TAXATION COMMITTEE

The Taxation Committee was assigned four studies for the 2021-22 interim:

- Section 45 of House Bill No. 1015 (2021) directed a study of the fiscal impact of providing a sales tax exemption for raw materials critical to the manufacturing process used to support biologic product generation, product impurity removal, chemical or physical product alteration, and analysis of in-process to final deliverable products.
- Section 1 of Senate Bill No. 2299 (2021) directed a study of the desirability and feasibility of providing a credit against the purchase of a motor vehicle in an amount not to exceed the total amount the person received for the private sale of the vehicle being replaced for purposes of calculating the motor vehicle excise tax.
- The Legislative Management assigned a study of economic development tax incentives pursuant to North Dakota Century Code Section 54-35-26.
- The Chairman of the Legislative Management assigned the committee the responsibility to study the feasibility and desirability of providing holistic tax reform and relief, focusing primarily on property tax relief and, to a lesser extent, income tax relief.

The Legislative Management assigned the committee the responsibility to receive four reports:

- An annual report from the Tax Commissioner on statewide property tax increases, pursuant to Section 57-20-04.
- An annual report from the Department of Commerce's Division of Community Services on renaissance zone progress, pursuant to Section 40-63-03(2).
- An annual report from the Department of Commerce compiling reports from cities that have renaissance zone property included in a tax increment financing district, pursuant to Section 40-63-03(10).
- A compilation and summary of state grantor reports filed annually by the Department of Commerce and the reports of state agencies that award business incentives for the previous calendar year, pursuant to Section 54-60.1-07.

Committee members were Senators Dale Patten (Chairman), Scott Meyer, Merrill Piepkorn, and Mark F. Weber and Representatives Dick Anderson, Jason Dockter, Robb Eckert, Patrick Hatlestad, Craig Headland, Tom Kading, Jim Kasper, Ben Koppelman, Vicky Steiner, and Wayne A. Trottier.

BIOLOGIC MANUFACTURING SALES TAX EXEMPTION STUDY

Section 45 of House Bill No. 1015 (2021) directed a study of providing a sales tax exemption for raw materials critical to the manufacturing process used to support biologic product generation, product impurity removal, chemical or physical product alteration, and analysis of in-process to final deliverable products.

Background

A sales tax exemption for materials used in the research and development of bioscience and biotechnology was proposed in House Bill No. 1456 (2021), which failed to pass, before being added as a study to House Bill No. 1015. House Bill No. 1456 would have provided a sales and use tax exemption for gross receipts from sales of tangible personal property purchased for the use, storage, or consumption directly and predominately in the research and development of bioscience and biotechnology. Bioscience was defined in the bill as the use of compositions, methods, and organisms in cellular and molecular research, development, and manufacturing processes in areas, including pharmaceuticals, medical therapeutics, medical diagnostics, medical devices, medical instruments, biochemistry, microbiology, veterinary medicine, plant biology, and agriculture and industrial, environmental, and homeland security applications of bioscience. Biotechnology was defined in the bill as the application of technologies to produce or modify products, to develop micro-organisms for specific uses, to identify targets for small pharmaceutical development, or to transform biological systems into useful processes or products. The term also was defined as the potential endpoints of the resulting products, processes, micro-organisms, or targets for improving human or animal health care outcomes. For purposes of the exemption, tangible personal property was defined to include capital equipment, instruments, apparatuses, inputs, and supplies used in laboratories, including microscopes, machines, glassware, chemical reagents, computers, computer software, and technical books and materials. The estimated fiscal impact of House Bill No. 1456 could not be determined during the 2021 legislative session.

Testimony provided on House Bill No. 1456 indicated the bioscience and biotechnology industry spans many markets, including manufacturing, services, and research activities. The bill received support from various economic development entities, the Bioscience Association of North Dakota, the North Dakota Soybean Growers Association, and a bioscience firm located in the state.

Sales and Use Tax Imposition and Exemptions

The application of sales and use tax is governed by Chapters 57-39.2 and 57-40.2. A sales tax of 5 percent is imposed on the gross receipts of retailers for all sales at retail of tangible personal property. The tax is paid by the purchaser and collected and remitted by the retailer. Use tax, which also is imposed at a rate of 5 percent, is applied to tangible personal property purchased at retail for storage, use, or consumption in this state or tangible personal property purchased outside this state but later brought into this state. Use tax is applied to the purchase price of an item at the time of purchase, or to the fair market value of the item at the time it is brought into this state. Use tax must be paid directly by the person storing, using, or consuming the property in the state if the tax was not remitted by the retailer at the time of purchase.

A wide range of products, services, and activities are exempt from the imposition of sales and use tax. In addition, various groups and entities, such as hospitals, schools, and state and federal governments, are exempt from paying sales and use tax on some, or all, of their purchases. Sales tax exemptions specific to manufacturing include the exemption provided in Section 57-39.2-04.3 for machinery or equipment used primarily for manufacturing or agricultural processing or solely for recycling.

Notable sales and use tax exemptions specifically targeting the bioscience and biotechnology industry include exemptions provided in Connecticut, Maine, Missouri, Texas, and Wisconsin. With the exception of House Bill No. 1456, no other recent legislation has been proposed in North Dakota relating to a sales tax exemption for materials used in the research and development of bioscience or biotechnology.

Testimony and Committee Considerations

The committee received information from representatives of the Bioscience Association of North Dakota regarding the bioscience and biotechnology industry in North Dakota and the potential benefits of a sales tax exemption specifically targeted to the bioscience and biotechnology industry. The committee was informed North Dakota is recognized as an upcoming leader in the biotechnology industry. According to a 2018 study conducted by the Biotechnology Innovation Organization, the bioscience and biotechnology industry adds $267.3 million per year to the North Dakota economy. As of 2020, 3,959 people were employed in the bioscience and biotechnology industry at over 570 establishments in the state with an average annual wage of $73,937. Since 2018, the number of bioscience and biotechnology entities in the state increased by 8.7 percent, and the number of bioscience and biotechnology industry employees in the state increased by 83.3 percent.

Representatives of the Bioscience Association of North Dakota indicated sales and use tax imposes a greater burden on bioscience and biotechnology companies than income tax. Bioscience and biotechnology companies review available sales tax exemptions when determining whether to locate their businesses in the state. Thirty-eight states provide a sales tax exemption applicable to equipment used in research and development, 36 states provide a sales tax exemption applicable to equipment purchased for biomanufacturing, and 11 states provide sales tax exemptions specifically targeted to bioscience firms. A number of states offer a more competitive business environment for the bioscience industry than North Dakota, including California, Massachusetts, New Jersey, New York, Connecticut, Pennsylvania, Maryland, North Carolina, and Texas.

The committee received testimony from the Tax Department regarding the application of the sales tax exemption applicable to certain raw materials. The committee was informed when a piece of tangible property is sold, it is subject to sales tax unless there is an exemption. If a product is sold as a raw material to be used in the production of another product, the company purchasing the raw material to incorporate into the final product can purchase the raw material without paying tax. However, if there are reagents, resins, or chemicals that react with the product but do not become part of the final product, those materials are considered consumables and are subject to sales tax.

The committee received testimony from representatives of the bioscience and biotechnology industry regarding the industry and the benefits of a sales and use tax exemption related to biologic and biotechnology research and development and manufacturing. The committee was informed the state has a growing ecosystem for bioscience and biotechnology. Providing a sales and use tax exemption related to biologic and biotechnology research, development, and manufacturing would be a tool to strengthen the bioscience and biotechnology ecosystem in the state by attracting biologic and biotechnology research and development projects.

Committee members recognized the bioscience and biotechnology industry is growing and acknowledged providing tax incentives to this industry may result in an increase in bioscience and biotechnology companies relocating to the state and may create more jobs in North Dakota communities. Committee members also analyzed state tax and finance incentives available to the bioscience and biotechnology, manufacturing, and agricultural industries to determine which incentives are available to the bioscience and biotechnology industry and elected not to proceed with recommending any additional incentives.

Conclusions

The committee makes no recommendations in regard to its study of providing a sales tax exemption for raw materials critical to the manufacturing process used to support biologic product generation, product impurity removal, chemical or physical product alteration, and analysis of in-process to final deliverable products.

MOTOR VEHICLE EXCISE TAX CREDIT STUDY

Senate Bill No. 2299 (2021) directed a study of the desirability and feasibility of providing a credit against the purchase of a motor vehicle in an amount not to exceed the total amount the person received for the private sale of the vehicle being replaced for purposes of calculating the motor vehicle excise tax. The study required a review of the current law applied to credits for trade-ins, motor vehicle sale industry practices, vehicles of a certain age, and the potential fiscal and technological impact on the state. The study also required consideration of the potential for tax fraud, the effect on child support collections, and implications regarding consumer protection.

Background

The provision of a motor vehicle excise tax credit against the purchase price of a replacement vehicle in an amount not to exceed the amount the person received for the sale of the vehicle the person is replacing was proposed in Senate Bill No. 2312 (2021), which failed to pass. The bill, in part, required the purchaser of the vehicle being replaced to provide the seller a copy of the motor vehicle purchaser's certificate required under Section 57-40.3-05. The bill required the seller to attach a copy of the purchaser's certificate to the seller's application for a certificate of title for the replacement vehicle. The bill allowed the credit to be claimed within 3 years of the date of sale listed on the purchaser's certificate. The fiscal note for the bill estimated a revenue reduction of $38,926,788 per biennium as a result of providing the credit. The fiscal note also indicated the Department of Transportation (DOT) would require two additional full-time equivalent (FTE) positions to process the additional workload resulting from the credit, at a cost of $247,056 per biennium.

Testimony provided on Senate Bill No. 2312 indicated concerns regarding the unequal motor vehicle excise tax treatment applied to the purchase of a replacement vehicle when the vehicle being replaced was traded in at the dealership versus sold in a private party sale. Currently, a trade-in credit only is allowed on retail motor vehicle sales.

Testimony provided by a representative of DOT indicated the expanded application of the credit would result in a significant increase in staff time to verify ownership and eligibility for the credit, increased service delivery time per transaction, and significant opportunities for misuse. Testimony provided by a representative of the Automobile Dealers Association of North Dakota in opposition to the expansion of the credit indicated more stringent consumer protection regulations apply to transactions entered by motor vehicle dealers than those entered by private parties, which might expose consumers to fraud or overestimated prices. The potential for avoidance of child support payments also was raised as a concern. Testimony indicated a lien is placed on a motor vehicle owned by an individual with an outstanding child support obligation. When the vehicle is sold, a motor vehicle dealer conducts a lien search and remits any required amount of the sale price to the Child Support Enforcement Division. In a private sale, the lien likely will go unnoticed unless the lien is marked on the title, which is uncommon. Concerns also were expressed regarding the potential for tax fraud in the absence of a sound method for validating the date of the sale and the purchase price of the motor vehicle sold in a private sale. Testimony addressed a partial solution to the issue Senate Bill No. 2312 sought to remedy. Testimony referenced "in and out" or "paper trade" transactions, which allow a purchaser to purchase a vehicle from a dealer and sell the vehicle they are replacing to a third party through the dealer, rather than directly. This practice allows the consumer to realize a tax credit on the trade-in.

In addition to the directive to study the law applied to vehicles of a certain age in Senate Bill No. 2299, a motor vehicle excise tax exemption also was proposed for the sale of vehicles of a certain age in Senate Bill No. 2255 (2021), which failed to pass. Senate Bill No. 2255 provided an exemption from motor vehicle excise tax for the sale of a vehicle that is at least 40 years old. The Department of Transportation indicated approximately 6,900 vehicles that are at least 40 years old are sold each year in the state. Based on the data provided by DOT, the estimated reduction in general fund and state aid distribution revenues anticipated as a result of the exemption was $1.3 million for the 2021-23 biennium. Testimony provided on Senate Bill No. 2255 indicated the vehicle age threshold of 40 years was selected because that is the age required for vehicles to qualify for antique license plates for a one-time registration fee of $10.

Motor Vehicle Excise Tax Imposition

Pursuant to Section 57-40.3-02, any vehicle required to be registered in North Dakota is subject to a motor vehicle excise tax of 5 percent of the purchase price of the motor vehicle. The purchase price of a motor vehicle equals the sales price less any trade-in amount, or the fair market value of the vehicle if the vehicle is acquired in a manner other than by purchase. The tax is in addition to motor vehicle registration fees imposed for license plates. The tax is collected by the Director of DOT who acts as an agent of the Tax Commissioner.

Recent Legislation

In addition to Senate Bill Nos. 2312 and 2255, which failed to pass, one additional bill relating to the imposition of motor vehicle excise tax was introduced during the 2021 legislative session. Senate Bill No. 2277, which was enacted by the 67th Legislative Assembly, created a motor vehicle excise tax exemption for any motor vehicle transferred from an individual to a former spouse of the individual if the transfer results from a divorce decree and occurs within 1 year after the date the divorce became final.

Testimony and Committee Considerations

The committee received testimony from a representative of DOT regarding the fiscal impact of Senate Bill Nos. 2312 and 2255. The committee was informed the data used to prepare the fiscal notes associated with the bills was car sales data for calendar years 2019 and 2020 and indicated a $1.3 million loss in revenue. The loss in revenue depicted on the fiscal note associated with Senate Bill No. 2255 was based on the number of vehicles that did not qualify for a motor vehicle exemption at that time, but would have qualified if the 67th Legislative Assembly had enacted Senate Bill No. 2255. The fiscal note associated with Senate Bill No. 2312 reflected an approximately $39 million loss in motor vehicle excise tax collections due to the proposed expansion of a purchase price tax credit for private motor vehicle sale transactions and the cost associated with two additional full-time employees.

The committee received information from a representative of the Department of Human Services regarding the child support lien registry. The committee was informed any real or titled property of an obligor or acquired by an obligor who is listed on the child support lien registry is subject to a lien. However, a child support lien is not effective against a good-faith purchaser of titled personal property unless the lien is recorded on the vehicle title. This good-faith purchasers exception protects individuals who are not in the business of buying and selling cars and are not aware of the law. The committee also was informed over 870 child support payments are made each year based on the online lien registry maintained by the department. An increase in private car sales to good-faith purchasers as compared to retail car sales likely will result in less past-due child support being collected.

The committee received testimony from a representative of the Tax Department regarding the history of motor vehicle excise tax and the application of a trade-in credit for retail motor vehicle sales. The committee was informed the state first imposed a tax in 1937 on a motor vehicle's selling price when registering it for the first time or applying for a certificate of title. In 1963, the state enacted a motor vehicle excise tax to be assessed on motor vehicles in lieu of personal property tax. This 1963 legislation did not include a trade-in allowance as part of the definition of the taxable purchase price. Legislation passed in 1965 amended the motor vehicle excise tax laws to ensure casual motor vehicle sales were subject to the motor vehicle excise tax and to add a motor vehicle trade-in allowance credit. Legislation passed in 1969 expanded the trade-in allowance credit to include additional trade-in items that would be subject to sales or use tax. The committee was informed of 6 of the 45 states that collect tax on sales of motor vehicles do not offer a trade-in tax credit on the retail sale of motor vehicles.

The committee received testimony from a representative of the Automobile Dealers Association of North Dakota. Testimony indicated the committee should review various items when considering the expansion of the motor vehicle excise tax credit to include private motor vehicle sales, including consumer protection issues, increased potential for tax fraud, lost tax revenue, and adverse effects on child support enforcement. Testimony indicated an "in and out" or "paper trade" sale is an available alternative to a private motor vehicle sale which would allow a consumer to claim the motor vehicle excise tax credit. In this type of sale, an automobile dealer purchases a trade-in vehicle from the consumer at the price the consumer was going to sell the vehicle to the third party and then immediately sells the vehicle to the third party at cost without any fees. This alternative allows a consumer to realize a tax credit on the trade-in.

Committee members expressed mixed opinions regarding expansion of the motor vehicle excise tax credit to include private motor vehicle sales. Committee members acknowledged the potential advantage provided to motor vehicle dealerships resulting from a trade-in credit being available to dealerships on retail motor vehicle sales and not to individuals who engage in private party vehicle sales. The committee determined an "in and out" or "paper trade" sale is a sufficient alternative to providing a credit applicable to private motor vehicle sales.

Conclusions

The committee makes no recommendations in regard to its study of the desirability and feasibility of providing a credit against the purchase of a motor vehicle in an amount not to exceed the total amount the person received for the private sale of the vehicle being replaced for purposes of calculating the motor vehicle excise tax.

ECONOMIC DEVELOPMENT TAX INCENTIVES STUDY

Section 54-35-26, 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 2021-22 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.

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. 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. The report describes the leading states as those with well-designed plans for regular reviews, experience in producing quality evaluations that measure economic impacts, and a process for applying the results of evaluations to inform policy decisions. North Dakota was identified as one of the states leading the way in evaluating incentives.

Tax Incentive Evaluation Law

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 requires each incentive be reviewed at least once every 6 years and provides the following 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.

Summary of the First 6-Year Review Cycle

The following incentives were reviewed by the designated interim committee during the first 6-year economic development tax incentive 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		

First 6-Year Review Cycle		
2015-16 Interim	**2017-18 Interim**	**2019-20 Interim**
Electrical generating facilities sales tax exemption Geothermal, solar, wind, and biomass energy device credit Telecommunications infrastructure sales tax exemption		

2021-22 Review of Incentives

The committee was selected to conduct the economic development tax incentives study during the 2021-22 interim and selected eight incentives to review from the list provided in Section 54-35-26. The committee selected the research expense credit, agricultural commodity processing facility investment credit, seed capital investment credit, soybean or canola crushing facility construction or retrofit credit, manufacturing automation equipment credit, new or expanding business exemptions, manufacturing and recycling equipment sales tax exemption, and new jobs credit from income tax withholding for study.

The committee received background information for each of the selected incentives which provided an explanation of the incentive, the perceived intent of the Legislative Assembly in creating or altering each incentive, and the data and testimony required to effectively review each incentive. The committee received information from representatives of the Tax Department and the Department of Commerce regarding the number of claimants, amounts claimed for each incentive, and other information related to the incentives selected for review. The committee also solicited testimony from interested parties regarding the incentives selected for study.

The committee discussed the difficulty of evaluating the impact and effectiveness of the incentives selected for study without access to a broad range of relevant data and testimony from interested parties. Committee members noted streamlined reporting requirements for each incentive likely would provide future committees tasked with evaluating incentives information useful to its analysis. Committee members received information regarding reporting requirements applicable to each incentive selected for study. Committee members ultimately expressed mixed opinions regarding the value and feasibility of streamlined or uniform reporting requirements across all incentives, as compared to reporting requirements uniquely targeted to each incentive.

Research Expense Credit

Explanation of the Credit

Section 57-38-30.5 provides for a research expense tax credit. The incentive is available to all income taxpayers and allows for a credit against state income tax liability for expenditures related to conducting qualified research in this state. The amount of the credit is equal to a percentage of qualified research expenses which exceed a defined base amount. The definitions of "qualified research expenses" and "base amount," for purposes of Section 57-38-30.5, have the same meaning as provided in Section 41 of the Internal Revenue Code [26 U.S.C. 41], with the exception that any expenses incurred for research conducted outside North Dakota are excluded. The credit is equal to 25 percent of the first $100,000 in qualified expenses that exceed the base amount and a varying percentage of any amounts exceeding the first $100,000. The percentage credit allowed on amounts exceeding the first $100,000 in excess qualified expenses varies based on the year in which a taxpayer first began conducting qualified research in this state.

For qualified research in North Dakota which began before 2007, the percentage credit allowed on amounts exceeding the first $100,000 in excess qualified expenses is 7.5 percent for tax year 2007, 11 percent for tax year 2008, 14.5 percent for tax year 2009, 18 percent for tax years 2010 through 2016, and 8 percent for tax year 2017 and any subsequent tax years. A taxpayer qualifying for the credit under these conditions is limited to claiming no more than $2 million in credits in any taxable year and may not apply the amount of any unused credits in any other taxable year.

For qualified research in North Dakota which began on or after January 1, 2007, and before January 1, 2011, the percentage credit allowed on amounts exceeding the first $100,000 in excess qualified expenses is equal to 20 percent for taxable years 2007 through 2016. If qualified research in North Dakota began on or after January 1, 2011, the percentage credit allowed on amounts exceeding the first $100,000 in excess qualified expenses is 8 percent. The percentage of allowable credit on amounts exceeding the first $100,000 in excess qualified expenses also is 8 percent for any credits claimed in taxable years after 2016, regardless of when the taxpayer first began conducting qualified research in this state.

A taxpayer may elect to use an alternative, simplified method for calculating the research and experimental expenditures income tax credit, which is similar to the simplified method provided under federal tax law for calculating the federal research tax credit. Under the alternative method, the credit is equal to 17.5 percent of the first $100,000 of the alternative excess research and development for the taxable year. The percentage credit allowed on amounts

exceeding the first $100,000 of the alternative excess research and development for the taxable year is 5.6 percent. Alternative excess research and development is defined in Section 57-38-30.5 as "the amount of qualified research expenses which exceeds 50 percent of the average qualified research expenses for the 3 taxable years preceding the taxable year for which the credit is being determined." If a taxpayer does not have qualified research expenses in 1 of the 3 taxable years preceding the taxable year the credit is determined, the amount of qualified research expenses for the taxable year is multiplied by 7.5 percent of the first $100,000 plus 2.4 percent of qualified research expenses for the taxable year in excess of $100,000.

For a taxpayer that began conducting qualified research in this state on or after January 1, 2007, any credit amount exceeding a taxpayer's liability may be carried back to each of the 3 preceding taxable years or carried forward to each of the 15 succeeding taxable years. 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. A taxpayer entitled to the credit, and filing a consolidated return, may claim the credit against the aggregate North Dakota tax liability of all corporations included on the consolidated return except in the case of credits received by way of sale, transfer, or assignment.

Perceived Goals in Creating or Altering the Credit

Section 57-38-30.5, which provides for a research expense tax credit, was created through the passage of House Bill No. 1645 (1987). As first enacted, Section 57-38-30.5 provided for a corporate income tax credit equal to 8 percent of the first $1.5 million of North Dakota qualified research expenses in excess of base period research expenses, and 4 percent of any amount exceeding $1.5 million in excess research expenses. The 1987 legislation was patterned after a Minnesota law that had proved to be very successful for that state. Upon a review of the legislative history pertaining to House Bill No. 1645, the perceived goal of the Legislative Assembly in creating this credit was to encourage new and existing North Dakota corporations to undertake research and development. The credit was seen as a tool to help stimulate economic development. The credit was expanded to limited liability companies in 1993 and to passthrough entities and individuals in 2007. Legislation passed in 2007 also broadened the scope of the credit by allowing a taxpayer to sell, transfer, or assign up to $100,000 in unused credits. The goal of expanding the credit in 2007 was to attract new businesses to this state to conduct research activity and retain those businesses already present. Additional technical corrections pertaining to definitions and filing methods were made in 2009 and safeguards were added in 2013 to prevent references to federal definitions from becoming ineffective if the federal research tax credit was discontinued. The credit was further modified by 2017 legislation, which created a uniform definition of "primary sector business" in Title 1. The most recent change to the credit was made in 2019, which provided an alternative, simplified method for calculating the research and experimental expenditures income tax credit.

Testimony and Committee Considerations

The committee received information from a representative of the Tax Department regarding the number of claimants and the amounts claimed on individual and corporate income tax returns from 2006 to 2020. According to the testimony, in 2020, the total reportable income tax reduction attributable to the credit was $7,711,106, and the credit was claimed on 473 individual tax returns and 23 corporate income tax returns. The committee also received testimony in support of retaining the credit from representatives of the Department of Commerce and Economic Development Association of North Dakota.

Testimony in support of retaining the credit indicated the credit helps the Department of Commerce attract technology and research and development companies to the state and encourages capital investment in North Dakota businesses. In addition, the credit supports economic diversification and workforce recruitment and is important to attract businesses to the state and remain competitive with other states. The committee did not receive testimony in support of eliminating or modifying the credit. The committee did not identify any concerns relating to the credit or ways in which the credit could be improved.

Conclusions

The committee makes no recommendation regarding the research expense tax credit.

Agricultural Commodity Processing Facility Investment Credit

Explanation of the 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 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 also must be certified by the Securities Commissioner, be in compliance with North Dakota security laws, and have an agricultural commodity processing facility in this state or intend to locate a facility within this state. An agricultural commodity processing facility consists of a facility that adds value to an agricultural commodity raised in North Dakota 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, 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 be in the form of a purchase ownership interest or right to receive payment of dividends from the business. A qualified business must file with the investor, Tax Commissioner, and 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. 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.

Perceived Goals in Creating or Altering the Credit

Provisions relating to the agricultural commodity processing facility investment tax credit were enacted in 2001 and 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. 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 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. The credit was broadened in 2005 to allow qualifying investments to be made by corporations and passthrough entities, but the credit was limited to investments made in the first 10 qualifying businesses. The maximum annual credit limit allowed per taxpayer also was increased from $20,000 to $50,000 and the lifetime amount of credit per taxpayer was limited to $250,000. The changes were intended to make the credit more functional and more user-friendly. Carryforward provisions related to the credit were revised in 2007 and extended to 10 years.

Testimony and Committee Considerations

The committee received information from a representative of the Tax Department regarding the number of individual and corporate income tax returns on which the agricultural commodity processing facility investment tax credit was claimed and the estimated reduction in tax from tax years 2006 through 2020. In 2020, the total reportable income tax reduction attributable to the credit was $590,809, and the credit was claimed on 64 individual tax returns and no corporate income tax returns. The committee also received testimony in support of retaining the credit from representatives of the Department of Commerce, Economic Development Association of North Dakota, and North Dakota Ethanol Producers Association.

Testimony in support of retaining the credit indicated the credit is immensely valuable to the Department of Commerce when recruiting new, value-added agriculture investments to the state. In addition, the credit has been instrumental in establishing and growing the state's ethanol industry by encouraging investment in value-added processing for commodities in the state. The credit supports economic diversification and workforce recruitment and is important to attract businesses to the state and remain competitive with other states. The committee did not receive testimony in support of eliminating or modifying the credit. The committee did not identify any concerns relating to the credit or ways in which the credit could be improved.

Conclusions

The committee makes no recommendation regarding the agricultural commodity processing facility investment tax credit.

Seed Capital Investment Credit

Explanation of the Credit

Section 57-38.5-03 provides for a seed capital 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 57-38.5-01 as a primary sector business, certified by the Director of the Department of Commerce's Division of Economic Development and Finance, which relies on innovation, research, or the development of new products and processes for growth and profitability. A qualifying business must be in compliance with the state's security laws and must be a for-profit corporation, passthrough entity, or joint venture with the majority of the businesses in-state employees being North Dakota residents. The business must have its principal office located in this state and perform the majority of its business activities in this state, with the exception of sales activities, or the

business must have significant current or anticipated operations in North Dakota, which consist of employing more than 10 employees or reaching more than $150,000 in annual sales. A qualifying business does not include a real estate investment trust.

The credit is equal to 45 percent of the amount of the qualified investment which must be at risk in the qualifying business for at least 3 years. 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. A taxpayer, or a member of the taxpayer's immediate family, with substantial interests in qualified business, may not receive a credit for qualified investments in that business.

A taxpayer may claim no more than $112,500 in credits per taxable year. Credit amounts exceeding a taxpayer's liability may be carried forward for up to 4 taxable years. Credits determined at the passthrough entity level must be passed through to the entity's partners, shareholders, or members in proportion to their respective ownership interests in the passthrough entity. Pursuant to Section 57-38.5-07, a qualified business is required to file with the investor, the Tax Commissioner, and the Department of Commerce 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. The total aggregate amount of all seed capital investment tax credits allowed per year is limited to $3.5 million. If the amount of credits applied for exceed the maximum yearly cap, credits must be awarded based on the date each investment was received by a qualifying business. The maximum aggregate amount of qualified investments upon which the credit may be based may not exceed $500,000 for any one qualified business over any combination of tax years.

Perceived Goals in Creating or Altering the Credit

Provisions relating to the seed capital investment tax credit were first enacted in 1993. The total aggregate amount of all seed capital investment tax credits allowed per year was limited to $250,000. Upon a review of the legislative history relating to the enactment of the seed capital investment tax credit, the perceived goal of the Legislative Assembly in creating the credit was to stimulate private investment in new and growing North Dakota companies to help diversify and expand the state's economy. It was estimated the seed capital investment tax credit could result in a reduction in general fund revenues of up to $500,000 during the 1993-95 biennium.

The credit was amended in 2001 to increase the aggregate amount of allowable seed capital investment tax credits from $250,000 to $1,000,000 through calendar year 2002 and to $2,500,000 after calendar year 2002. The number of North Dakota employees a qualified business was required to employ was decreased to 10 and annual sales requirements were decreased to $150,000. An organization that attracted investments to build and own a value-added agricultural processing facility that it leased with an option to purchase to a primary sector business also could be classified as a qualified business.

The credit was amended in 2003 to eliminate the $250,000 limit per qualifying business and increase the available credit amount from 30 to 45 percent of the amount of the qualifying investment. Amendments in 2005 further expanded the credit to allow it to be claimed by corporations and passthrough entities. Changes in 2005 also limited qualified investments in a qualified business for which a credit could be claimed to a maximum of $500,000. Changes to the credit in 2007 expanded the credit to allow investments by an angel fund to be eligible for the seed capital investment tax credit and reduced the maximum amount that could be claimed by a taxpayer to $112,500 per year. Provisions regarding certification of a qualified business by the Department of Commerce also were revised.

Testimony and Committee Considerations

The committee received information from a representative of the Tax Department regarding the number of individual and corporate income tax returns on which the seed capital investment credit was claimed and the estimated reduction in tax from tax years 2006 through 2020. In 2020, the total reportable income tax reduction attributable to the credit was $1,291,600, and the credit was claimed on 50 individual tax returns and no corporate income tax returns. The committee also received testimony in support of retaining the credit from representatives of the Department of Commerce and Economic Development Association of North Dakota.

Testimony in support of retaining the credit indicated the credit helps the Department of Commerce attract technology and research and development companies to the state and encourages capital investment in North Dakota businesses. In addition, the credit supports economic diversification and workforce recruitment and is important to attract businesses to the state and remain competitive with other states. The committee did not receive testimony in support of eliminating or modifying the credit. The committee did not identify any concerns relating to the credit or ways in which the credit could be improved.

Conclusions

The committee makes no recommendation regarding the seed capital investment credit.

Soybean or Canola Crushing Facility Construction or Retrofit Credit

Explanation of the Credit

Section 57-38-30.6 provides for a soybean or canola crushing facility construction or retrofit credit. The incentive is available to corporate income taxpayers and allows for a credit against state income tax liability in the amount of 10 percent per year for 5 years of the taxpayer's direct costs incurred after December 31, 2008, to adapt or add equipment to retrofit an existing facility or to construct a new facility in this state for the purpose of producing crushed soybeans or canola. Credit amounts exceeding a taxpayer's liability may be carried forward to each of the 5 succeeding taxable years, but a taxpayer is limited to claiming no more than $250,000 in credits over any combination of taxable years. Eligible costs incurred by a taxpayer before a facility begins crushing soybeans or canola may not be claimed for purposes of the credit until taxable years on or after crushing begins.

Perceived Goals in Creating or Altering the Credit

Provisions relating to construction or retrofit income tax credits were enacted in 2003. As enacted, Section 57-38-30.6 provided a corporate income tax credit for costs incurred to adapt or add equipment to retrofit an existing facility or construct a new facility in this state for the purpose of producing or blending diesel fuel containing at least 2 percent biodiesel fuel by volume. The credit was expanded in 2009 to apply to the costs incurred to adapt or add equipment to retrofit an existing facility or construct a new facility in this state for the purpose of producing crushed soybeans or canola. The perceived goal of the Legislative Assembly in creating this credit was to encourage the modification of existing facilities or the construction of new facilities capable of crushing soybeans or canola to process those commodities in North Dakota rather than shipping them out of state for processing. It was noted large amounts of soybeans were being shipped to neighboring states such as Minnesota and South Dakota for crushing and processing. The credit was viewed as a tool to help build a stronger rural economy in North Dakota. The estimated fiscal effect of the soybean or canola crushing facility construction or retrofit credit could not be determined during the 2009 legislative session.

Testimony and Committee Considerations

The committee received information from a representative of the Tax Department regarding the number of individual and corporate income tax returns on which the soybean or canola crushing facility construction or retrofit credit was claimed and the estimated reduction in tax from tax years 2006 through 2020. The committee was informed the credit has not been claimed through the 2020 taxable year. The committee also received testimony in support of retaining the credit from representatives of the Department of Commerce, North Dakota Soybean Growers Association, Economic Development Association of North Dakota, and Archer Daniels Midland Company.

Testimony provided in favor of retaining the credit indicated the credit is valuable to the Department of Commerce when recruiting new, value-added agriculture investments to the state. The credit also is valuable to the soybean industry. Soybeans are a profitable crop in the state, typically grown in every county. As of April 2022, the closest soybean crushing plant was located in Aberdeen, South Dakota. A representative of the North Dakota Soybean Growers Association provided information regarding plans for construction of two soybean crushing facilities in the state which would help meet the fast-growing demand from food, feed, industrial, and biofuel customers. The estimated crushing capacities of both anticipated soybean crushing facilities only would accommodate half of the statewide soybean capacity. One of the companies with plans to construct a soybean crushing facility indicated the state incentive package received by the company was key in solidifying the company's decision to continue expanding operations in the state.

A representative of the North Dakota Soybean Growers Association recommended the committee consider indexing incentives available to the soybean crushing industry to account for changes in the soybean crushing plant market because the incentive programs were established several years ago. No other recommended modifications were provided to the committee. The committee did not receive testimony in support of eliminating the credit. The committee did not identify concerns relating to the credit.

Conclusions

The committee makes no recommendation regarding the soybean or canola crushing facility construction or retrofit credit.

Manufacturing Automation Equipment Credit

Explanation of the Credit

Section 57-38-01.36 provides for an income tax credit for purchases of manufacturing machinery and equipment for the purpose of automating a manufacturing process in this state to improve job quality and increase productivity. The incentive is available to any income taxpayer certified by the Department of Commerce as a primary sector business. A primary sector business is defined in Section 1-01-49 as a business that employs knowledge or labor to add value to a product, process, or service that results in the creation of new wealth. The credit is equal to 20 percent of the cost of the manufacturing machinery and equipment purchased in the taxable year for purposes of automating a manufacturing process to improve job quality and increase productivity. Qualified expenditures for purchases of manufacturing

machinery and equipment used to calculate the automation tax credit may not be used to calculate any other income tax deduction or credit allowed under Chapter 57-38.

For purposes of Section 57-38-01.36, qualifying manufacturing machinery and equipment means new or used automation and robotic equipment used to upgrade or advance a manufacturing process. Qualifying manufacturing machinery and equipment does not include replacement automation and robotic equipment that does not upgrade or advance a manufacturing process. A qualifying purchase of manufacturing machinery and equipment includes items acquired under a capital lease, but only for the taxable year in which the lease was executed. For purposes of calculating the credit, items acquired under a capital lease will be valued at fair market value at the time the lease was executed. The credit must be claimed in the taxable year in which the manufacturing machinery and equipment was purchased, and the amount of the credit claimed may not exceed the taxpayer's income tax liability. Any credit amount exceeding a taxpayer's liability may be carried forward to each of the 5 succeeding taxable years.

The aggregate amount of credits allowed may not exceed $1 million in each calendar year. Any credits left unclaimed at the end of a calendar year may be carried forward for dispersal in the succeeding calendar year. If a claim for credits is made in excess of the statutorily available amount, the Tax Commissioner shall prorate the available credits among all claimants. If a taxpayer entitled to the credit is filing a consolidated return, the taxpayer may claim the credit against the aggregate North Dakota tax liability of all corporations included on the consolidated return. 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.

The Department of Commerce must provide the Tax Commissioner the name, address, and federal identification number or Social Security number of each taxpayer approved as qualifying for the credit. The Department of Commerce also must provide the Tax Commissioner with a list of any items approved as qualified expenditures. The taxpayer must provide the Tax Commissioner the name, address, and federal identification number or Social Security number of the taxpayer making the purchase as well as a list of each item of machinery or equipment purchased for purposes of automation, the amount paid for each item, and the date on which payment for the item was made. This information must be provided with the taxpayer's return.

Within 1 year after claiming the tax credit, a taxpayer must file a report documenting the improved job quality or increased productivity required to receive the credit and any other information the Tax Commissioner determines is necessary. For purposes of Section 57-38-01.36, "improved job quality" means a 5 percent increase in average wages or a 5 percent improvement in workplace safety as documented through participation in Workforce Safety and Insurance safety incentive programs. "Increased productivity" is defined as no less than a 5 percent increase in output or a 5 percent increase in the number of units produced per automated line per time period. Failure to document the improved job quality or increased productivity requirements is cause to disallow the credit due to noncompliance. If a taxpayer fails to document the improved job quality or increased productivity requirements, the Tax Commissioner must notify the taxpayer, and the taxpayer must file an amended return within 90 days after the date of the notice. If an amended return is not filed timely, the Tax Commissioner must disallow the credit and assess any tax due as final and irrevocably fixed.

The credit is available through December 31, 2022.

Perceived Goals in Creating or Altering the Credit

Provisions relating to an automation income tax credit for purchases of manufacturing machinery and equipment used to automate a manufacturing process were first discussed by the 2009-10 interim Workforce Committee as a result of the committee's study of technology-based entrepreneurship and economic development best practices. Provisions relating to the credit were enacted in 2011, but were made effective for the future tax years of 2013 through 2015. The credit was equal to 20 percent of costs incurred and the aggregate amount of credits allowed for all taxpayers was capped at $2 million in any calendar year. The perceived goals of the Legislative Assembly in creating this credit were to allow North Dakota manufacturing businesses to remain competitive, to advance the manufacturing sector, and to foster continued production in a labor constrained environment. The credit was amended in 2015 to extend through taxable year 2017; however, the previous $2 million annual credit cap was reduced to $500,000 per year for calendar years 2016 and 2017. The credit also was modified to provide a method to prorate the credits among all qualified claimants if the cap is reached, and included a sunset provision indicating the tax credit was effective for the first 3 taxable years beginning after December 31, 2014. No additional legislation was passed to extend the automation tax credit in Section 57-38-01.33 prior to the expiration date.

Following the expiration of Section 57-38-01.33, provisions regarding an automation tax credit were revisited in 2019 legislation, and ultimately passed in a form substantially similar to the credit formerly available under Section 57-38-01.33. The 21st century manufacturing workforce incentive, codified at Section 57-38-01.36, provides a similar income tax credit of 20 percent of the cost of the manufacturing machinery and equipment purchased in the taxable year for purposes of automating a manufacturing process. However, distinctions exist between the automation tax credit

under the expired Section 57-38-01.33 and the automation tax credit provided in Section 57-38-01.36. These distinctions include additional taxpayer reporting requirements demonstrating improved job quality or increased productivity and a $1 million limit on the aggregate amount of credits available in each calendar year. The credit also includes a sunset provision, indicating the credit will be available only for the first 4 taxable years beginning after December 31, 2018.

The legislative history indicates the Legislative Assembly's goals related to the continuation of an automation tax credit in the form of the 21st century manufacturing workforce incentive were consistent with the Legislative Assembly's goals when establishing the former version of the automation tax credit under Section 57-38-01.33. The Legislative Assembly emphasized the credit is to be used to incentivize improvement of job quality and increased productivity in the industry.

Testimony and Committee Considerations

The committee received information from a representative of the Tax Department regarding the number of claimants and the amounts claimed on individual and corporate income tax returns from 2006 to 2020. According to the testimony, in 2020, the total reportable income tax reduction attributable to the 21st century manufacturing workforce incentive was $1,185,249, and the credit was claimed on 34 individual tax returns and no corporate income tax returns. The Tax Department's testimony also indicated the reportable income tax reduction attributable to carryover of unused credits under the now expired manufacturing automation credit program was $794,672, based on claims made on 20 individual income tax returns and 2 corporate tax returns. The committee also received testimony in support of retaining the credit from representatives of the Department of Commerce, Economic Development Association of North Dakota, Greater North Dakota Chamber, and Cloverdale Foods Company.

Testimony in favor of retaining the credit indicated the total output from manufacturing in the state was $4.16 billion in 2019, which comprised 7.28 percent of the state's economic output. Retaining the credit would provide manufacturers a tool to continue to improve efficiencies and remain competitive in the global marketplace. The credit also would continue to encourage manufacturers to be innovative in their equipment investments, including upgrading or advancing equipment to increase job quality and production capacity. The manufacturing industry also has used automation as a solution to both statewide and nationwide workforce shortage issues.

A representative of the Economic Development Association of North Dakota indicated numerous manufacturers in North Dakota have spoken to the importance of the credit. Representatives of Cloverdale Foods Company testified to the importance of the credit, and indicated over the past 5 years, Cloverdale Foods Company submitted over $5 million of qualified automation projects through the automation tax credit program. Cloverdale Foods Company invested heavily in automation to upgrade old equipment, remain competitive, increase efficiency and output, and maintain a safe working environment. Representatives of Cloverdale Foods Company indicated the automation tax credit program is essential to the success of new categories of production and to maximize the manufacturing plant's overall capacity.

The committee reviewed a bill draft to eliminate the sunset provision on the income tax credit for purchases of manufacturing machinery and equipment for automating manufacturing processes. The bill draft would have removed the December 31, 2022, expiration date, while retaining the remainder of the statutory provisions in current law. The committee received testimony in support of the bill draft, including recommendations for expansion of the credit. The committee was informed due to proration of the aggregate maximum $1 million credit allowance, companies only have been receiving as a credit an average of 8.8 percent of the cost of the manufacturing machinery and equipment purchased in a taxable year. A representative of the Economic Development Association of North Dakota recommended increasing the program's aggregate credit allowance to $4 million per biennium. A representative of the Greater North Dakota Chamber recommended increasing the aggregate credit allowance to $2.5 million per year to support the manufacturing industry. No other recommended modifications were provided to the committee. The committee did not receive testimony from interested parties in support of eliminating the credit.

The committee recognized the importance of the automation manufacturing credit, and numerous committee members expressed support for the credit. The committee also discussed potential expansion of the credit to include automated practices beyond automation for manufacturing purposes. Committee members ultimately indicated a desire to defer to a private sponsor to introduce legislation related to the credit during the next legislative session.

Conclusions

The committee makes no recommendation regarding the automation manufacturing credit.

New or Expanding Business Exemptions

Explanation of the Exemptions

The primary economic development tool in Chapter 40-57.1 authorizes cities or counties to grant the operator of a new or expanding business a partial or complete property tax exemption or the option to make payments in lieu of taxes. Property tax exemption also may be granted for property owned by a local development organization for the purposes

of attracting new industry to the state. For purposes of the exemption, a "project" must be a revenue-producing new or expanding primary sector business. A project also may include projects in the retail sector in cities or counties with a population of less than 40,000 if the voters have provided the governing body authority to grant retail exemptions and the governing body has established criteria for granting those exemptions.

Under Chapter 40-57.1, if a project has local competitors, the project operator is required to notify competitors of the project owner's pending application for an exemption in the official newspaper of the city or county. Additional hearing and notice requirements must be met if the Department of Commerce determines the total cost of the project is estimated to exceed $1 billion. Impacted school districts and townships are included in any exemption or payment in lieu of tax negotiations and deliberations and notice must be sent to affected counties and school districts if a city anticipates a property will receive an incentive for more than 5 years. The affected county or school district may elect to disallow the incentive from applying to its portion of the property tax for incentives granted after July 31, 2017.

A city or county may grant a partial or complete property tax exemption for up to 5 years and may extend the exemption for up to 5 additional years if the project produces or manufactures a product from agricultural commodities produced in this state or the project is situated on property leased from a government entity. The option to make payments in lieu of taxes may be extended to a project operator through the 20th year following the date the project commenced. The governing body of a city or county may revoke or reduce a property tax exemption or revoke or increase a project operator's payments in lieu of taxes if the governing body finds the project operator provided inaccurate or untrue information, used the property for purposes other than anticipated, improved the property to a greater extent than what was anticipated, or if ownership of the property changed since the incentive was approved.

A project owner also may receive an income tax exemption for up to 5 years from the date the project commenced pursuant to Section 40-57.1-04. The income tax exemption is equal to the amount of net income realized by the project, or in the case of an expansion, the net income generated by the expanded portion of the business. A project owner must submit an application for the income tax exemption to the State Board of Equalization within 1 year of commencing project operations and provide notice of the potential exemption to competitors as directed by the State Board of Equalization. For purposes of the income tax exemption, a "project" is defined as any new or expanding revenue-producing tourism or primary sector business. The Department of Commerce reviews applications to verify a project's eligibility as a primary sector or tourism business. The exemption is granted if the State Board of Equalization finds it is in the best interest of the people of North Dakota. A project is not eligible for a property or income tax exemption under Chapter 40-57.1 if it has an outstanding lien for unpaid state or local taxes, if granting the exemption would endanger existing businesses or foster unfair competition, or if the business is receiving a property tax exemption through tax increment financing. A project operator is required to provide state and property tax clearance records for exemptions granted after July 31, 2017.

Perceived Goals in Creating or Altering the Exemptions

Provisions of new or expanding business property and income tax exemptions were enacted in 1969 by the passage of Senate Bill No. 39 and the creation of Chapter 40-57.1. As enacted, Chapter 40-57.1 only applied to new businesses and required a project operator to receive a property tax exemption as a condition to qualifying for an income tax exemption. A city or county also was required to apply to the State Board of Equalization for the income tax exemption on behalf of the project operator. The intent of the Legislative Assembly in creating the new business income and property tax exemption was stated clearly in the bill. Section 1 of the bill provided, in pertinent part, the purpose of the newly created chapter was:

> [T]o sanction, authorize, and encourage activities in the public interest and for the welfare of the state of North Dakota, its subdivisions and people by assisting in the establishment of industrial plants and promotion of economic activities within the state, and thereby increasing production of wealth, and adding to the volume of employment, particularly during those seasons when employment in farming and ranching is slack, thus alleviating unemployment among the people of the state.

Chapter 40-57.1 was amended in the 1970s to add notice requirements for local competitors; in the 1980s to extend the property tax exemption to revenue-producing entities and property owned by a local development corporation and restrict the property tax exemption from applying to certain large industrial projects; and in the 1990s to allow the property tax exemption to apply to the expansion and retention of existing buildings and the income tax exemption to apply to primary sector businesses and tourism businesses. Provisions also were added in the 1990s mandating a project owner to verify the owner's state and local tax liens have been satisfied as a condition to receiving the income tax exemption. Legislation enacted since 2001 allowed small cities and counties to grant the exemption to retail businesses, required enhanced notice for competitors for projects estimated to exceed $1 billion, and required cities that anticipated granting a property tax incentive for more than 5 years to notify impacted counties and school districts and allow those taxing districts to prohibit the incentive from applying to their portion of the property tax.

Testimony and Committee Considerations

The committee received information from a representative of the Tax Department regarding the number of individual and corporate income tax returns on which the income tax exemption was claimed and the estimated reduction in tax from tax years 2006 through 2016. The committee also received testimony from representatives of the Department of Commerce and Economic Development Association of North Dakota in support of retaining the exemptions.

Testimony provided in favor of retaining the exemptions indicated the exemptions help the state and localities recruit and maintain projects in the state, including major projects in the energy, agriculture, and manufacturing industries. In addition, the exemptions have been successful in assisting in the creation and expansion of businesses. Specifically, the exemptions helped a local company invest approximately $20 million to expand its facility, which resulted in the creation of numerous jobs, ranging from entry level to management positions. The committee did not receive testimony in support of eliminating or modifying the exemptions. The committee did not identify any concerns relating to the exemptions or ways in which the exemptions could be improved.

Conclusions

The committee makes no recommendation regarding the new or expanding business property and income tax exemptions.

Manufacturing and Recycling Equipment Sales Tax Exemption

Explanation of the Exemption

Section 57-39.2-04.3 provides a sales tax exemption for machinery or equipment used directly in manufacturing or recycling tangible personal property. For purposes of the exemption, manufacturing includes the meaning normally ascribed to the term and the processing of agricultural products but does not include mining or refining activities, oil and gas extraction, or the generation of electricity. Recycling is defined as the collection or recovery of materials that otherwise would be waste and conversion of those materials to a product for sale or a raw material for use in manufacturing. To qualify for the exemption, the machinery or equipment must be used in a new manufacturing plant or recycling facility or used to create a physical or economic expansion of an existing plant or facility. An economic expansion is classified as an increase in production volume, employment, or the types of products that can be manufactured or recycled.

Perceived Goals in Creating and Altering the Exemption

Provisions of the manufacturing and recycling sales tax exemption were first enacted by House Bill No. 1048 (1991). As originally enacted, the exemption applied only to manufacturing machinery and equipment used directly in manufacturing tangible personal property or processing agricultural products. The exemption replaced an existing 3 percent reduced sales tax rate on these items. The perceived goal of the Legislative Assembly in creating the exemption was to attract new manufacturing plants to the state and encourage the expansion of existing manufacturing plants. The exemption was viewed as a driver for job creation and increased income tax collections as a result of manufacturing plant construction and expansion.

The exemption was expanded in 1993 to apply to machinery or equipment used directly in a new recycling facility or in the physical or economic expansion of an existing recycling facility. The definition of machinery also was expanded to include environmental control equipment and devices purchased or constructed at any point from the initial stages of manufacturing through the completion and packaging of an end product. The definition of machinery was further expanded in 1994 to include computer equipment that controls or monitors the function of machinery used in the manufacturing process and devices used through the completion of the product, including packaging and all processes before the completed product is transported from the plant. Machinery or equipment was required be used in the manufacturing process at least 50 percent of the time to qualify for the exemption. The definition of "used directly" also was expanded to include machinery and equipment used to conduct research, and development and design activities related to the manufacturing process of the plant. The definition of manufacturing for purposes of the credit also was temporarily expanded in 1999 to include the refining of crude oil through July 31, 2002. The final change to the exemption was made in 2015 to allow a customer to qualify for an exemption at the time of purchase or apply for a refund of sales tax paid on a mold purchased by a customer and used directly by a manufacturer in the manufacturing process. The credit was further modified by 2017 legislation, which created a uniform definition of "primary sector business" in Title 1.

Testimony and Committee Considerations

The committee received data from a representative of the Tax Department regarding the number of claimants and the amount exempted in relation to the manufacturing and recycling sales tax exemption. The data indicated an aggregate total of $14,295,789 in sales tax was not collected from 260 taxpayers from fiscal years 2017 to 2021 as a result of the manufacturing sales tax exemption, and $645,034 was not collected from 29 taxpayers as a result of the recycling sales tax exemption during the same period. The committee also received testimony from representatives of the Department of Commerce and Economic Development Association of North Dakota in support of retaining the exemption.

Testimony provided in favor of retaining the exemption indicated the manufacturing industry has a substantial impact on the supply chain, and the agricultural and energy industries rely on local manufacturing partners for the success of their operations. With the exception of Hawaii, every state has an exemption for raw manufacturing materials, and North Dakota is one of eight states that tax manufacturing equipment at any level. Maintaining this exemption is important to remain competitive with other states and will provide manufacturers a tool to continue to improve efficiencies and remain competitive in the global marketplace. The committee did not receive testimony from interested parties in support of eliminating or modifying the sales tax exemption. The committee did not identify any concerns relating to the exemption or ways in which the exemption could be improved.

Conclusions

The committee makes no recommendation regarding the manufacturing and recycling sales tax exemption.

New Jobs Credit from Income Tax Withholding

Explanation of the Credit

Chapter 52-02.1 allows an employer engaged in a primary sector business to enter an agreement with Job Service North Dakota to establish training and education programs directed at new jobs within the employer's business. The agreement must specify the date the program will commence; identify program costs; and provide a guarantee by the employer for payment of program costs and an assurance any deferral of payment will not exceed 10 years from the date the program commences. The agreement also must provide an assurance that every employee participating in the program will be paid at least $10 per hour, plus benefits, by the end of the 1st year of employment and for the life of the loan; list the maximum amount of the credit from withholding or tuition and fee payments allowed for the project; and specify on-the-job training costs for employees may not exceed 50 percent of the annual gross wages and salaries for the new jobs in the 1st full year following the date the project commences. If program costs will require financing, the loan or grant must be secured and payable from a sufficient portion of future receipts of payments authorized by the agreement. Job Service North Dakota may not enter an agreement until an employer requiring financing has qualified for financing.

Once the agreement is executed, Job Service North Dakota will notify the Tax Commissioner who must credit the income tax withholding on wages paid by the employer to each new employee participating in the program. An amount equivalent to the credited amount must be transmitted to the State Treasurer for allocation to a special fund from which payments will be made to the lender that provided the program loan or to the employer if the program costs were self-funded. Once the program costs have been satisfied, the employer's credits must cease. A new employee participating in a program will receive full credit for the amount withheld while the cost of the program is being reimbursed.

An employer that is not a primary sector business, but contracts to provide employees to a primary sector business also may qualify for program services developed and coordinated by Job Service North Dakota if the employer and the primary sector business are parties to the same Job Service North Dakota agreement and the Job Service North Dakota agreement designates the employer as the recipient of the program services.

Perceived Goals in Creating or Altering the Credit

Provisions of the new jobs credit from income tax withholding were enacted through the passage of House Bill No. 1518 (1993). The perceived goal of the Legislative Assembly in creating the credit was to encourage community economic development by incentivizing businesses to locate to or expand within North Dakota by providing government-assisted new jobs training. The credit was viewed as a way to reward employers for training workers for new, skilled, and higher paying jobs and as a way for North Dakota to compete with other states for new businesses. The credit was amended in 1999 to add a reimbursement option for employers that self-financed training costs, and in 2017 to add a uniform definition of "primary sector business" to include a definition of "new wealth." The credit also was amended in 2019 to allow an employer that is not a primary sector employer to qualify for program services if the employer contracts to provide employees to a primary sector business and meets other requirements.

Testimony and Committee Considerations

The committee received information from a representative of the Tax Department indicating $2,200,958 in withholding collections was allocated to the new jobs credit program in fiscal year 2020 and $2,162,711 was allocated in fiscal year 2021. The committee also received testimony from representatives of the Department of Commerce, Economic Development Association of North Dakota, Traill County Economic Development Commission, and Job Service North Dakota in support of retaining the credit.

Testimony in support of the credit indicated the new jobs training program is used actively across the state and is an important program for primary sector employers and area economic developers that recruit new companies to the state. The program provides employers a tool to help recruit, train, and retain employees and combat the workforce shortage in the state. For example, the credit is being used successfully by many companies in the Jamestown area, including manufacturers and value-added agricultural companies, and a farm and industrial equipment manufacturing company in Hillsboro.

A representative of Job Service North Dakota indicated over the last 2 bienniums, Job Service North Dakota entered 29 new job training program contracts, which created 852 FTE positions and generated $2,920,675 in available training dollars that will be returned to the employers during the 10-year duration of the contract. During the current biennium, Job Service North Dakota has entered five contracts, which created 222 FTE positions and generated an additional $941,924 in available training funds. The committee did not receive testimony from interested parties in support of eliminating or modifying the credit. The committee did not identify any concerns relating to the credit or ways in which the credit could be improved.

Conclusions

The committee makes no recommendation regarding the new jobs credit from income tax withholding.

PROPERTY AND INCOME TAX REFORM AND RELIEF STUDY

The Legislative Management Chairman directed the committee to study the feasibility and desirability of providing holistic tax reform and relief, focusing primarily on property tax relief and, to a lesser extent, income tax relief. The study was required to include consideration of current and projected state revenues and expenditures, the stability of state revenue sources identified as a funding source for tax relief, the intended recipients of tax relief, and potential restrictions on tax relief.

Income Tax Reform and Relief Background

Individual Income Tax Rate History

The committee reviewed the history of individual income tax rates from 1919 to date. The committee was informed individual income tax rates established in 2001 for the five income brackets for each filing status were reduced by legislation enacted in 2009, 2011, 2013, and 2015. The following schedule provides information on the lowest and highest individual income tax rate for the 2007-09 biennium through the 2015-17 biennium and the percentage decrease in individual income tax rates from biennium to biennium:

Individual Income Tax Rates	Individual Income Tax Rates as a Percentage of Taxable Income				
	2007-09 Biennium	2009-11 Biennium	2011-13 Biennium	2013-15 Biennium	2015-17 Biennium
Range of tax rates	2.10% to 5.54%	1.84% to 4.86%	1.51% to 3.99%	1.22% to 3.22%	1.10% to 2.90%
Percentage increase (decrease) from prior biennium		(12.3%)	(17.9%)	(19.3%)	(9.9%)

Individual income tax rates have not been altered since the 2015 legislative session. Thus, the current tax rates, as applied to each available filing status, range from a low of 1.10 to a high of 2.90 percent.

The following schedule provides information on individual income tax collections by tax year, including actual collections, and the cumulative effect of individual income tax rate reductions approved by the Legislative Assembly during the 2009-11 biennium through the 2015-17 biennium. If the Legislative Assembly had not approved any individual income tax rate reductions during the 2009-11 biennium through the 2015-17 biennium, tax collections would have been based on the 2008 tax rates in effect prior to any rate reductions.

Cumulative Effect of Individual Income Tax Rate Reductions (Based on 2008 Tax Rates)[1]									
	2009-11 Biennium		2011-13 Biennium		2013-15 Biennium		2015-17 Biennium		
	Tax Year 2009	Tax Year 2010	Tax Year 2011	Tax Year 2012	Tax Year 2013	Tax Year 2014	Tax Year 2015	Tax Year 2016	Total 2009-16
Actual individual income tax collections	$291,551,674	$379,196,662	$377,728,193	$534,370,310	$408,008,964	$464,588,152	$341,696,065	$297,945,510	$3,095,085,530
Effect of the rate reductions[2]	$40,890,372	$53,182,656	$146,881,911	$207,793,153	$294,179,062	$334,973,294	$310,981,826	$271,163,903	$1,660,046,177
Total individual income tax collections without the rate reductions	$332,442,046	$432,379,318	$524,610,104	$742,163,463	$702,188,026	$799,561,446	$652,677,891	$569,109,413	$4,755,131,707

[1]The information for the income tax rate reductions was provided by the Tax Department and is reported by tax year rather than fiscal year because the Tax Department only calculates the information by tax year. The income tax payments and refunds can span multiple fiscal years, but the fiscal year effect is approximately the same as the preceding tax year. For example, income tax collections in fiscal year 2010 (the 1st year of the 2009-11 biennium) are an approximate reflection of the tax collections from tax year 2009.

[2]The amounts shown for the effect of the individual income tax rate reductions reflect the cumulative individual income tax relief provided by the Legislative Assembly based on the rate reductions approved by the Legislative Assembly in 2009, 2011, 2013, and 2015, which was a reduction of 12.3, 17.9, 19.3, and 9.9 percent, respectively.

Individual Income Tax Deductions, Credits, and Exempt Activities

The committee reviewed the 18 individual income tax deductions and 23 individual income tax credits. The committee also reviewed individual income tax-exempt activities.

Individual Income Tax Burden

North Dakota individual income tax collections for fiscal year 2020 were just over $352 million. A Census Bureau per capita comparison of individual income tax collections for fiscal year 2019 ranked North Dakota 41st out of 43 states that impose individual income tax collections. Of the 43 states, 25 states had a per capita individual income tax burden at least double North Dakota's per capita individual income tax burden. In regard to the state's tax climate, North Dakota was ranked 26th out of 50 states in the individual income tax category on the Tax Foundation's *2022 State Business Tax Climate Index*, with an overall tax climate index rank of 16th out of 50 states.

Corporate Income Tax Rate History

The committee reviewed the history of corporate income tax rates from 1919 to date. The Legislative Assembly reduced corporate income tax rates in the 2009, 2011, 2013, and 2015 legislative sessions. The following schedule provides information on the lowest and highest corporate income tax rate for the 2007-09 biennium through the 2015-17 biennium and the percentage decrease in corporate income tax rates from biennium to biennium:

	Corporate Income Tax Rates as a Percentage of Taxable Income				
Corporate Income Tax Rates	**2007-09 Biennium**	**2009-11 Biennium**	**2011-13 Biennium**	**2013-15 Biennium**	**2015-17 Biennium**
Range of tax rates	2.60% to 6.50%	2.10% to 6.40%[1]	1.68% to 5.15%	1.48% to 4.53%	1.41% to 4.31%
Percentage increase (decrease) from prior biennium		N/A[1]	(19.5%)	(11.9%)	(4.9%)

[1]The 2009 Legislative Assembly reduced the number of corporate income tax brackets from five to three and reduced the tax rates in each bracket. As a result, the percentage change from the prior biennium cannot be calculated.

Corporate income tax rates have not been altered since the 2015 legislative session. Thus, the current corporate income tax rates applicable to corporations range from 1.41 to 4.31 percent.

The following schedule provides information on corporate income tax collections by tax year, including actual collections, and the cumulative effect of corporate income tax rate reductions approved by the Legislative Assembly during the 2009-11 biennium through the 2015-17 biennium. If the Legislative Assembly had not approved any corporate income tax rate reductions during the 2009-11 biennium through the 2015-17 biennium, tax collections would have been based on 2008 tax rates in effect prior to any rate reductions.

Cumulative Effect of Corporate Income Tax Rate Reductions (Based on 2008 Tax Rates)[1]									
	2009-11 Biennium		**2011-13 Biennium**		**2013-15 Biennium**		**2015-17 Biennium**		
	Tax Year 2009	**Tax Year 2010**	**Tax Year 2011**	**Tax Year 2012**	**Tax Year 2013**	**Tax Year 2014**	**Tax Year 2015**	**Tax Year 2016**	**Total 2009-16**
Actual corporate income tax collections	$74,471,905	$139,076,051	$138,910,271	$206,732,706	$190,563,515	$193,073,757	$94,967,392	$73,341,168	$1,111,136,765
Effect of the rate reductions[2]	$3,919,574	$7,319,792	$42,731,143	$63,594,468	$92,278,785	$93,494,349	$53,249,807	$41,123,621	$397,711,539
Total corporate income tax collections without the rate reductions	$78,391,479	$146,395,843	$181,641,414	$270,327,174	$282,842,300	$286,568,106	$148,217,199	$114,464,789	$1,508,848,304

[1]The information for the income tax rate reductions was provided by the Tax Department and is reported by tax year rather than fiscal year because the Tax Department only calculates the information by tax year. The income tax payments and refunds can span multiple fiscal years, but the fiscal year effect is approximately the same as the preceding tax year. For example, income tax collections in fiscal year 2010 (the 1st year of the 2009-11 biennium) are an approximate reflection of the tax collections from tax year 2009.

[2]The amounts shown for the effect of the corporate income rate reductions reflect the cumulative corporate income tax relief provided by the Legislative Assembly based on the rate reductions approved by the Legislative Assembly in 2009, 2011, 2013, and 2015. In Senate Bill No. 2199 (2009), the Legislative Assembly reduced the number of corporate income tax brackets from five to three and reduced the corporate tax rates in each bracket. In House Bill No. 1047 (2011), the Legislative Assembly reduced corporate income tax rates by 19.5 percent. In Senate Bill No. 2156 (2013), the Legislative Assembly reduced corporate income tax rates by 11.9 percent. In Senate Bill No. 2349 (2015), the Legislative Assembly reduced the corporate income tax rates by 4.9 percent.

Corporate Income Tax Deductions, Additions, Credits, and Reporting Requirements and Methods

The committee reviewed the six corporate income tax deductions, five corporate income tax additions, and 16 corporate income tax credits. The committee also reviewed corporations exempt from the corporate income tax, corporate income tax-exempt activities, information regarding combined reporting requirements for corporations, and an overview of the "water's edge" election.

Corporate Income Tax Burden

North Dakota corporate income tax collections for fiscal year 2020 were just over $91.5 million. According to the Tax Foundation, which provides a comparison of state corporate income tax rates as of January 1, 2022, North Dakota's top corporate income tax bracket rate of 4.31 percent was the fourth lowest nationally of states that impose a corporate income tax, with only North Carolina, Oklahoma, and Missouri reporting lower corporate income tax rates. In terms of the state's tax climate, North Dakota was ranked 9th out of 50 states in the corporate tax category on the Tax Foundation's *2022 State Business Tax Climate Index*, with an overall tax climate index rank of 16th out of 50 states.

Past Income Tax Interim Studies

The committee reviewed past interim studies related to individual or corporate income tax, including studies conducted during the 2011-12, 2015-16, 2019-20, and 2021-22 interims.

Property Tax Reform and Relief Background

Property Tax Overview

Property tax is levied in every state and provides a vital source of revenue for local governments. In North Dakota, just over $1.13 billion in property tax was levied in 2019 for payment in 2020. Property tax is levied on real property, personal property, or both, depending on the state. The tax on personal property was abolished in North Dakota in 1970. Classification and valuation marks the first step in the property tax cycle. Property is classified as either residential, commercial, agricultural, or centrally assessed. Assessors apply various calculations to the true and full value of property in each classification to arrive at a property's taxable value.

A property owner dissatisfied with the valuation of property has the right to contest the assessment to the local, county, and state boards of equalization or through the tax abatement process. Equalization is the process provided by law to adjust property assessments to be consistent with market value or agricultural value. A property owner may present evidence to the local board of equalization to argue for a reduction in the valuation of the person's property. In place of the equalization process, a property owner may elect to use a more formal abatement process in contesting a property tax assessment. Several layers of review are involved in the abatement process, which may culminate in appeal of the decision of the board of county commissioners to the district court and then to the North Dakota Supreme Court.

Once valuations are finalized following the equalization process, each taxing district prepares a preliminary budget based on anticipated expenditures for the upcoming year. The amount budgeted by a taxing district may not result in a tax levy exceeding levy limitations established by statute. The county treasurer has until December 26 to mail a property tax statement to the owner of each parcel of real property. Property statements must include the true and full value of the property; the total mill levy applied to the property; the amount of tax levied in dollars against the parcel by the county, school district, city, and township for the current year and the 2 immediately preceding taxable years; and the dollar amount of property tax savings realized by the property owner through legislative tax relief. Property taxes are due January 1 following the year of assessment and are payable without penalty until March 1 of the year in which due. The committee also reviewed information regarding payments in lieu of property tax.

Property Tax Statistics

The committee reviewed information published by the Tax Department, which indicated $1,133,974,223 in property tax was levied in 2019 for payment in 2020. This amount represents a 5 percent increase over the total amount levied for payment in 2019. Additional information published by the Tax Department indicated the majority of the property tax levied in 2019 was levied by school districts, followed by the amount of property tax levied by cities, counties, smaller miscellaneous taxing districts, and townships.

Traditional Controls on Growth of Property Tax Levies

In studying the growth of property tax levies, the committee reviewed the traditional controls that serve to limit the growth of levies. These controls include state law, governing body self-restraint, and taxpayer and citizen participation. Various restricting factors are found in state law, including constitutional and statutory provisions imposing mill levy limits, voter-approval requirements, and debt limits. In addition, statutory provisions have provided for property tax relief and state assumption of program costs for some local government functions. Governing body self-restraint also serves as a traditional limiter on the growth of property tax levies. Local elected officials are presumed to act in the best interests of the political subdivision and taxpayers. Political considerations relating to being elected or reelected serve to restrain local spending to a level deemed acceptable by the majority of voters. Local elected officials also are taxpayers of the taxing district they serve and likely do not want an excessive property tax levy any more than other taxpayers. Another

limiting factor related to governing body restraint involves taxpayer and citizen participation. Taxpayers subject to property tax tend to voice their preferences to elected officials both through direct communication and by casting votes on ballot measures relating to taxation and spending.

Significant Property Tax Reform and Relief Legislation

The committee undertook a broad review of property tax reform and relief legislation from 2007 through 2021.

In 2007, the Legislative Assembly provided temporary property tax relief through the income tax system through the passage of Senate Bill No. 2032. The bill provided income tax credits in the amount of a percentage of property taxes paid on a residential property occupied as a primary residence and for agricultural and commercial property owned by an individual whose primary residence was in North Dakota. The income tax relief provided $115 million of benefit to taxpayers but the method of delivering the relief created some confusion and administrative difficulties. The relief was not extended in the 2009 legislative session.

In 2009, the Legislative Assembly provided property tax relief through the passage of Senate Bill No. 2199 by reducing school district property tax levies and appropriating $295 million for the biennium for allocation to school districts through mill levy reduction grants.

In 2011, The Legislative Assembly provided property tax relief through the passage of House Bill No. 1047 by reducing up to 75 mills of school district levy authority and appropriating $341,790,000 for the biennium for allocation to school districts through mill levy reduction grants.

In 2013, the Legislative Assembly provided property tax reform or relief through the passage of House Bill Nos. 1013, 1015, 1306, and 1107 and Senate Bill Nos. 2036 and 2171. House Bill No. 1013 provided a substantial expansion of state funding for elementary and secondary education, including state payment of up to 50 mills of school district property tax levies and a reduction of up to 75 mills in school district property tax levies. Senate Bill No. 2036 created a new approach to property tax relief funding by providing a state-paid credit against property taxes and mobile home taxes in the amount of 12 percent of the taxes levied by all taxing districts against the property. House Bill Nos. 1015 and 1306 and Senate Bill No. 2171 provided property tax relief through the homestead credit and disabled veterans' homestead credit in an amount estimated to exceed $27 million for the biennium. House Bill No. 1107 provided the withholding of state aid distribution fund allocations from counties as a penalty for failure to implement soil type and soil classification data.

In 2015, the Legislative Assembly provided property tax reform or relief through the passage of House Bill Nos. 1057 and 1059 and Senate Bill Nos. 2005, 2031, 2144, 2206, and 2217. House Bill No. 1057 relocated the statutory provision mandating that property owners receive notice of certain assessment increases and notice and opportunity for taxpayers to appear if a board is considering increasing an assessment by an amount prescribed in statute. Senate Bill No. 2005 extended the 12 percent state-paid property tax credit through tax year 2016 and appropriated $250 million for allocations of state-paid property tax relief credit funds for the biennium. House Bill No. 1059 extended the 12 percent state-paid property tax credit indefinitely, provided an equivalent credit for rural electric cooperatives, modified the transmission line per mile tax rate, and allowed certain transmission line tax payments to qualify for the state-paid property tax relief credit. Senate Bill No. 2031 provided funding for a portion of elementary and secondary education, including a 3 percent increase in the state's per-student payment in each year of the biennium and continued state funding of up to 115 mills of local property tax. Senate Bill No. 2144 combined various levies for counties, cities, townships, and other political subdivisions and repealed unnecessary or consolidated levy provisions. Senate Bill No. 2206 provided for state assumption of a significant share of county social service costs beginning in 2016 and required the 2016 county social service board budget be reduced by the amount of costs to be assumed by the state, with an allowable increase for county employee salary and benefits. Senate Bill No. 2217 required any taxing entity authorized to levy property taxes, or have property taxes levied on its behalf, to file a financial report with the city or county auditor in the year for which the levy will apply showing the ending balances of each fund or account held by the taxing entity during the preceding calendar year.

In 2017, the Legislative Assembly provided property tax reform or relief through the passage of House Bill No. 1015 and Senate Bill Nos. 2206 and 2288. House Bill No. 1015 required each county auditor to submit a report to the Tax Commissioner containing each taxing district's property valuation, property tax levy, and any other requested information and required the Tax Commissioner to use the information to prepare a statewide report of property tax increase. Senate Bill No. 2206 created a 2-year pilot program for the state-payment of county-funded economic assistance and social service costs, suspended a county's ability to levy up to 20 mills for human service purposes for taxable years 2017 and 2018, required the savings to be reflected on property tax statements, created a credit to provide comparable savings to centrally assessed companies that make payments in lieu of taxes, and repealed the 12 percent state-paid property tax credit effective for taxable years beginning after 2016. Senate Bill No. 2288 made various changes to property tax levy increase notice and public hearing provisions and assessment dates.

In 2019, the Legislative Assembly provided property tax reform or relief through the passage of House Bill Nos. 1041, 1174, and 1268 and Senate Bill Nos. 2052, 2124, and 2265. House Bill No. 1041 provided for an adjustment to the total amount of special assessment credits allowed against a property that qualified for the homestead tax credit. House Bill No. 1174 provided for the full amount of an individual's Social Security benefits to remain part of income for purposes of calculating income for the homestead property tax credit even if the benefits are excluded for purposes of calculating income tax liability. House Bill No. 1268 increased the maximum amount a county may levy for emergency medical service purposes from 10 to 15 mills. Senate Bill No. 2052 provided the board of a school district the ability to levy up to 5 mills for purposes of developing a school safety plan upon approval by a majority of the qualified electors voting on the question. Senate Bill No. 2124 provided the manner in which legislative property tax relief associated with the state takeover of social service costs must be calculated and displayed on property tax statements. Senate Bill No. 2265 phased school districts levying less than 60 mills to a uniform 60-mill deduction by 2025 for purposes of calculating state aid payments.

In 2021, the Legislative Assembly provided property tax reform or relief through the passage of House Bill No. 1157 and Senate Bill No. 2213. House Bill No. 1157 allowed a township to levy the number of mills necessary to address natural disasters or other emergency conditions upon approval of a majority of electors of the township voting on the question. Senate Bill No. 2213 increased the value to which the property tax credit for disabled veterans may be applied from the first $6,750 of taxable valuation to the first $8,100 of taxable valuation.

Past Property Tax Interim Studies

The committee reviewed past interim studies related to property tax, including studies conducted during the 2011-12, 2013-14, 2015-16, 2017-18, 2019-20, and 2021-22 interims.

Testimony and Committee Considerations

The committee reviewed information regarding current and projected state revenues and expenditures, a flowchart of state funds, and information regarding the state budget and legacy fund. The committee was informed general fund appropriations for the 2021-23 biennium total $5.01 billion, including $4.88 billion of ongoing funding and $130 million of one-time funding. Estimated oil and gas tax revenues for the 2021-23 biennium total $3.72 billion, $1.05 billion of which represents the state funds share of oil and gas tax revenues. State revenue attributable to individual and corporate income tax for the 2021-23 biennium is $780 million, which includes $570 million for individual income tax and $210 million for corporate income tax. General fund tax and fee revenues are 14 percent more than forecast during the 2021 legislative session through February 2022 and oil tax revenues are 29 percent more than forecast during the 2021 legislative session through March 2022. The committee was informed legacy fund earnings have been substantial; however, earnings are subject to volatility due to market fluctuations.

The committee received testimony from a representative of the Department of Mineral Resources regarding the oil production outlook for the state. The testimony indicated 37 drilling rigs are operating in the state, and the state produces about 1.1 million barrels of oil per day at a price in excess of $100 per barrel. Over the next approximately 12 years, the state oil production rate is projected to increase to about 1.4 million barrels per day and plateau. An estimated 40,000 wells will be in production in 2040. Drilling inventory in the state likely will be exhausted within approximately 18 years, after which enhanced oil recovery methods will be needed to further develop oil production.

The committee was informed if the average price of a barrel of crude oil exceeds the trigger price of $94.69 for 3 consecutive months, the oil extraction tax will increase from 5 to 6 percent until the average price drops below the trigger price for 3 consecutive months. The average price of a barrel of crude oil is based on the West Texas Intermediate oil prices. In addition, the committee was informed stripper wells are exempt from the oil extraction tax. A well located in the Bakken Formation qualifies as a stripper well when it produces less than 35 barrels of oil per day. The number of stripper wells is projected to increase in the late 2030s based on the anticipated number of producing wells and estimated daily production rate at that time.

The committee solicited testimony from a representative of the Department of Public Instruction regarding K-12 education funding and property tax. The committee was informed the cost of providing adequate K-12 education is funded by a combination of state and local taxes, with statewide taxes funding approximately 75 percent of the cost. The local share of K-12 education funding is equal to 60 mills on the taxable valuation of property in the school district and 75 percent of other local in lieu of property tax revenue. The K-12 education funding formula is student driven and uses various weighting factors to account for increased costs associated with school district size and serving students with special needs. A base per student funding rate is set by the Legislative Assembly and is designed to generate the funding necessary to educate students to state standards.

Representatives of the Tax Department provided information on a number of topics, including challenges and administrative difficulties associated with the homestead income tax credit and commercial property income tax credit contained in Senate Bill No. 2032 (2007). The committee was informed the program established by the bill posed

administrative difficulties, including challenges associated with intermingling tax types administered at different levels of government, verification of parcel level data, communication, identifying property owners not subject to state income tax filing requirements, and the certificate program. The department noted a significant portion of the $1.1 million appropriated to the department to administer the program was expended on information technology programming to allow counties to upload county parcel information to the department's system so claimed credits could be verified. In addition, counties incurred costs and loss of time related to processing the certificates issued through the program. The department suggested tax relief in a fixed amount without intermingling tax types likely would be easier for the department to administer and more transparent to the public.

The committee received information from a representative of the Tax Department regarding individual and corporate income taxes paid based on income level and individual and corporate income tax deductions and credits claimed by taxpayers. The committee reviewed individual income tax data relating to the number of returns, total net tax liability, average net tax liability, and the effect of the tax relief credit provided in House Bill No. 1515 (2021) for various income levels based on federal adjusted gross income for tax years 2019 through 2021. The committee reviewed corporate income tax data relating to the number of returns, total net tax liability, and average net tax liability for various income levels based on North Dakota taxable income for tax years 2019 through 2021. The committee also received data related to individual and corporate income tax credits, including the number of returns and credit amount for each individual and corporate income tax credit for tax years 2019 through 2021. The individual and corporate income tax deduction data provided to the committee included the number of returns, deduction amount, and estimated tax reduction attributable to each individual and corporate income tax deduction for tax years 2019 through 2021. The department noted the 2021 individual tax year data and the 2020 and 2021 corporate income tax data are incomplete.

The committee also received information from the Tax Department related to the status of the income tax credit authorized in House Bill No. 1515, including an overview of the qualification criteria, the estimated fiscal impact, and a comparison of the estimated credits to the actual credits awarded to date. Committee members were informed the income tax credit is estimated to reduce income tax collections by $211 million for the 2021-23 biennium, including $104 million in fiscal year 2022 and $107 million in fiscal year 2023. The department received 405,990 returns as of June 13, 2022. Of these returns, 266,947 were eligible for a full or partial credit and $101.5 million of credits have been claimed.

A representative of the North Dakota Association of Counties provided information regarding the calculation of property tax. The committee received an overview of the valuation process for locally assessed property, centrally assessed property, rural electric cooperatives, and telecommunications companies. The committee was informed of the budget preparation process, including the county budget cycle timeline, political subdivision budget worksheets, calculation of mill rates, and maximum levy worksheets.

The committee reviewed the significant dates and deadlines associated with the property tax cycle and the contents of the notice of estimated property tax and the tax statement. The committee discussed the feasibility of including special assessment information on the notice of estimated property tax required under Section 57-15-02.2. The committee received information from a city auditor, a representative of the North Dakota League of Cities, and the North Dakota Association of Counties regarding the issue. The committee was informed moving any of the deadlines associated with special assessments would pose significant challenges for city and county auditors and others involved with the special assessment process. The committee was informed, from a process standpoint, special assessment installments paid in the previous taxable year would be relatively easy to include on the notice. However, the committee was cautioned this practice may result in confusion for taxpayers due to potential discrepancies between the previous year's special assessment installment paid and the special assessment installment amount due in the current year.

The committee received information regarding proposed property tax relief legislation anticipated to be introduced during the next legislative session. The proposed legislation would include lowering the local contribution under the K-12 school funding formula from the current 60-mill requirement to 30 mills applied to the school district's 2022 taxable value and would lock in taxable valuations at the school district's 2022 value for the biennium for purposes of calculating the local contribution under the formula. The proposed legislation also would require school boards to discuss budgets in dollar amounts rather than number of mills to encourage transparency and prudent spending. The relief program would be funded by legacy fund earnings. Some committee members expressed support for the proposed legislation, noting benefits of concentrating on property tax relief through school funding. Other committee members expressed concern regarding the potential cost of the relief and the potential for political subdivisions to increase property taxes to backfill the relief provided through the proposed legislation.

The committee received testimony regarding a second item of proposed tax relief legislation anticipated to be introduced during the next legislative session. The proposed legislation would provide for a refundable income tax credit in the amount of 10 percent of property taxes paid on a taxpayer's primary residence. Some committee members questioned whether the proposal was a redistribution of tax dollars rather than tax relief. Other committee members

expressed concerns related to the restrictions contained in Section 18 of Article X of the Constitution of North Dakota, commonly referred to as the "gift clause," and the potential for political subdivisions to backfill the relief provided to taxpayers through the income tax credit. Another committee member noted the plan would provide a modest percentage of property taxes paid directly to taxpayers.

The Governor and Tax Commissioner provided information regarding proposed income tax relief legislation, which they anticipated would be introduced during the next legislative session. The proposed legislation would create the lowest flat income tax in the nation at 1.5 percent. Under the plan, the first $54,725 of income for an individual and the first $95,600 of income for a married couple filing jointly, including the federal standard deduction, would be at a zero tax rate. The committee was informed the plan would provide every North Dakota income taxpayer an income tax benefit and income tax liability would be eliminated for nearly 60 percent of North Dakota taxpayers. The committee also was informed the state budgetary environment would support passage of the plan from a fiscal standpoint.

Committee members expressed opposing viewpoints regarding whether to pursue property or income tax relief. Some committee members expressed support of income tax relief, noting it would ensure tax relief is provided directly to taxpayers, help attract and retain workforce, improve the state business climate, and provide tax relief while ensuring property taxes are controlled at the local level. Conversely, committee members favoring property tax relief noted constituents have identified property tax as a more significant concern than state income tax. Committee members discussed the importance of determining the dollar amount of property tax relief and source of revenue before determining what type of tax relief to provide.

Conclusions

The committee makes no recommendations in regard to its study of the feasibility and desirability of providing holistic tax reform and relief, focusing primarily on property tax relief and, to a lesser extent, income tax relief.

REPORTS RECEIVED BY THE COMMITTEE

Property Tax Increase Report

The committee was assigned the responsibility to receive an annual report from the Tax Department on property tax increases pursuant to Section 57-20-04. The report is due by April 1 of each year and must include the annual increase in property taxes levied by each taxing district of the state after adjusting for property that was not taxable in the preceding year and property that is no longer taxable which was taxable in the preceding year. The committee received detailed information regarding the year-to-year change in dollars levied by counties, cities, and school districts in the state. The 2021 and 2022 reports contain the top 50 changes in taxes levied, including information related to school district levies, city park levies, citywide levies, and countywide levies. The 2022 report indicates the average ad valorem tax percentage change from 2020 to 2021 was 2.79 percent for counties, 5.99 percent for cities, and 4.64 percent for school districts.

The committee received a demonstration of an online tool created by the Tax Department which enables users to view mill levies imposed by political subdivisions and property tax changes for existing property for each political subdivision of the state. Testimony indicated the report is a continued effort to provide transparency in the budget process.

Renaissance Zone and Tax Increment Financing Report

The committee was assigned the responsibility to receive an annual report from the Department of Commerce's Division of Community Services on renaissance zone progress, pursuant to Section 40-63-03(2), and a report compiling reports from cities that have renaissance zone property included in a tax increment financing district, pursuant to Section 40-63-03(10). According to the 2020 report on renaissance zone progress, 1,926 projects have been approved and 1,498 projects have been completed since the inception of the renaissance zone program. A survey of renaissance zone communities conducted in 2020 indicated renaissance zones created 11 new businesses, 8 business expansions, and 38 new jobs. The benefits realized by the 77 projects that reached completion in 2020 amounted to $2,021,308 in income tax exemptions and $3,090,887 in property tax exemptions. According to the 2021 report on renaissance zone progress, 1,976 projects have been approved and 1,554 projects have been completed since the inception of the renaissance zone program. A survey of renaissance zone communities conducted in 2021 indicated renaissance zones created 20 new businesses, 13 business expansions, and 211 new jobs. The benefits realized by the 50 projects that reached completion in 2021 amounted to $2,557,405 in income tax exemptions and $8,552,426 in property tax exemptions. Testimony indicated the renaissance zone program is functioning as intended.

State Grantor Report

The committee was assigned the responsibility to receive from the Department of Commerce an annual compilation and summary of the reports of state agencies that awarded business incentives for the previous calendar year pursuant to Section 54-60.1-07. The business incentive accountability law became effective January 1, 2006. The law applies to businesses that receive incentives totaling $25,000 or more in a given year from state or local grantors. The law requires the recipient business enter a business incentive agreement with the grantor, which must provide a description of the

incentive to be granted as well as the job goals the business seeks to achieve within the first 2 years. A recipient business must report progress toward achieving stated goals.

The report details the distribution of business incentives by type, public purpose, and type of business. The report also provides the number of agreements entered by year and identifies whether the goal was to create jobs, retain jobs, or neither. The 2020 report indicated from 2016 through 2020, 865 business incentive agreements were entered into the database, totaling an incentive value of $124,835,930. The report also indicated over the last 5 years, 4,113.5 jobs were created and retained compared to a goal of 1,990.5 jobs, and 81 percent of business incentives met their goals within 2 years from the benefit date. The 2021 report indicated from 2017 through 2021, 841 business incentive agreements were entered into the database, totaling an incentive value of $172,619,977. The report also indicated over the last 5 years, 3,400.5 jobs were created and retained compared to a goal of 1,466 jobs, and 76 percent of business incentives met their goals within 2 years from the benefit date.