ECONOMIC DEVELOPMENT TAX INCENTIVES REVIEW - BACKGROUND MEMORANDUM

INTRODUCTION

North Dakota Century Code Section 54-35-26 (appendix), enacted by Senate Bill No. 2057 (2015), provides for the review of a specified list of economic development tax incentives and requires each incentive be reviewed at least once every 6 years. The Legislative Management selected the interim Taxation Committee to review tax incentives during the 2019-20 interim.

BACKGROUND

The practice of legislatively mandating the periodic review of economic development tax incentives began to gain popularity following the 2007-09 recession. As states continued to look at austerity options and ways to grow economies, reviewing tax incentives was viewed as sound public policy to ensure state dollars were being spent in a prudent and effective manner.

Washington was one of the first states to enact legislation mandating the review of tax incentives. Legislation enacted in Washington in 2006 requires periodic performance audits of tax preferences. Washington's review process requires a showing that the tax preference benefits the state's economy and mandates the review of each tax preference at least once every 10 years. The state's joint Legislative Audit and Fiscal Review Committee evaluates tax preferences to determine whether each tax preference is meeting its public policy objectives. The committee provides its report and recommendations to a seven-member citizen commission. After incorporating comments from the citizen commission, the committee forwards the final report to the Legislative Assembly.

Oregon takes a slightly different approach to reviewing incentives. Legislation enacted in Oregon 2009 placed sunset dates on 50 of the state's 53 active tax credits thereby prompting a review of each credit before renewal. Credits were divided into three groups, expiring at the end of 2011, 2013, and 2015, to stagger the sunset dates for purposes of review. The state passed additional legislation in 2013, which requires the preparation of a detailed report on each of the expiring credits. The majority of Oregon's tax credits expire after 6 years.

Iowa established its review process in 2010 through the creation of a Legislative Tax Expenditure Committee. The committee is tasked with reviewing each of the state's tax expenditures at least once every 5 years. The committee's evaluation must contain a statement on the policy goals of the tax expenditure and a return on investment calculation. The return on investment calculation must include a statement identifying whether the benefits of the tax expenditure are worth the costs of providing the tax expenditure.

In 2012 The Pew Charitable Trusts (Pew) began tracking the progress states were making in evaluating tax incentives and published a report entitled *Evidence Counts: Evaluating State Tax Incentives for Jobs and Growth*. The report identified states leading the way in evaluating the effectiveness of tax incentives, states meeting some of the criteria for effective evaluations, and states not meeting any criteria in terms of the scope or quantity of evaluations. Pew continues to publish materials relating to incentive evaluations and provides periodic updates of each state's national rating in evaluating incentives.

In the most recent May 2019 update, Pew identified 16 states leading the way in evaluating incentives, 15 states making progress in evaluating incentives, and 19 states trailing behind in evaluating incentives. Pew classifies leading states as those with well-designed plans to regularly evaluate incentives, experience producing quality evaluations that measure economic impact, and a process for informing policy choices. States classified as making progress are states that have enacted policies that require regular evaluations of major tax incentives. States classified as trailing behind are states that lack a well-designed plan to regularly evaluate incentives.

North Dakota joined the ranks of states identified as leaders in evaluating incentives in Pew's May 2019 state evaluation rating update. Pew credited North Dakota's improved rating to the state's review of the dynamic economic impact of incentives. The dynamic economic impact of incentives was evaluated through the receipt of economic impact reports provided by the Bank of North Dakota. The Bank created the reports using economic modeling software it acquired in 2017.

CREATION OF NORTH DAKOTA'S REVIEW PROCESS

North Dakota instituted a formal economic development tax incentive review process by enacting Senate Bill No. 2057 (2015), which has been codified as Section 54-35-26. The impetus behind the introduction of Senate Bill No. 2057 was by directive of the chairman of the Legislative Management to the 2013-14 interim Taxation Committee to study state economic development tax incentives. The study directed consideration of whether a regular review process should be established to ensure economic development tax incentives are serving the purposes for which the incentives were created.

The 2013-14 interim Taxation Committee received testimony from multiple parties to determine the best practices for evaluating tax incentives. The committee received testimony from a representative of Pew pertaining to methods the organization had observed and analyzed in other states that evaluate tax incentives. The committee also arranged a panel discussion comprised of representatives from Pew, the City of Bismarck, the Economic Development Association of North Dakota, and the Department of Commerce to gain insight on the best methods to apply when evaluating incentives.

The committee reviewed data provided by representatives of the Tax Department and the Department of Commerce, which detailed the number of claimants and the amounts claimed for various tax incentives. The committee used this information to select the incentives best suited for periodic review. The committee developed a list of considerations to take into account when conducting evaluations. The committee also determined it was prudent to review the purpose for which each incentive was created to ascertain whether the incentive was generating the intended results.

STATUTORY PROVISIONS

Section 54-35-26 directs the review of specified economic development tax incentives by an interim committee selected by the Legislative Management. The review entails an assessment of whether each listed incentive is serving the purposes for which it was enacted in a cost-effective and equitable manner. The statute, as originally enacted, included a list of 21 incentives. The statute requires each incentive be reviewed at least once every 6 years and provides the eight items that may be considered when evaluating incentives:

1. The extent of achievement of the goals of the incentive and whether unintended consequences have developed in its application;
2. Whether the design and application of the incentive can be improved;
3. The extent of complementary or duplicative effects of other incentives or governmental programs;
4. Whether the incentive has a positive influence on business behavior or rewards business behavior that is likely to have occurred without the incentive;
5. The effect of the incentive on the state economy, including the extent of primary sector operation of the recipient and any competitive disadvantage imposed or benefit conferred on other state businesses, any benefit or burden created for local government, and the extent of the incentive's benefit that flows to out-of-state concerns;
6. The employment opportunities generated by the incentive and the extent those represent career opportunities;
7. Whether the incentive is the most effective use of state resources to achieve desired goals; and
8. If the committee's analysis of the incentive is constrained by lack of data, whether statutory or administrative changes should be made to improve collection and availability of data.

The statute requires the interim committee to identify the list of incentives that will be reviewed each interim before October 1 of each odd-numbered year and provide a plan for reviewing any remaining incentives. The committee is required to identify the perceived goals of the Legislative Assembly in creating or altering each of the economic development tax incentives selected for review and the data and testimony required to evaluate each incentive. The committee may request data and analysis from state agencies or instrumentalities, including the Department of Commerce, the Tax Commissioner, and the Economic Development Foundation. If the requested data is not available, or is available but cannot be disclosed, the entity receiving the request shall advise the committee on options for obtaining the information or an adequate substitute.

The committee is required to report its findings and recommendations, together with any legislation required to implement those recommendations, to the Legislative Management at the conclusion of its review. In addition to issuing recommendations related to the operation of incentives, the committee's recommendations also may include changes to the list of incentives subject to review and amendments to the substantive provisions of the statute.

2015-16 INTERIM COMMITTEE REVIEW AND LEGISLATION

The Political Subdivision Taxation Committee was the interim committee tasked with reviewing tax incentives during the 2015-16 interim. The committee received information from representatives of the Department of Commerce and the Tax Department to assist in determining which incentives to review during the 2015-16 interim.

The committee elected to review all income tax incentives, incentives scheduled to expire in 2017, incentives seeing little to no use, and the manufacturing automation equipment tax credit. The manufacturing automation equipment tax credit was selected pursuant to the statement of legislative intent in Senate Bill No. 2340 (2015), which encouraged the review of this incentive during the 2015-16 interim. The committee selected 14 incentives for review from the statutorily mandated list and four additional incentives that were not statutorily mandated for review.

At the conclusion of its study, the committee declined to recommend any changes to the soybean, canola, biodiesel, or agricultural commodity processing facility credits. The committee refrained from recommending legislation to extend or eliminate the sunset date on the sales tax exemption for wind-powered electrical generating facilities as the interim Energy Development and Transmission Committee recommended House Bill No. 1028 (2017) to eliminate the sunset date. House Bill No. 1028 failed to pass. The committee did not have adequate time to review the geothermal, solar, wind, and biomass energy device credit; research expense credit; internship program credit; workforce recruitment credit; new jobs credit from income tax withholding; new or expanding business exemption; or renaissance zone credits and exemptions. The committee recommended a future interim committee review these incentives.

In regard to the remaining incentives selected by the committee for review, eight bills were recommended for introduction during the 2017 legislative session.

1. House Bill No. 1044, to provide a uniform definition of "primary sector business."
2. House Bill No. 1045, to increase allowable credit amounts and carryforward periods related to the seed capital investment tax credit and sunset the availability of the angel fund investment tax credit for investments made after December 31, 2017.
3. House Bill No. 1046, to eliminate the sunset date of June 30, 2017, on the telecommunications infrastructure sales tax exemption.
4. House Bill No. 1047, to eliminate the sunset date of December 31, 2017, on the manufacturing automation equipment income tax credit.
5. House Bill No. 1048, to repeal the certified nonprofit development corporation income tax credit.
6. House Bill No. 1049, to repeal the wage and salary income tax credit.
7. House Bill No. 1050, to repeal the microbusiness income tax credit.
8. Senate Bill No. 2044, to allow the interim committee selected to review economic development tax incentives during the 2017-18 interim to obtain software capable of generating dynamic fiscal impact statements for incentives selected for review.

The 2017 Legislative Assembly enacted all but House Bill Nos. 1046 and 1047, which failed to pass. House Bill No. 1045 and Senate Bill No. 2044 were amended substantially prior to passage. House Bill No. 1045 was modified from a bill that eliminated the angel fund credit and expanded the seed capital credit to a bill that sunsets the angel fund tax credit and created a new angel investor tax credit. Senate Bill No. 2044 was modified from a bill that allowed the interim committee studying incentives to obtain fiscal impact analysis software for use during the 2017-18 interim to a bill that allowed the committee to receive dynamic fiscal impact analysis from the Bank of North Dakota during the 2017-18 interim.

In addition to the bills recommended by the interim committee, other relevant legislation passed by the 2017 Legislative Assembly pertaining to Section 54-35-26 included Senate Bill No. 2166, which added development or renewal area incentives to the statutory list of incentives designated for review.

2017-18 INTERIM COMMITTEE REVIEW AND LEGISLATION

The Taxation Committee was the interim committee tasked with reviewing tax incentives during the 2017-18 interim. The committee selected seven incentives to review from the list in Section 54-35-26. Six of the seven incentives selected for review included incentives selected during the 2015-16 interim, which the Political Subdivision Taxation Committee had insufficient time to analyze. The Taxation Committee selected the new jobs credit from income tax withholding, the internship program credit, the workforce recruitment credit, the research expense credit, new or expanding business exemptions, renaissance zone tax credits and exemptions, and development or renewal area incentives including tax increment financing incentives.

At the conclusion of its study, the committee declined to recommend any changes to the incentives selected for review. The committee received a significant amount of testimony and information regarding workforce incentives. The committee did not recommend eliminating the internship program credit or workforce recruitment credit, despite the limited use of the credits, as the committee determined the credits might be used more widely in the future considering the state's increasing workforce needs. The committee recommended legislation that reached beyond the scope of existing workforce incentives in an attempt to address increasing workforce needs. The committee recommended Senate Bill No. 2039, to create a skilled workforce scholarship program, and House Bill No. 1040, to create a 21st century manufacturing workforce income tax credit, for introduction during the 2019 legislative session.

The 2019 Legislative Assembly enacted House Bill No. 1040 in a form substantially similar to the draft legislation recommended by the committee. The only changes to the 21st century manufacturing workforce credit as enacted was the addition of an expiration date and a reduction in the annual available credit amount from $2 million to $1 million. The skilled workforce scholarship program provisions in Senate Bill No. 2039 failed to pass; however, a skilled workforce scholarship program was successfully enacted by House Bill No. 1171.

2019-20 INTERIM COMMITTEE REVIEW

The Taxation Committee is the interim committee tasked with reviewing tax incentives during the 2019-20 interim. The following chart provides the incentives reviewed in previous interims and the remaining incentives that must be reviewed during the 2019-20 interim, before the end of the first 6-year review cycle.

First 6-Year Review Cycle		
2015-16 Interim	**2017-18 Interim**	**2019-20 Interim**
Agricultural commodity processing facility investment tax credit	Renaissance zone credits and exemptions	Manufacturing and recycling equipment sales tax exemption
Angel fund investment tax credit	Research expense credit	Fertilizer or chemical processing facility sales tax exemption
Biodiesel fuel credits	Internship program credit	Carbon dioxide capture and injection sales tax exemption
Manufacturing automation tax credit	Workforce recruitment credit	Qualified data center sales tax exemption
Microbusiness income tax credit	New or expanding business exemptions	Fuel tax refunds
Seed capital investment tax credit	New jobs credit from income tax withholding	Coal severance and conversion tax exemptions
Soybean or canola crushing facility credit	Development or renewal area incentives	Oil and gas gross production and oil extraction tax exemptions
Wage and salary credit		
Certified nonprofit development corporation investment tax credit		
Electrical generating facilities sales tax exemption		
Geothermal, solar, wind, and biomass energy device credit		
Telecommunications infrastructure sales tax exemption		

STUDY APPROACH

Unlike in previous years, the committee is not required to select which incentives to carry forward for review during the next interim because this is the last review period in the first 6-year review cycle. In reviewing the final seven incentives mandated for study under Section 54-35-26, the committee may find it helpful to receive:

1. Background information on each of the incentives selected for review;
2. Fiscal information detailing the number of claimants and amount claimed for each incentive; and
3. Testimony from interested parties regarding the use of the incentives selected for review.

ATTACH:1