

ECONOMIC DEVELOPMENT TAX INCENTIVE STUDY - COMPUTER AND TELECOMMUNICATIONS EQUIPMENT SALES TAX EXEMPTION

Pursuant to North Dakota Century Code Section 54-35-26, created by 2015 Senate Bill No. 2057, a variety of economic development tax incentives are to be reviewed by a Legislative Management interim committee over the ensuing six-year period. The study is aimed at ensuring that economic development tax incentives are serving their intended purposes in a cost-effective and equitable manner. This memorandum has been provided to assist in the review of the computer and telecommunications equipment sales tax exemption and provides an explanation of the incentive, the perceived goals of the Legislative Assembly in creating or altering the incentive, and the data and testimony that will be required to conduct an effective analysis of the incentive.

EXPLANATION OF THE COMPUTER AND TELECOMMUNICATIONS EQUIPMENT SALES TAX EXEMPTION

Section 57-39.2-04.3 provides for a sales and use tax exemption for purchases of computer and telecommunications equipment made by primary sector businesses other than manufacturers and recyclers. The primary sector business must be certified by the Director of the Department of Commerce's Division of Economic Development and Finance and add value to a product, process, or service through the employment of knowledge or labor which results in the creation of new wealth. To qualify for the exemption, the computer or telecommunications equipment must be an integral part of a new primary sector business or create a physical or economic expansion of an existing primary sector business. Items purchased to replace existing computer or telecommunications equipment will not qualify for the exemption. To receive the exemption at the time of purchase, the primary sector business must receive a certificate from the Tax Commissioner verifying that the equipment the business intends to purchase qualifies for the exemption. If a certificate of exemption is not received prior to the business making the purchase, the business may apply to the Tax Commissioner for a refund of the applicable amount of tax paid. If a contractor purchases or installs the computer or telecommunications equipment, the primary sector business may apply for a refund of the amount of sales or use tax paid by the contractor on qualifying items.

PERCEIVED GOALS OF THE LEGISLATIVE ASSEMBLY IN CREATING OR ALTERING THE COMPUTER AND TELECOMMUNICATIONS EQUIPMENT SALES TAX EXEMPTION

The original provisions of Section 57-39.2-04.3 were created through the passage of 1991 House Bill No. 1048. At that time, Section 57-39.2-04.3 only provided for a sales and use tax exemption for purchases of manufacturing machinery and equipment purchased for use in a new manufacturing plant or for use in a physical or economic expansion of an existing manufacturing plant. Through the passage of 1993 Senate Bill No. 2051, the exemption was expanded to apply to purchases of manufacturing machinery and equipment purchased for use in new recycling facility or for use in a physical or economic expansion of an existing recycling facility. Additional qualifiers were added to the definition of "machinery" through the passage of 1993 Senate Bill No. 2509 and 1994 Special Session House Bill No. 1520. The expiration date tied to the exemption was removed in 1995, through the passage of Senate Bill No. 2077, and in 1999, the definition of "manufacturing" was broadened to include the refining of crude oil through the passage of Senate Bill No. 2421.

It was not until 2001 that the sales tax exemption pertaining to purchases of computer and telecommunications equipment first appeared. The passage of 2001 Senate Bill No. 2352 provided for the current language found in Section 57-39.2-04.3, which became effective for taxable events occurring after June 30, 2001. Upon a review of the legislative history relating to Senate Bill No. 2352, the perceived goal of the Legislative Assembly in providing this exemption was to promote a favorable business climate to encourage high-tech companies to locate in North Dakota and to encourage existing primary sector businesses to expand creating the potential for new jobs and economic growth. It was anticipated that the sales tax exemption for purchases of computer and telecommunications equipment would result in a total reduction of \$185,000 in general fund and state aid distribution fund revenues during the 2001-03 biennium.

Information provided to the Political Subdivision Taxation Committee by the Department of Commerce on July 29, 2015, indicates the amount of the sales tax exemption realized by all claimants during the 2013-15 biennium was less than \$1,772,462.

**DATA AND TESTIMONY REQUIRED TO CONDUCT AN EFFECTIVE ANALYSIS OF THE
COMPUTER AND TELECOMMUNICATIONS EQUIPMENT SALES TAX EXEMPTION**

Data pertaining to the following items will need to be collected to effectively analyze the incentive:

1. The number of claimants;
2. The fiscal impact of the incentive;
3. Employment opportunities, business growth, or diversity in the state's economy resulting from the availability of the incentive;
4. Negative impacts created as a result of the incentive; and
5. Out-of-state impacts resulting from the incentive.

Testimony will need to be solicited from the following parties to effectively analyze the incentive:

1. The Department of Commerce;
2. The Tax Department; and
3. The North Dakota Economic Development Foundation.