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ECONOMIC DEVELOPMENT TAX INCENTIVE STUDY - AGRICULTURAL COMMODITY PROCESSING FACILITY INVESTMENT TAX CREDIT

Pursuant to North Dakota Century Code Section 54-35-26, enacted in 2015, a variety of economic development tax incentives must be reviewed by a Legislative Management interim committee once in each 6-year review cycle. 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 agricultural commodity processing facility investment tax credit and provides an explanation of the incentive, the perceived goals of the Legislative Assembly in creating or altering the incentive, the outcome of past reviews of the incentive, and the data and testimony required to conduct an effective analysis of the incentive.

EXPLANATION OF THE AGRICULTURAL COMMODITY PROCESSING FACILITY INVESTMENT TAX CREDIT

Section 57-38.6-03 provides for an agricultural commodity processing facility investment tax credit. The incentive is available to all income taxpayers and allows for a credit against state income tax liability for qualified investments made in a qualifying business. A "qualifying business" is defined in Section 57-38.6-01 as an entity organized or incorporated in this state after December 31, 2000, for the primary purpose of being an agricultural commodity processing facility. A qualifying business must be certified by the Securities Commissioner, be in compliance with North Dakota security laws, and either have an agricultural commodity processing facility in this state or intend to locate a facility within this state. Section 57-38.6-01 provides that an agricultural commodity processing facility consists of a facility that adds value to an agricultural commodity raised in this state or a livestock feeding, handling, milking, or holding operation that uses a byproduct from a biofuels production facility.

The credit is equal to 30 percent of the amount of the qualified investment which may consist of direct cash payments, direct cash transfers from a retirement plan if the investor maintains a separate account and controls where the plan's assets are invested, or transfers of a fee simple interest in real property in this state. A qualifying investment must be at risk in the qualifying business for at least 3 years and must be in the form of a purchase ownership interest or right to receive payment of dividends from the business. Investments placed in escrow will not qualify for the credit. A qualifying business must expend investment amounts for equipment, plant facilities, research and development, marketing, or working capital. Investments consisting of real property must be used as an integral part of a qualifying business's operations in this state.

A taxpayer may claim no more than $50,000 in credits per taxable year and no more than $250,000 in credits over any combination of taxable years. Credit amounts exceeding a taxpayer's liability may be carried forward for up to 10 taxable years following the year in which the investment was made. A passthrough entity entitled to the credit must be considered the taxpayer for purposes of the credit and the amount of credit allowed must be determined at the passthrough entity level and passed through to the entity's partners, shareholders, or members in proportion to their respective ownership interests in the passthrough entity. Pursuant to Section 57-38.6-06, a qualified business must file with the investor, the Tax Commissioner, and the Director of the Department of Commerce's Division of Economic Development and Finance information identifying each taxpayer making an investment, the amount remitted by the taxpayer, and the date on which the investment was received by the qualifying business.

PERCEIVED GOALS OF THE LEGISLATIVE ASSEMBLY IN CREATING OR ALTERING THE AGRICULTURAL COMMODITY PROCESSING FACILITY INVESTMENT TAX CREDIT

Provisions relating to an agricultural commodity processing facility investment tax credit were first enacted through the passage of Senate Bill No. 2386 (2001). The bill provided a credit to individual income taxpayers for investments in a cooperative or limited liability company organized to process and market agricultural commodities, having an agricultural commodity processing facility in this state, and having a majority of its ownership interests owned by producers of unprocessed agricultural commodities. The maximum annual investment for which the credit was allowed was $20,000 and no more than 50 percent of the credit could be claimed in a single taxable year. The credit also could not exceed 50 percent of the taxpayer's income tax liability. Investments were required to remain in a qualifying business for the same period of time, and be expended for the same purposes, as specified in current law.

Upon a review of the legislative history relating to Senate Bill No. 2386, the perceived goal of the Legislative Assembly in creating this credit was to provide an incentive to encourage investment in value-added processing facilities for North Dakota commodities. The credit was described as a tool that would benefit producers, create jobs, and reduce reliance on federal assistance to maintain farm income. Credits related to the production and sale of ethanol in Minnesota and South Dakota were discussed and it was noted that the average cost of constructing an ethanol plant was roughly $40 million. The estimated fiscal effect of the agricultural commodity processing facility investment tax credit could not be determined during the 2001 legislative session.

In 2005, the credit was amended through the passage of Senate Bill No. 2281, which broadened the credit by allowing qualifying investments to be made by corporations and passthrough entities but limited the credit to investments made in the first 10 qualifying businesses. The bill also increased the maximum annual credit limit allowed per taxpayer from $20,000 to $50,000 and capped the lifetime amount of credits available per taxpayer to $250,000. The bill also reduced the carryforward period from 15 to 5 years and included provisions relating to the amount of credit that could be claimed per year by a taxpayer that made an investment before 2005, but did not qualify for the credit due to limitations provided in the seed capital investment tax credit. The changes made by the bill were intended to make the credit more functional and more user-friendly. The fiscal impact of expanding the credit to corporations and passthrough entities could not be determined during the 2005 legislative session.

Senate Bill No. 2081 (2007) further amended the credit to require that qualifying investments be in the form of cash or a fee simple interest in real property in this state. The bill also revised provisions relating to certification of qualified businesses and credit limitations and extended the carryforward period from 5 to 10 years. The remaining changes to the credit were mostly technical in nature and occurred during the 2009 and 2013 legislative sessions. The passage of House Bill No. 1324 (2009) eliminated the optional long-form filing method (Form ND-2) and replaced it with a simplified filing method for any taxpayer who did not have tax deductions or credits, and House Bill No. 1106 (2013) streamlined the lengthy description of a passthrough entity by providing a definition of the term at the outset of the income tax chapter.

PAST REVIEW OF THE AGRICULTURAL COMMODITY PROCESSING FACILITY INVESTMENT TAX CREDIT

The agricultural commodity processing facility investment tax credit was last reviewed by the 2015-16 interim Political Subdivision Taxation Committee. During the course of its study, the committee received information from representatives of the Tax Department and the Department of Commerce detailing the amount claimed for the credit and the number of claimants. The committee was informed 17 investors in agricultural commodity processing facilities earned credits totaling $12,497,869 for investments in 23 companies since 2001. Of the 23 companies that received investments, 12 remained in operation. The total direct, indirect, and induced employment related to the credit amounted to 331 jobs in 2014. The cost of offering the incentive as compared to the increase in state tax revenue resulting from the availability of the incentive amounted to a 9.5 percent annual rate of return in 2014. Incentives similar to the agricultural commodity processing facility investment tax credit are found in six other states.

The committee also received information pertaining to the differences between the soybean and canola crushing facility equipment credit and the agricultural commodity processing facility investment tax credit. The primary difference between the credits is that a company receives the benefit under the first incentive and a taxpayer investing in a company receives the benefit under the second incentive. The soybean and canola crushing facility equipment credit serves to motivate companies to locate to this state, whereas the agricultural commodity processing facility investment tax credit encourages investment in processing facilities already located in this state. The committee received testimony from representatives of the North Dakota Ethanol Producers Association, the North Dakota Association of Rural Electric Cooperatives, and various other industry representatives in support of retaining the investment tax credit. The committee did not recommend any legislation to eliminate or modify the credit.

DATA AND TESTIMONY REQUIRED TO CONDUCT AN EFFECTIVE ANALYSIS OF THE AGRICULTURAL COMMODITY PROCESSING FACILITY INVESTMENT TAX CREDIT

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.