Excess federal Railroad Retirement Tax Act tax withheld		
26. Credit for federal tax on gasoline and special fuels (form 4136)		
27. Regulated investment company credits (form 2439)		
28. Self-employment tax		
29. Social security tax and railroad retirement tax on tips		

Table 2

Analysis of House Bill 1113 (First Engrossment):

Components of federal income tax liability and changes to current law

Prepared by Joseph J. Becker, Auditor III/Research Specialist, North Dakota Office of State Tax Commissioner
January 1999

Bill provisions		Description of federal provisions cited in bill			Change from current law
Page and line reference	N.D.C.C. § citation	I.R.C. § citation	Description of federal tax provision	Applicable federal form (1998)	
Page 2, lines 2–6	Subsection 5 (in general)	Section 1 Subsection a Subsection b Subsection c Subsection d Subsection e Subsection f Subsection g Subsection h	Individual income tax rates: Married filing joint and qualifying widow(er) Head of household Single Married filing separate Estate or trust income tax rates Indexing of tax rates Tax on unearned income of child under age 14— Income reported on child's return Income reported on parent's return Maximum capital gain tax rates— Individuals Estate or trust	An individual uses one of the following forms: Form 1040EZ (line 10) Form 1040A (line 25) Form 1040 (line 40) Schedule G (Form 1041) Form 8615 (Form 1040/1040A) Form 8814 (Form 1040) Schedule D (Form 1040) Schedule D (Form 1041)	No change; rewrite only.
Page 2, lines 2–6	Subsection 5 (in general)	Section 3	Alternate tax tables (individuals only)	Not applicable	No change; rewrite only.
Page 2, lines 7–8	Subdivision a of subsection 5	Section 55	Alternative minimum tax (AMT)— Individuals Estate or trust	Form 6251 (Form 1040) Schedule I (Form 1041)	Proposed change: Remove the adjustment for the investment tax credit allowed under current law.
Page 2, lines 9–12	Subdivision b of subsection 5	Section 402	Tax on a lump-sum distribution	Form 4972 (Form 1040/1041)	Proposed change: Add an exception to the inclusion of this tax in the case of a nonresident individual, estate or trust.
Page 2, lines 13–14	Subdivision c of subsection 5	Section 667	Tax on an accumulation distribution of a trust— Individuals Estate or trust	Form 4970 (Form 1040) Schedule G (Form 1041)	No change; rewrite only.
Page 2, lines 15–18	Subdivision d of subsection 5	Section 72(m)(5)	10% tax on excess benefits received from a qualified retirement plan or an annuity	No special form is provided—individuals include this tax on line 56, Form 1040.	No change; rewrite only.

Bill provisions		Description of federal provisions cited in bill			Change from current law
Page and line reference	N.D.C.C. § citation	I.R.C. § citation	Description of federal tax provision	Applicable federal form (1998)	
Page 2, lines 19–20	Subdivision e of subsection 5	Section 72(q)(1)	10% tax on an early distribution from an annuity contract	Form 5329, Part 1 (Form 1040)	No change; rewrite only.
Page 2, lines 21–22	Subdivision f of subsection 5	Section 72(t)(1)	10%* tax on an early distribution from a qualified retirement plan, individual retirement account (IRA), or I.R.C. § 457 plan *25% in the case of a SIMPLE IRA	Form 5329, Part 1 (Form 1040)	No change; rewrite only.
Page 2, lines 23–27	Subdivision g of subsection 5	Section 4973(a)	6% tax on excess contributions to an individual retirement account (IRA), medical savings account (MSA), individual retirement annuity under I.R.C. § 408(b), a custodial account treated as an annuity contract under I.R.C. § 403(b)(7)(A) (relating to custodial accounts for regulated investment company stock), and an education individual retirement account under I.R.C. § 530	Form 5329, Part 2 (Form 1040)	Proposed change: Add an exception to the inclusion of this tax in the case of a nonresident individual, estate or trust.
Page 2, lines 28–30	Subdivision h of subsection 5	Section 4974(a)	50% tax on excess accumulations in an individual retirement account (IRA), qualified retirement plan, or Section 457 plan	Form 5329, Part 4 (Form 1040/1041)	Proposed change: Add an exception to the inclusion of this tax in the case of a nonresident individual, estate or trust.
Page 3, lines 1–2	Subdivision i of subsection 5	Section 4980A	15% tax on excess distributions from a qualified retirement plan	Not applicable for 1998; repealed by the '97 Taxpayer Relief Act. Formerly calculated and reported on Form 5329, Part 4 (Form 1040).	No change; rewrite only.
Page 3, lines 3–4	Subdivision j of subsection 5	Section 53	Credit for prior year minimum tax	Form 8801 (Form 1040/1041)	No change; rewrite only.
Page 3, lines 5–6	Subsection 5 (in general)	N/A	N/A	N/A	No change; rewrite only.
<p>Amendment to bill as introduced—The amendment to the bill as introduced adds new language to account for any modifications to the calculation method or tax rates prescribed under I.R.C. §§ 1 and 3 that Congress chooses to place in other sections of the Internal Revenue Code. Notable examples include the following:</p> <ul style="list-style-type: none"> • I.R.C. § 641(c) provides for a special income tax computation on income that a trust receives from stock in a Subchapter S corporation. • I.R.C. § 1341 (sometimes referred to as the "claim-of-right" provision) provides for a special income tax calculation for taxpayers who are required to pay back income in a year following the year in which the taxpayer paid tax on the income. • I.R.C. § 1301, added by the Taxpayer Relief Act of 1997, provides for the new 3-year income averaging method for farmers. 					No change; rewrite only.