NORTH DAKOTA LEGISLATIVE MANAGEMENT

Minutes of the

POLITICAL SUBDIVISION TAXATION COMMITTEE

Tuesday and Wednesday, December 1-2, 2015
Roughrider Room, State Capitol
Bismarck, North Dakota

Representative Jason Dockter, Chairman, called the meeting to order at 9:00 a.m.

Members present: Representatives Jason Dockter, Larry Bellew, Mark A. Dosch, Craig Headland, Kathy Hogan, Lawrence R. Klemin, William E. Kretschmar, Alisa Mitskog, Gail Mooney, Naomi Muscha, Mike Nathe, Nathan Toman, Robin Weisz; Senators Brad Bekkedahl, Randall A. Burckhard, Dwight Cook, Jim Dotzenrod, Tim Mathern, Jessica Unruh

Members absent: Representatives Ben Koppelman and Mike Lefor

Others present: John Walstad, Legal Division Director, Legislative Council
Representative Wesley R. Belter, member of the Legislative Management, was also in attendance.
See Appendix A for additional persons present.

It was moved by Senator Mathern, seconded by Senator Burckhard, and carried on a voice vote that the minutes of the September 9, 2015, meeting be approved as distributed.

SOCIAL SERVICES FINANCING STUDY

Department of Human Services

Chairman Dockter called on Ms. Maggie D. Anderson, Executive Director, Department of Human Services, for presentation of information (Appendix B) regarding an update on the progress of the County Social Services Finance Working Group. Ms. Anderson said the working group met on three prior occasions. She said a subgroup has also been formed to review county financial information and caseload data. She provided an update on the human services grant, created by Section 6 of 2015 Senate Bill No. 2206 to replace levy 1222, and said $1.9 million has been appropriated for the grant program for calendar year 2016 and $2 million has been appropriated for calendar year 2017. She said the department drafted emergency rules for the grant program. She said the rules will be presented to the Administrative Rules Committee on December 7, 2015. She provided information on counties that requested and were awarded funding pursuant to the grant program and explained any discrepancies between the amounts requested and the amounts awarded. She said $1.7 million of the available $1.9 million was awarded for calendar year 2016. She said the remaining $200,000 will be turned back as the department does not have the ability to roll these unspent funds forward to calendar year 2017.

Ms. Anderson provided a summary (Appendix C) of the data the working group has collected including counties' actual expenditures for calendar year 2014, counties' calendar year 2015 budgets which will be updated with actual expenditure amounts in February, counties' estimated calendar year 2016 budgets amounts had 2015 Senate Bill No. 2206 not passed, estimated costs assumed by the state as a result of the passage of the bill, and the gross allowable budget after making any adjustments required by the bill. She also provided information (Appendix D) illustrating the increase or decrease in county expenditures in years 2011 through 2014. She said the working group is continuing to collect caseload information for a variety of program areas and will be comparing that data to cost information as it develops a methodology to adequately fund counties to administer economic and child welfare programs and maintain local access to services. She said the working group hopes to have a final draft of the proposed methodology in the coming months. She said the working group will be encouraging counties to create efficiencies where possible.

In response to a question from Senator Burckhard, Ms. Anderson said the increases in Ward County's expenditures may be attributable to additional staff added in the fall of 2013 in response to Medicaid Expansion or increased demand for foster care services in relation to oil activity.

In response to a question from Representative Kretschmar, Ms. Anderson said the portions of the handout labeled as "Dakota Central" represent a consortium of counties that merged into the Dakota Central Social Services district for purposes of sharing administration of programs.

In response to a question from Representative Weisz, Ms. Anderson said a variety of factors may lead to variations in per capita costs for social services from county to county. She said counties with large concentrations of clientele in rural areas may incur greater costs than counties servicing predominantly urban areas, due to increased transportation requirements. She said costs may also vary due to differing pay scales offered for similar positions from county to county.

In response to a question from Representative Dosch regarding the average cost per case, Ms. Anderson said she could provide the Legislative Council staff two documents from the Department of Human Service's website. She said the first document provides information on the number of individuals receiving services in each program area and the average cost per case. She said the second document provides an unduplicated count of eligible recipients receiving services through social service programs.

In response to a question from Representative Hogan, Ms. Anderson said home- and community-based services are not necessarily service costs the state would be assuming. She said counties may be expending time to provide these services but they are also billing Medicaid and receiving payments. She said the working group is discussing how to address services that are not currently funded with federal or state dollars.

In response to a question from Representative Hogan, Mr. Steven J. Reiser, Director, Dakota Central Social Services, said some home- and community-based services are Medicaid eligible and some are not. He said the subgroup is discussing how to address cases that are not eligible for Medicaid reimbursement and is referring to these cases as county-funded cases. Representative Hogan said the committee needs to be sensitive to aging services as counties are often the sole provider of in-home care services to low-income elderly in many rural areas.

In response to a question from Senator Mathern, Ms. Anderson said the working group had not addressed any issues beyond financial arrangements. She said the working group has not discussed the restructuring of services or administration. Senator Mathern said it would behoove the committee to review the actual structure behind delivery of services, in addition to financing, as it moves forward with the study.

In response to a question from Senator Cook, Ms. Anderson said information regarding the number of mills a county has been able to reduce from its budget as a result of the passage of 2015 Senate Bill No. 2206 would be available after January 1, 2016.

Chairman Dockter requested the working group provide this information to the committee at a future meeting date.

In response to a question from Representative Klemin, Ms. Anderson said working group meeting minutes are not available for distribution until the minutes are approved at the following meeting. She said the subgroup is not preparing meeting minutes as the subgroup's primary task is simply to review large amounts of financial and other related data.

In response to a question from Representative Hogan, Ms. Anderson said Mr. Reiser and his colleagues have been working to collect data and compile a master list of all county-funded items.

Chairman Dockter requested that Mr. Reiser provide this information to the committee at a future meeting date and invited comments by interested persons in attendance.

North Dakota Association of Counties

Mr. Terry Traynor, Assistant Director, North Dakota Association of Counties, presented information (Appendix E) regarding the social services financing study. He reviewed information pertaining to state fiscal year 2013 to provide perspective on the sources of social services funding, funding amounts, and impacts on property taxes. He said property tax is a poor fit for funding social services and gave an example of the disparity in the amounts homeowners would be paying for social service related costs when applying 2013 costs to three homes having similar true and full value. He said the amount paid by the homeowners residing in the three different counties provided in his example ranged from \$120 to \$560 per year. He said it is logical for the state to fund social services in light of how much of the program is driven by state and federal policy. He said it would be beneficial for the reimbursement formula to take into account rural transportation issues and additional cost differences related to the size of a county and said he anticipates counties retaining their current administrative roles. He said provisions should also be placed in the formula to address local option services and services that are mandatory but unfunded, such as indigent burials. He said biennial growth for certain items like salaries and health insurance should also be taken into account when developing the funding formula. He said any formula that unduly restricts a county's ability to deliver services should be avoided.

In response to a question from Senator Unruh, Mr. Traynor said it is possible the lower cost to one of the homeowners provided in his example could be a result of the sharing of administrative services as the county in that example is part of the Dakota Central Social Services district.

In response to a question from Senator Cook, Mr. Traynor said focusing on whether counties have skin in the game somewhat presupposes that counties are going to inflate their budgets. He said if the formula is done right, and counties are reimbursed on a caseload basis, counties will only be getting paid for the work they do. He said if a county is unable to meet its caseloads based on the determined reimbursement amounts, the county will have to make some hard decisions on whether it shares staff with neighboring counties or makes other adjustments. He said he agreed that the study should take into account the delivery system but thinks there are ways to build items into a financial reimbursement system that encourage efficiencies.

Representative Nathe said this issue reminds him of the K-12 funding formula and asked whether the counties would accept a greater level of control from the state if the state is the entity providing the funding. Mr. Traynor said these types of structural issues are certainly up for debate. He said the desire to retain local delivery of services lies in each county's need to deliver services at all hours of the day or night to vulnerable groups requiring services. Representative Nathe said, as the study progresses, the committee should keep in mind ways to prevent county budgets from being inflated up to the maximum amount of funding available and also requested data be provided on counties' ending fund balances. Mr. Traynor said the state has taken over some significant dollars and will have to watch how the next 2 years play out to see if any issues arise.

Chairman Dockter requested that Mr. Traynor provide the requested ending fund balance information to the committee at a future meeting date.

In response to a question from Senator Mathern regarding multicounty social service districts and county sharing arrangements, Mr. Traynor said county social service directors have prepared an extensive document detailing all social service sharing agreements. He said director and staff services have been shared between Wells, Foster, and Eddy Counties for at least 15 years and the boards of these three counties recently decided to form a district similar to the Dakota Central Social Services district. He said a member of the working group from the Wells County Commission may be able to provide additional information to the committee regarding the benefits derived from sharing services.

Chairman Dockter directed the Legislative Council staff to reach out to the appropriate parties and request this information be presented to the committee at a future meeting date.

Committee Discussion

In response to a question from Representative Klemin, the Legislative Council staff said the objective of the social services study is to develop a plan to transition the costs of operating social service programs from county property tax levies to general fund appropriations. She said if the committee chooses to undertake a broad review of factors impacting that transition it may be feasible to consider items such as staffing or delivery systems that could impact costs. She said the study does not explicitly reference any considerations for transferring county employees to the state level.

Senator Cook said there was implied direction that there would not be a transfer of staff but given the importance of the study, the committee should allow all issues to remain on the table for discussion. He said he is open to finding efficiencies but also hesitant to impose any type of forced consolidations on counties.

Representative Klemin said a similar shift was previously undertaken with the court system when it was transitioned from the county level to the state level.

Chairman Dockter said the committee has received a large amount of information it needs to review. He said as the committee proceeds with the study, time may become a factor in making any decisions as complex as the decision to transfer employees.

Representative Weisz said it may be premature for the committee to commit to including or precluding considerations of transferring employees. He said the committee will have to review the determinations made by the working group and decide whether the committee is satisfied with the working group's determinations. He said he would prefer to leave all topics concerning the study open for discussion.

Senator Mathern asked if the committee could receive a presentation from the National Council of State Legislatures, the Council of State Governments, or some association of human service centers to gain a better understanding of the most common ways other states manage their human service budgets.

Chairman Dockter directed the Legislative Council staff to reach out to those groups and see if any information is available.

In response to a question from Senator Cook, Ms. Anderson said she will deliver the committee's comments regarding the potential for staffing changes to the working group for consideration and additional discussion.

In response to a question from Representative Nathe, Ms. Anderson said Ms. Kim Jacobson, Director, Traill County Social Services has been assembling a document detailing how counties are sharing services. Ms. Anderson said the working group will be reviewing this information to see how it may impact costs. She said the working group has not discussed the topic of forced consolidations but she would be willing to have the working group consider incentivized consolidations as a point of discussion going forward. She said the funding formula will likely encourage efficiencies and may potentially encourage some counties to consolidate.

Representative Hogan said she recalled the process of shifting from a county to a state administered child support system and it may be beneficial for the committee to review information pertaining to any cost savings and program outcomes that resulted from that shift. Ms. Anderson said Mr. Jim Fleming, Director, Child Support Enforcement Division, Department of Human Services, was with the agency both prior to and following that shift and would likely be able to present additional information to the committee.

Chairman Dockter directed the Legislative Council staff to work with Ms. Anderson and Mr. Fleming to have this information presented to the committee at a future meeting date.

CONTRACTOR SALES AND USE TAX STUDY

Chairman Dockter called on the Legislative Council staff for presentation of a bill draft [17.0009.01000] relating to the elimination of sales and use tax on items purchased by or for an exempt entity and installed by a contractor. The Legislative Council staff said the bill draft contains provisions pertaining to both sales and use tax. She said a contractor purchasing items on behalf of an exempt entity for use in the completion of a contract with an exempt entity is required to obtain certain items prior to purchasing tangible personal property of withdrawing that property from the contractor's inventory on behalf of the exempt entity. She said the contractor is required to obtain a purchasing agent authorization letter and a copy of the exempt entity's exemption certificate. She said the tangible personal property must be incorporated as part of an improvement to real property and the exempt entity must own the real property upon the completion of the contract for the exemption to apply. She said the bill draft defines an exempt entity as any entity that can purchase items on its own behalf without the payment of sales or use tax but does not include an entity purchasing items as a new or expanding business for purposes of completing a specific project. She said the bill also contains use tax provisions that serve to exempt tangible personal property purchased by an exempt entity, but subsequently installed by a contractor, from use tax. She said tangible personal property must be incorporated as part of an improvement to real property and the exempt entity must own the real property upon the completion of the contract for the use tax exemption to apply. She said the language that has been stricken in the bill regarding the use tax exemption for tangible personal property purchased by a hospital or long-term care facility does not act to eliminate the exemption for these groups. She said the language was simply removed because purchases made by these groups are now addressed within the new language provided on page 5 of the bill draft.

Tax Department

Chairman Dockter called on Mr. Myles Vosberg, Director, Tax Administration Division, Tax Department, for comments on the bill draft and presentation of information (Appendix F) regarding the anticipated fiscal effect of eliminating the payment of sales and use tax on items purchased by or for an exempt entity and installed by a contractor. Mr. Vosberg said, under current law, a contractor who holds a sales tax permit and is registered with the Secretary of State has the ability to use an exemption certificate to buy materials without the payment of sales tax. He said this practice serves more as a tax deferral than a true exemption because when a contractor uses those materials for a project, the contractor must remit use tax. He said the provisions of the bill draft exempt the contractor from the requirement to remit use tax on materials used in the performance of a contract with an exempt entity. He said a contractor would be required to retain a copy of the purchasing agent authorization letter and a copy of the exempt entity's exemption certificate so the contractor would be able to verify which items were purchased pursuant to the contract with the exempt entity if the Tax Department ever conducts an audit.

In response to a question from Representative Dosch, Mr. Vosberg said it would be possible to continue to charge the tax and then allow a contractor to apply for a refund upon the completion of the project. He said this is done in various instances for purchases relating to projects for new or expanding businesses. He said this practice can be somewhat burdensome for contractors because they are the ones who have to provide all of the purchasing invoices in order to receive a refund. He said some projects, like the nearly $500 million hospital being constructed in Fargo, would require the collection of a large volume of invoices and the exempt entity would be required to finance any use tax costs until the refund was issued.

In response to a question from Representative Klemin, Mr. Vosberg said the requirement for the exempt entity to own the real property upon the completion of the contract was attempting to avoid situations in which an exempt entity is hiring a contractor to make involvements to real property that the entity is simply leasing or renting. Representative Klemin suggested deleting the phrase "upon the completion of the contract" and requiring the exempt entity to own the real property, and the improvements thereon, at the time the contract is entered into.

Chairman Dockter directed the Legislative Council staff to prepare an amended version of the bill draft to reflect these changes.

In response to a question from Senator Bekkedahl, Mr. Vosberg said it is possible that a private party could build a park structure or something similar and then turn it over to an exempt entity upon completion. He said he did not know how often this this type of scenario would occur.

In response to a question from Representative Klemin, Mr. Vosberg said the portion of the definition of an exempt entity that excludes a new or qualifying business serves to distinguish purchases made by entities that are exempt from paying sales or use tax on everything they purchase from those new or expanding business entities that may receive an exemption on certain purchases made for specified projects. He said purchases made by these entities, such as an oil refinery or a specific manufacturer, already have individual exceptions placed within the sales and use tax laws.

In response to a question from Senator Cook, Mr. Vosberg said an example of a contractor owing use tax on an item the contractor has never owned could include a situation in which an exempt entity owns a building and purchases carpet or heating equipment the exempt entity then contracts to have installed. He said even though the exempt entity was able to purchase the carpet or heating equipment without paying sales tax the contractor would still be required to remit sales tax on any items he uses in the performance of the installation contract. He said the more common scenario involves the contractor purchasing the items being installed and then building the cost of paying use tax on those items into the total amount charged to complete the contract. He said the law would need to be changed if the committee would like to see separately stated charges for materials and labor on a contract. He said dividing these charges out could be problematic for lump sum contracts because it would require a contractor to disclose their costs for materials. Senator Cook said he would like to see a bill draft that only addresses exempting items of tangible personal property a contractor never owns from use tax.

Chairman Dockter directed the Legislative Council staff to prepare a bill draft exempting the payment of use tax on tangible personal property purchased by an exempt entity and used by a contractor.

Representative Weisz said he did not think the committee should distinguish between whether tangible personal property is purchased by the exempt entity or purchased by the contractor if the intent is to allow the exempt entity to acquire tangible personal property without payment of sales or use tax. He said in the case of items purchased by a contractor and installed on behalf of a political subdivision, the ultimate payment of the increased contract price resulting from a contractors incorporation of use tax charges results in shifting the burden for payment of use tax onto local residents in the form of increased property taxes.

Mr. Vosberg reviewed the amounts provided in his handout pertaining to the potential fiscal impact of eliminating the payment of sales and use tax on items purchased by or for an exempt entity and installed by a contractor. He said the estimated biennial fiscal impact of $44.22 million was arrived at by assuming total contract costs of $1.474 billion per year for political subdivisions, schools, hospitals, state agencies, federal agencies, and other exempt entities. He said he assumed materials represented 30 percent of the total amount of contract costs and multiplied that amount by the 5 percent sales and use tax rate. He said the resulting amount was then multiplied by two to arrive at an estimated biennial fiscal impact.

In response to a question from Representative Weisz, Mr. Vosberg said of the $44.22 million fiscal impact, only $1.5 million is related to hospital and other care facility contracts and a little over $3.5 million is related to federal contracts. Representative Weisz said the amount that remains after deducting that $5 million from the overall $44.22 million is the amount that represents a tax shift onto local property taxpayers or a circular payment of sales and use tax with other state tax revenues.

Chairman Dockter said the fiscal note attached to the initial draft of 2015 House Bill No. 1401 was a determining factor in the exemption failing to advance.

Chairman Dockter invited comments by interested persons in attendance.

Comments by Interested Persons

Mr. Larry Syverson, Executive Secretary/Director of Governmental Relations, North Dakota Township Officers Association, said the association supported the early draft of 2015 House Bill No. 1401, prior to the language being converted into a study, and it continues to support efforts to exempt tangible personal property purchased or installed on behalf of an exempt entity by a contractor from sales and use tax. He said the association supports the concepts in this bill draft because it does not think shifting property tax revenues to pay sales and use tax is a proper use of local dollars. He said the association supports language that would allow the sales and use tax exemption to be claimed up front rather than requiring an entity to apply for refunds.

INCOME TAX RECIPROCITY STUDY

Chairman Dockter called on the Legislative Council staff for presentation of a memorandum entitled *Income Tax Reciprocity Agreement Between North Dakota and Montana*. The Legislative Council staff said the committee previously extended a request to the Chairman of the Legislative Management to add a study of the income tax reciprocity agreement between North Dakota and Montana to the list of the committee's studies this interim. She said the study was requested due to increased cross-border employment in the western part of the state and was approved on July 31, 2015. She reviewed the background memorandum pertaining to the agreement and provided a brief example to illustrate the operation of the agreement.

Tax Department

Chairman Dockter called on Mr. Joseph Becker, Auditor III, Tax Department, for presentation of information (Appendix G) regarding the history of the income tax reciprocity agreement between North Dakota and Montana and the estimated fiscal impact of the agreement. Mr. Becker said the agreement has operated quite smoothly since its inception. He said he is not aware of any fiscal impact study having ever been conducted in regard to the agreement. He said information would need to be extracted from both North Dakota and Montana income tax returns to properly evaluate the agreement's fiscal impact. He said there have generally been more Montana residents working in North Dakota than North Dakota residents working in Montana. He said based on data collected for the 2013 tax year, 4,932 Montana residents were working in North Dakota. He said of those individuals, 3,061 filed a North Dakota income tax return to claim a refund of income tax withheld and the remaining 1,871 individuals elected to have their North Dakota employers exempt their wages from North Dakota income tax withholding. He said the total amount refunded to Montana residents for the 2013 tax year exceeded $1.9 million. He said information obtained from the Montana Department of Revenue shows approximately 289 North Dakota residents working in Montana during the 2013 tax year. He said of these individuals, 132 filed a Montana income tax return to claim a refund of the Montana income tax withheld and the remaining 157 individuals elected to have their Montana employers exempt their wages from Montana income tax withholding. He said the total amount of wages exempted under the reciprocity agreement was just over $2.3 million. He said information on the total amount refunded was not provided by the Montana Department of Revenue.

Mr. Becker said there is an overall negative fiscal impact on North Dakota revenue and an overall positive impact on Montana revenue based on the available 2013 data. He said the negative impact on North Dakota revenue is due to the fact that the amount of Montana residents' wages exempt from North Dakota income tax is greater than the amount of North Dakota residents' wages exempt from Montana income tax. He said there is a positive impact on Montana's revenue because Montana receives the full amount of tax on its residents working in North Dakota instead of having to give up a large portion of that revenue through the credit provided for taxes paid to North Dakota. He said on the individual level, a Montana resident will pay the same amount of income tax overall, whether they have to file and pay in North Dakota and in their home state or whether they are working under a reciprocity agreement. He said this is due to the fact that Montana income tax rates are higher than North Dakota income tax rates. He said a North Dakota resident on the other hand receives two benefits under the reciprocity agreement. He said the North Dakota resident gets to pay tax at the lower North Dakota rate and they get the convenience of not having to file an income tax return in Montana. He said a very rough estimate of the fiscal impact of the agreement can be arrived at by using figures from the 2013 tax year and then applying various averages and assumptions. He said an estimated $3.5 million would be the amount lost in North Dakota revenues and gained in Montana revenues.

In response to a question from Representative Headland, Mr. Becker said he was aware of the reciprocity agreement between Minnesota and Wisconsin. He said roughly $600,000 was expended in those states to collect returns to determine the fiscal impact of that agreement. He said due to the large number of Wisconsin residents working in Minnesota, as compared to the number of Minnesota residents working in Wisconsin, the study determined that Minnesota would lose roughly $6 million per year as a result of the reciprocity agreement. He said Minnesota pulled out of the agreement in 2009.

In response to a question from Representative Klemin, Mr. Becker said North Dakota is losing revenue due to the disparity in the number of Montana residents working in North Dakota as compared to the number of North

Dakota residents working in Montana. He said if the reciprocity agreement were not in place, North Dakota would be taxing all Montana residents working in North Dakota and Montana would be giving those individuals a credit for the tax paid in North Dakota when those residents filed their Montana returns. He said as a result, North Dakota would gain roughly $3.5 million in revenue whereas Montana would lose $3.5 million in revenue. He said individual North Dakota residents working in Montana would be on the losing end because those individuals would be subject to having taxes withheld from their wages at the higher Montana income tax rates. He said the quoted $3.5 million is only a rough estimate because the Tax Department does not have a complete set of data to analyze. He said the agreement allows for the exchange of information between states but the only information currently being exchanged relates to the exemption forms employees return to their employers. He said the only information contained on these forms is the taxpayer's identity and the taxpayer's prior wages, if any exist.

In response to a question from Representative Klemin, Chairman Dockter said the Legislative Council staff will forward a copy of the reciprocity agreement to the committee members.

In response to a request from Senator Bekkedahl for an average of the figures from the last 10 to 20 years to avoid any uncharacteristic high or low years, Mr. Becker said the Tax Department could provide the committee with whatever information is available. He said the data related to North Dakota residents working in Montana is not as complete because Montana does not have that information readily available.

In response to a question from Representative Headland, Mr. Becker said legislative authority is not needed to terminate the reciprocity agreement. He said the Tax Commissioner has the authority to withdraw from the agreement.

Committee Discussion

Representative Headland said he did not understand why North Dakota would remain a party to an agreement that was negatively impacting state revenues.

Senator Cook said the committee should be aware of any other agreements that exist between North Dakota and Montana before a withdrawal from the reciprocity agreement is considered.

Chairman Dockter directed the Legislative Council staff to research existing agreements between North Dakota and Montana.

In response to a question from Representative Nathe, Mr. Walstad said repealing the statute allowing for income tax reciprocity agreements would not affect reciprocity agreements related to education. He said repealing the statute would affect the Tax Commissioner's ability to continue the income tax reciprocity agreement with Minnesota because the statute simply grants the Tax Commissioner authority to enter into agreements with other states. He said the statute does not only pertain to agreements with Montana.

In response to a request from Representative Klemin, Chairman Dockter directed the Legislative Council staff to provide the committee a copy of the statute allowing for income tax reciprocity agreements and any other pertinent statues allowing for reciprocity agreements.

In response to a question from Senator Mathern regarding why the Tax Commissioner feels the reciprocity agreement is beneficial, Mr. Ryan Rauschenberger, Tax Commissioner, Tax Department, said one justification for the agreement is the benefit to individual taxpayers working along the border between North Dakota and Montana. He said a taxpayer who may only work for a limited amount of time in Montana, or who frequently travels back and forth between the two states, has the convenience of only filing a return in one state and only having one income tax rate apply. He said historically, the effects of the agreement have not been as lopsided. He said the Tax Department would be happy to have continued discussions regarding the value of the agreement going forward.

Representative Headland said, as a North Dakota taxpayer, he may be getting overtaxed due to the estimated $3.5 million in revenue going to Montana even though the wages on which that revenue is generated are originating in North Dakota.

In response to a question from Representative Burckhard, Commissioner Rauschenberger said no other agreements come to mind that would be affected if the income tax reciprocity agreement between North Dakota and Montana was terminated.

Senator Dotzenrod said the committee should also review the reciprocity agreement between North Dakota and Minnesota to determine the fiscal effects that may be associated with that agreement.

Chairman Dockter directed the Legislative Council staff to work with the Tax Department to have that information presented to the committee at a future meeting date.

Senator Cook said no tax savings are realized by a Montana resident working in North Dakota. He said the Montana resident receives a credit for any tax paid to North Dakota but is still required to pay any remaining balance of Montana income tax liability after the credit is applied.

In response to a question from Representative Mooney, Commissioner Rauschenberger said individuals from the business community may be able to better address how commerce might be impacted if the agreement were eliminated.

In response to a question from Representative Klemin, Commissioner Rauschenberger said, to his knowledge, the agreement does not impact any other taxes the employer may have to pay such as workforce insurance or other payroll taxes.

In response to a question from Representative Headland, Commissioner Rauschenberger said North Dakota could have a reciprocity agreement in place with just Minnesota.

ECONOMIC DEVELOPMENT TAX INCENTIVES STUDY

The Pew Charitable Trusts Roundtable Meeting

Chairman Dockter called on the Legislative Council staff for presentation of information from an Evaluator Roundtable Meeting hosted by The Pew Charitable Trusts (PEW) relating to the review and evaluation of economic development tax incentives. The Legislative Council staff said she attended a roundtable meeting along with Mr. Walstad and various other state representatives to discuss states' experiences evaluating tax incentives. She said topics discussed at the meeting included ways states could identify goals, choose metrics, and access data when evaluating incentives. She said tools for measuring impacts and methods evaluators could use to make informed policy decisions were also reviewed at the meeting. She reviewed a variety of notable items mentioned by representatives from various states including Washington's requirement that performance statements accompany tax incentive statutes and the various disclosure and reporting provisions found in states such as Iowa and Oklahoma. She said representatives from other states shared their experiences with merging or eliminating incentives. She said 60 incentives were reviewed in Oregon and either merged, eliminated, or split into narrower topic areas. She said following the review in Oregon, the list of incentives was reduced from 60 to 30. She said Rhode Island also undertook a large review of incentives and eliminated roughly 40 different personal income tax incentives and then proceeded to broaden the tax base and lower rates. She said Rhode Island representatives noted some taxpayers were unhappy about losing carryforwards, but overall the decision to eliminate some incentives and broaden the base was very successful in Rhode Island.

The Legislative Council staff said there was also discussion regarding the various economic models states use when evaluating incentives. She said the Regional Economic Models, Inc. (REMI) model was used in quite a few states. She said the committee will be receiving more information regarding this software from company representatives later in the day. She said she also noticed that there were several state economists in attendance at the meeting, which is an area of expertise not found within North Dakota's Legislative Council staff. She said many states seemed to have dedicated divisions housing economists in addition to legal and fiscal divisions.

Mr. Walstad agreed and said there were several economists at the meeting and it seemed common in other states to have separately dedicated, nonpartisan economists. He said these state economists seemed to provide a function that has long been requested by legislators in this state. He said unlike a fiscal note that will tell the legislature how much tax revenue may be lost due to a certain incentive, the information provided by an economist goes a step further and looks at the positive effects an incentive may have on the economy if it is successful.

In response to a question from Representative Hogan, the Legislative Council staff said materials were provided at the roundtable meeting and she would provide them to the committee members after verifying with PEW that the materials could be released.

Regional Economic Models Incorporated

Chairman Dockter called on Mr. Billy Leung, Vice President, and Mr. John Bennett, Economic Associate, REMI, to present information (Appendix H) regarding the features and capabilities of the REMI software application and explain how the software could be used to assist in the analysis of economic development tax incentives. Mr. Bennett reviewed the makeup of REMI's clientele, the data sources used in REMI models, and the features of Tax-PI. He said Tax-PI is an off-the-shelf software tool used for economic forecasting, macroeconomic demographic forecasting, and policy impact analysis. He said Tax-PI is customizable to a user's state and allows the user to run "what-if" scenarios to determine the potential impact of certain tax incentives or policies. He said the software essentially provides the tools needed to create dynamic fiscal notes.

In response to a question from Senator Mathern, Mr. Leung said measurements relating to the negative societal impacts of an incentive are not directly built into the model, but any additional factors can be analyzed if the user has sufficient data to input into the model.

In response to a question from Senator Cook, Mr. Bennett said approximately 10 of the 20 states using REMI use Tax-PI to generate fiscal notes. He said California and Florida have statues requiring the preparation of dynamic fiscal notes for any legislation over a certain amount. Mr. Leung said dynamic fiscal notes are pretty accurate. He said accuracy increases based on the amount of data a user is able to input into the model and the amount of time a user has to run the scenario. He said results calculated for scenarios input into the model in New Mexico, that only allowed for a brief 24-hour turn-around time, were found to be 80 to 90 percent accurate while scenarios having a turn around time of one month or more were approximately 98 percent accurate. He said accuracy depends mostly on the data that is available, the amount of time a user has to run various scenarios, and the skill of the person using the software.

In response to a question from Representative Klemin, Mr. Leung said the results of an analysis run using REMI's Tax-PI software are quite objective. He said the structure and equations used in the model are all standard. He said as long as the assumptions the user is applying are reasonable and all of the user's inputs are disclosed and explained, the results will be objective.

Mr. Bennett said Utah rented REMI software for six months to determine if the state's legislature would be interested in shifting to dynamic scoring. He said REMI software was also used in Washington to assess the very generous tax credits that state provides to the aerospace industry. He said REMI software allows a user to run simple or complex simulations depending on the amount of data and time available to the user.

In response to a question from Representative Nathe, Mr. Bennett said the model can be used by institutions of higher education and was recently used by the Mississippi Institutions of Higher Learning.

In response to questions from Senator Cook, Mr. Bennett said the model would default to using historical trends when running simulations dependent on the price of oil. He said as historical trends are not as relevant in light of today's oil market, North Dakota may be better suited by inputting data provided by local experts who may have a better sense of future oil prices. He said the Texas Legislative Budget Board is statutorily required to incorporate information from dynamic fiscal notes in any legislation having a static fiscal impact of $50 million or greater. He said California has the same requirement. He said he is not aware of REMI being used to run any scenarios related to the apportionment factors.

In response to a question from Senator Mathern, Mr. Bennett said REMI's forecast goes all the way out to the year 2060. Mr. Leung said the farther out a user goes in the model, the less accurate the result becomes.

In response to a question from Representative Klemin, Mr. Bennett said the initial cost to purchase the software would be $136,000 and the yearly renewal costs would be just under $30,000 in each following year. He said these fees entitle an agency to designate two users and provides those users with unlimited training and technical support from REMI's staff.

In response to a question from Representative Mitskog, Mr. Justin Dever, Co-Deputy Commissioner, Department of Commerce, said the Department of Commerce previously used REMI's PI+ software which did not include the fiscal component that is offered in REMI's Tax-PI software. He said the Department of Commerce primarily used REMI software to evaluate individual projects. He said overall the Department of Commerce was pleased with the performance of REMI's software but there was simply not room in the department's budget to purchase Tax-PI. He said the use of Tax-PI would be beneficial for the Department of Commerce's roll in evaluating the impact of tax incentives and for the department's general use as well. He said the department is currently considering other means to estimate the fiscal impact of the incentives the committee is evaluating.

In response to a question from Representative Hogan, Mr. Dever said the economic development reports the Department of Commerce currently generates are not public records because they contain information specific to individual companies. He said the information that will be provided to the committee will be on a per-incentive basis rather than a per-company basis.

In response to a question from Senator Mathern, Mr. Dever said the Department of Commerce would require additional software to provide an analysis of something like the North Dakota and Montana income tax reciprocity agreement. Mr. Dever said using REMI's software to provide information on a topic such as the reciprocity agreement would also involve a bit of a learning curve as the department's staff are not experts in tax policy.

In response to a question from Representative Mooney regarding whether REMI software would be best placed with the Tax Department, the Department of Commerce, or the Legislative Council, Chairman Dockter said the conversation is currently just focusing on whether the committee even has the ability to purchase the software. He said the committee would need to have further discussions regarding which agency would be most appropriate to house the software if the committee is able to secure funding.

In response to a question from Representative Nathe, Mr. Dever said the Department of Commerce currently has one person trained to serve as the primary user of REMI software and one person that serves as an assistant. He said he is not aware of how long it took to train those individuals to use the software.

In response to a question from Representative Dosch, Mr. Dever said the Office of Management and Budget currently uses Moody's Analytics for revenue forecasts. He said he is not familiar with how REMI might compare to Moody's Analytics.

Mr. Bennett said data from Moody's Analytics can be used within the REMI model. Mr. Leung said California uses Moody's Analytics to drive part of its revenue forecast. He said what REMI has that Moody's Analytics does not is impact analysis and that is why Moody's Analytics often refers clients to REMI for additional services.

Senator Cook said he would like more information on the number of states that require dynamic fiscal notes in relation to their budgets and of those, how many use REMI's software to generate that information.

Representative Klemin said he would like to know how many states have units within their legislatures containing individuals who are specifically trained to do this type of analysis. He said he would also like to receive a copy of the statutes from Texas and California that require the use of dynamic fiscal notes.

In response to a question from Chairman Dockter, Mr. Bennett said a rental option similar to what was provided to Utah could be an option for North Dakota. He said any amount paid for a rental could be applied toward the ultimate purchase price if the committee decided to acquire the software long-term.

In response to a question from Representative Klemin, Chairman Dockter directed the Legislative Council staff to request additional information from REMI representatives regarding pricing information and any trial period or short-term rental options and also see if there are any public reports regarding Utah's pilot project.

In response to a question from Chairman Dockter, Mr. Walstad said there are some funds available in the budget for interim committee activities. He said any committee expenditures would need to be approved by the Chairman of the Legislative Management. He said as there are currently some uncertainties as to pricing and the agency that would be using the software, it may be best for the committee to make a broad motion to allow Chairman Dockter to contact the Chairman of the Legislative Management to discuss any potential funding requests. He said he would followup on the amount of funds that may be available to the committee.

Representative Klemin said there are millions of dollars of revenue either to be gained or lost as a result of some of these incentives. He said the cost of acquiring software to adequately address the financial impact of these incentives is relatively small in comparison. He said another factor that should be addressed with the Legislative Management is the agency that would be using the software if it is acquired. He said any potential users would also likely need to be trained on how to use the software so staffing needs are another factor the committee should consider.

Senator Mathern agreed that many months of training may be required for staff to determine which data should be entered and which assumptions should be made in order to obtain accurate results. He said he agreed that the committee should move forward with receiving cost estimates and having additional discussions but encouraged the committee to recognize that there may not be a magic bullet to getting results this interim. He said the committee may ultimately have to rely on the partial picture that can be provided by the Department of Commerce when evaluating this interim's list of incentives.

Representative Dosch said the REMI representatives were very specific in their statements that the only individuals that can use the software are the two licensed users. He said the committee needs to consider which agency would be most appropriate to house the software. He said this is an especially important consideration if there is any intent to use this software to generate fiscal notes during the legislative session.

Chairman Dockter said he agreed that the committee needs to have further discussions on the agency best suited to use the software and whether the two users could be split between two different agencies. He said issues regarding whether additional funding would be required for the staff needed to operate the software would also need to be discussed. He said there are several variables the committee would need to consider.

Senator Cook said it is not his intent that REMI software be broadly used in the preparation of all fiscal notes. He said that decision would need to be made by the entire legislative body. He said if the Legislative Council is the agency remitting the funds to purchase the software, that may be the most appropriate agency to house the software.

It was moved by Senator Cook, seconded by Representative Headland, and carried on a voice vote that the Chairman be given authority to contact the Chairman of the Legislative Management to start a conversation regarding acquisition of services from REMI to assist in identifying the fiscal impacts of the incentives being reviewed by the committee.

Tax Department

Chairman Dockter called on Commissioner Rauschenberger for a presentation (Appendix I) regarding the data and information collected by the Tax Department on each incentive selected for review during the 2015-16 interim and the manner in which the data and information may be disclosed to the committee. Commissioner Rauschenberger said his handout provides a listing of the information the Tax Department will be able to provide to the Department of Commerce on each of the incentives the committee will be reviewing. He said data can be provided to the Department of Commerce on an individual level for purposes of imputing data into a model and producing aggregate information to share with the committee.

In response to a question from Senator Cook, Commissioner Rauschenberger said the angel fund report provided to the Legislative Management includes the name and address of each enterprise and the report is public information.

In response to a question from Senator Cook regarding whether the Tax Department should be the agency preparing dynamic fiscal notes if they are ever required, Commissioner Rauschenberger said he thinks the Tax Department should be involved at least to some degree if the responsibility is not placed entirely within the Tax Department. He said the Tax Department possesses a large volume of knowledge regarding how credits and exemptions are administered, how they are used, and who is using them. He said the Tax Department has had several discussions regarding dynamic fiscal notes and the potential benefits and hazards of using them. He said he has heard from other states that use dynamic fiscal notes and some states have had success using them while others have not. He said the Office of Management and Budget would likely have some opinions on the use of dynamic fiscal notes in the budgetary realm. He said it would be a large shift to prepare dynamic fiscal notes across the board. He said the legislature could end up with quite a few fiscal notes that show zero fiscal impact but actually end up costing the state some money. He said sometimes dynamic fiscal notes are accurate and sometimes they are not. He said when they are not, a state can end up in a tough fiscal situation.

In response to a question from Representative Klemin, Commissioner Rauschenberger said he could have a representative from the Tax Department provide the committee with an example of a dynamic fiscal note and an explanation of how they are used.

Department of Commerce

Chairman Dockter called on Mr. Dever for a presentation (Appendix J) regarding the data and information the Department of Commerce will receive from the Tax Department and Job Service North Dakota and the manner in which that data and information will be analyzed and provided to the committee. Mr. Dever said the Department of Commerce will match up the costs of incentives with any associated benefits in order to compute a return on investment. He said the Department of Commerce will be using an input-output model to estimate indirect and induced economic impacts and job creation. He said the Department of Commerce is reviewing options that will allow some conversion of economic impacts into estimated fiscal impacts to demonstrate each incentive's return to the state in terms of tax revenue. He said the Department of Commerce can also provide the committee information relating to any complementary or duplicative government programs available to businesses that qualify for the incentives being reviewed this interim.

In response to a question from Senator Dotzenrod, Mr. Dever said the Department of Commerce will not be able to provide detailed information on the extraneous impacts an incentive may have without the use of some type of software such as REMI's Tax-PI.

In response to a question from Representative Nathe, Mr. Dever said the Department of Commerce uses REMI's software mainly to determine the effects of larger projects. He said the Department of Commerce probably analyzes 30 to 40 incentives per year.

In response to a question from Representative Weisz, Mr. Dever said the Department of Commerce will be able to provide information regarding the return on investment for each incentive so the committee can see whether that return is a net positive. He said the Department of Commerce can provide the committee information on the impacts created by taxpayers that received incentives. He said the committee will need to determine whether the activities that may have occurred as a result of the incentive are worth any cost of providing the incentive. He said there are various ways the committee can assess an incentive's return on investment. He said the Department of Commerce will not be able to speak to an individual company's motives for certain activities or expansions or definitively state whether the availability of incentive is what enticed a company's specific actions. He said the committee will need to assess whether certain activities occurred as a result of the availability of incentives. He said the multistate survey memorandums provided by the Legislative Council staff will be useful in the committee's assessment of whether certain activities would have occurred in North Dakota when reviewing which incentives may have been available to those companies in other states.

In response to a question from Representative Mitskog, Mr. Dever said the Department of Commerce will provide the committee with as much useful information as possible with the resources it has at its disposal.

Senator Cook said the committee needs to be as scientific as possible in its assessment and needs to be careful because so much of this assessment is subjective. He said the committee should try to avoid any results that could lead to a large employer leaving the state.

Chairman Docker said he agreed and that is why the committee will be inviting interested parties to appear and provide testimony on how certain incentives may be keeping business activity in this state.

In response to a question from Senator Mathern, Mr. Dever agreed that companies often look at a host of variables when deciding whether to come to, or remain in, this state. He said for some companies, natural gas supply is a huge variable, and for others, energy prices or access to renewable energy may be a significant consideration. He said overall tax policy can also play as big a role in a company's decision as the availability of individual incentives.

In response to a question from Representative Mitskog, Mr. Dever said the Department of Commerce occasionally will followup with companies regarding their decision not to locate in North Dakota. He said individual companies would be able to provide better information to the committee regarding the role the availability of incentives may have played in a company's decision.

In response to a question from Representative Mooney, Mr. Dever said if the Department of Commerce elects to use a sample size of data to assess frequently used credits such as the renaissance zone credits, the department will randomly select the sample and describe any methodology used to arrive at the results when the information is presented to the committee.

Representative Headland said it may be difficult to move forward with legislation if the committee is not able to get a full picture of the fiscal impact of some of these incentives.

Government Accounting Standards Board Statement 77

Chairman Dockter said the committee has a large amount of information to gather and review in order to make informed decisions regarding the committee's various studies. He said the committee will need to stay focused on the task at hand to deliver any proposed legislation at the end of this process. He said there have been some recent developments relating to political subdivision financial reporting with the approval of Government Accounting Standards Board (GASB) Statement 77.

Chairman Docker called on the Legislative Council staff for a brief overview of GASB Statement 77. The Legislative Council staff said GASB Statement 77 pertains to political subdivision financial statement reporting requirements and the duty to disclose various reductions in tax revenue resulting from tax abatements. She said financial statements are prepared by state and local governments and the information contained in the statements is reviewed to assess whether a government has sufficient revenue to pay for services. She said the statements are also reviewed to determine the sources of a government's financial resources, how financial resources are used, and how the government's economic condition may have changed over time. She said governments often use tax abatements to encourage economic development but the use of tax abatements can limit a government's revenue raising capacity. She reviewed the definition of an abatement for purposes of GASB Statement 77 and said GASB Statement 77 requires the disclosure of tax abatement information as it pertains to the reporting government's own tax abatement agreements as well as any agreements entered into by other governments that reduces the reporting government's tax revenues. She described the information that must be reported, including the gross dollar amount of taxes abated during the period. She said this information may become over the course of the 6-year study of economic development tax incentives. She said GASB Statement 77 went into effect in August 2015, but does not require action on the part of political subdivisions until the next reporting cycle. She said she contacted Mr. Augie Ternes, State Auditor's office, and Mr. Ternes would be willing to present additional information to the committee regarding GASB Statement 77 at a future meeting date.

Chairman Dockter directed the Legislative Council staff work with Mr. Ternes to have this information provided to the committee at a later date.

Senator Cook said he recently attended a National Conference of State Legislatures task force meeting where GASB Statement 77 was discussed. He said the response to most of the attendee's questions regarding tax abatements was that GASB Statement 77 probably would not trigger any real changes to a reporting government's financial statements. He said a clear definition of what would qualify as a tax abatement was not provided.

Tax Department

Chairman Dockter called on Mr. Vosberg for presentation of additional fiscal data related to the economic development tax incentives identified in North Dakota Century Code Section 54-35-26. Mr. Vosberg said the first document (Appendix K) provides information on the number of claimants and amount of income tax credits and deductions that were received over the last several years. He said this document provides updated information which includes 2014 data. He said the second document (Appendix L) is also an updated version of a document previously provided to the committee regarding the number of claimants and amount of sales tax exemptions provided for new and expanding businesses. He said this document also includes additional data pertaining to the 2011 through 2015 fiscal years. He said the final document (Appendix M) provides information regarding the total amount of oil extraction tax incentives received each year since 1987.

In response to a question from Senator Bekkedahl, Mr. Vosberg said the information relating to oil extraction tax incentives includes all incentives that were available in each year for which data was provided.

In response to a question from Representative Burckhard, Mr. Vosberg said both high prices and high volume would have an impact on why the numbers on the last chart are higher in years 2012 through 2015.

Incentive Background Memorandums and Multistate Surveys

Chairman Dockter called on the Legislative Council staff for presentation of memorandums entitled *Economic Development Tax Incentive Study - Electrical Generating Facilities Sales Tax Exemption* and *Electrical Generating Facilities Sales Tax Exemption - Multistate Survey*. The Legislative Council staff said the second memorandum, along with the next several memorandums the committee will be reviewing represent the corresponding multistate surveys that accompany each of the incentives the committee reviewed at its prior meeting. She said the changes made to the background memorandum for each incentive simply reflect the changes approved at the prior meeting to add certain data or testimony to be reviewed for each incentive. She said only six states were found to have incentives similar to North Dakota's electrical generating facilities sales tax exemption. She said additional incentives were found in the property or income tax realm in other states but she excluded these results to narrow the comparison to only sales tax exemptions. She said a basic description of each incentive has been provided in the chart along with the statutory citation for each incentive should the committee wish to review any additional details.

In response to a question from Senator Cook regarding whether South Dakota responded to the questionnaire, the Legislative Council staff said she did not compile the data provided in the multistate memorandums through the use of a questionnaire. She said she used a database to search for various state incentives and then proceeded to include or eliminate certain incentives after reviewing the provisions of each for features similar to the incentives being evaluated by the committee.

In response to a question from Senator Mathern, the Legislative Council staff said information has not been provided in any of the memorandums in regard to federal incentives.

Representative Hogan asked whether one of the main differences between the incentive offered in North Dakota and those offered in other states was North Dakota's focus on traditional energy development rather than renewable energy sources. In response, the Legislative Council staff said there are various differences between the incentives from state to state. She said the incentives included in each multistate survey are simply those that were most similar to the incentives the committee is studying.

Representative Klemin said the new requirements imposed by the Clean Power Plan will limit emissions significantly and likely require companies to make large investments for upgrades to avoid closures. He said the committee may want to consider the effect the Clean Power Plan may have on this incentive.

Chairman Dockter said the committee could invite industry representatives to speak at a later date regarding any impacts that may occur as a result of the Clean Power Plan.

Senator Cook said if power plants begin to shut down as a result of the Clean Power Plan the state would see a large reduction in tax revenues. He said the committee may need to discuss whether a tax reduction is needed to help this industry meet the requirements under the Clean Power Plan and avoid closures.

Chairman Dockter called on the Legislative Council staff for presentation of memorandums entitled *Economic Development Tax Incentive Study - Research Expense Tax Credit* and *Research Expense Tax Credit - Multistate Survey*. The Legislative Council staff said the multistate survey related to the research expense tax credit is one of the lengthier memorandums the committee will be reviewing as the majority of states offer a research and expense tax credit. She said many states also piggyback off of the definitions found in the federal credit, as does North Dakota. She said a copy of the federal definitions was requested at the committee's prior meeting and was sent out in advance. She provided an abbreviated summary of the federal definitions and said a very basic scenario can be used to illustrate a real world example of what qualified research and qualified research expenses may entail. She provided an example of a tire company looking to improve the performance and grip of the tires it sells. She said this type of research and experimentation would be classified as qualified research for purposes of the credit. She said if the company buys five different types of rubber to run its experiments on, the amount paid for the rubber would be a qualified research expense. She said if the company paid employees to test the properties of those five types of rubber, the amount paid in compensation to those employees would also be a qualified research expense, as would the amount paid to the individual supervising those employees. She said if the data collected from the experimentation on the rubber is shipped offsite to be analyzed in a third-party's computer system, those costs would also be classified as qualified research expenses. She said hopefully this illustration provides a more tangible example of the types of activities this credit seeks to incentivize and the types of expenditures that may be included for purposes of calculating the credit. She said one of the main features that came to her attention when preparing this multistate survey was the extended carryforward periods offered for this credit in multiple states.

In response to a question from Senator Cook, Chairman Dockter said the committee will begin receiving testimony from interested parties to evaluate whether the goals of each incentive are being met now that the committee has reviewed all of the pertinent background information.

Chairman Dockter called on the Legislative Council staff for presentation of memorandums entitled *Economic Development Tax Incentive Study - Agricultural Commodity Processing Facility Investment Tax Credit* and *Agricultural Commodity Processing Facility Investment Tax Credit - Multistate Survey*. The Legislative Council staff reviewed the multistate memorandum and said incentives similar to the agricultural commodity processing facility investment tax credit were not as prevalent in other states.

Chairman Dockter called on the Legislative Council staff for presentation of memorandums entitled *Economic Development Tax Incentive Study - Angel Fund Investment Tax Credit* and *Angel Fund Investment Tax Credit - Multistate Survey*. The Legislative Council staff reviewed the multistate memorandum and said comparable angel fund credits were found in 11 other states. She said one caveat to note if trying to compare the incentives offered in multiple states is that the comparison is rarely apples to apples. She said though one state appears to offer a higher percentage of a credit, the amount of the investment that percentage may be applied to must also be taken into consideration when determining if a credit may be more beneficial in one state versus the other. She said additional items like carryforward periods, and even a state's overall income tax rates, can also skew any attempts to make direct comparisons.

Chairman Dockter called on the Legislative Council staff for presentation of memorandums entitled *Economic Development Tax Incentive Study - Automation Tax Credit* and *Automation Tax Credit - Multistate Survey*. The Legislative Council staff said the background memorandum provides a description of the incentive, the perceived goals of the Legislative Assembly in enacting or amending the provisions of the incentive, and the data and testimony necessary to conduct a review of the incentive. She said the automation tax credit is the first credit the committee is reviewing today that references primary sector businesses. She said a request was made at the previous committee meeting to review the various definitions of primary sector business throughout Century Code to see if any variations existed. She said her review revealed nine instances in which the phrase was defined. She said for the most part, the definition of a primary sector business was fairly consistent and was defined as "an individual, corporation, limited liability company, partnership, or association that through the employment of knowledge or labor adds value to a product, process, or service which results in the creation of new wealth." She said areas where some of the language deviated included definitions that required a primary sector business be certified by the Department of Commerce, definitions that did not require the resulting creation of new wealth, and definitions that excluded certain types of business or added additional requirements.

Senator Cook requested that this information be supplied in a memorandum and that a bill be drafted to provide a consistent definition of primary sector business throughout Century Code.

Chairman Dockter directed the Legislative Council staff to prepare the memorandum and bill draft for the committee's review.

Chairman Dockter called on the Legislative Council staff for presentation of memorandums entitled *Economic Development Tax Incentive Study - Seed Capital Investment Tax Credit* and *Seed Capital Investment Tax Credit - Multistate Survey*. The Legislative Council staff said the background memorandum provides a description of the incentive, the perceived goals of the Legislative Assembly in enacting or amending the provisions of the incentive, and the data and testimony necessary to conduct a review of the incentive. She reviewed the multistate survey and said she found seven similar incentives in other states.

Chairman Dockter called on the Legislative Council staff for presentation of memorandums entitled *Economic Development Tax Incentive Study - Microbusiness Income Tax Credit*, *Economic Development Tax Incentive Study - Wage and Salary Credit*, and *Economic Development Tax Incentive Study - New or Expanding Businesses Income Tax Exemption*. The Legislative Council staff said the committee previously reviewed the background memorandums for all but the new or expanding business income tax exemption. She said this memorandum provides a description of the incentive, the perceived goals of the Legislative Assembly in enacting or amending the provisions of the incentive, and the data and testimony necessary to conduct a review of the incentive. The Legislative Council staff also reviewed a memorandum entitled *Incentives Fostering Job Creation and Expansion in Targeted Businesses or Locations - Multistate Survey*. She said this multistate memorandum pertains to all four of the previously mentioned incentives as the provisions of those incentives are quite specific. She said the memorandum serves to illustrate the incentives available in other states that encourage job creation and expansion in targeted businesses or locations.

In response to a question from Representative Klemin, the Legislative Council staff said the amount claimed for an incentive cannot be disclosed due to confidentiality restrictions if five or fewer taxpayers claimed the incentive.

In response to a question from Representative Nathe regarding the decrease in the amount claimed for the new and expanding business exemption in 2014 as compared to 2013, Mr. Becker said the data available to the Legislative Council staff when that memo was originally prepared did not include the full amount of data from 2014. He said this updated information has been provided on the chart the committee received from the Tax Department this morning. He said at the time the first set of data was provided to the committee, all of the 2014 income tax returns had not yet been received.

Chairman Dockter called on the Legislative Council staff for presentation of a memorandum entitled *Economic Development Tax Incentive Study - Telecommunications Infrastructure Sales Tax Exemption*. The Legislative Council staff said the background memorandum provides a description of the incentive, the perceived goals of the Legislative Assembly in enacting or amending the provisions of the incentive, and the data and testimony necessary to conduct a review of the incentive. She also reviewed a memorandum entitled *Telecommunications Infrastructure Sales Tax Exemption - Multistate Survey* and said similar incentives were found in seven other states.

Chairman Dockter called on the Legislative Council staff for presentation of memorandums entitled *Economic Development Tax Incentive Study - Biodiesel Fuel Credits* and *Economic Development Tax Incentive Study - Soybean or Canola Crushing Facility Construction or Retrofit Credit*. The Legislative Council staff said the background memorandums provide a description of the incentives, the perceived goals of the Legislative Assembly in enacting or amending the provisions of the incentives, and the data and testimony necessary to conduct a review of the incentives. She also reviewed a memorandum entitled *Biodiesel Fuel Credits and Soybean and Canola Crushing Credits - Multistate Survey* and said similar credits related to soybeans, canola, and biodiesel were found in eight other states.

Representative Klemin said these credits provide a good example of incentives that will be difficult to evaluate because there are five or fewer taxpayers claiming the incentive.

Representative Mitskog asked whether there would be enough information to input into something like a REMI model on some of the incentives the committee is reviewing. In response, the Legislative Council staff said this remains to be seen. She said one of the items the committee is tasked with reviewing is whether the committee's evaluation of an incentive is constrained by lack of data and whether any administrative changes should be made to improve the collection or availability of data. She said several states require certain information be provided upfront by individuals seeking to claim tax incentives or require certain waivers of confidentiality for specific data needed to evaluate the effectiveness of incentives. She said there are various administrative avenues the committee could consider taking if it finds there is insufficient information available to conduct an adequate assessment of an incentive's impact or effectiveness. Representative Mitskog said it would be beneficial to hear from industry representatives at the next committee meeting to gain some additional information.

Chairman Dockter said he agreed with Representative Mitskog's statements and interested parties will be encouraged to appear and comment on the benefits derived from various incentives and the rationale for continuing to offer certain incentives.

Senator Cook said he would like to know how often the biodiesel and soybean incentives are claimed in other states.

Chairman Dockter directed the Legislative Council staff to contact the states listed in the multistate survey to see how often those incentives are being claimed.

In response to a question from Representative Nathe, the Legislative Council staff said no credits were claimed for the soybean or canola crushing facility construction or retrofit credit in tax years 2006 through 2008 because the credit was not available for soybeans or canola until the 2009 tax year.

In response to a question from Senator Cook, Mr. Scott Rising, North Dakota Soybean Growers Association, said there is a facility that crushes both soybeans and canola in Velva, North Dakota. He said there is also a facility with limited soybean crushing capabilities in Enderlin.

Chairman Dockter called on the Legislative Council staff for presentation of a memorandum entitled *Economic Development Tax Incentive Study - Renaissance Zone Income Tax Credits and Exemptions*. The Legislative Council staff said the background memorandum provides a description of the incentive, the perceived goals of the Legislative Assembly in enacting or amending the provisions of the incentive, and the data and testimony necessary to conduct a review of the incentive. She also reviewed a memorandum entitled *Renaissance Zone Income Tax Credits and Exemptions - Multistate Survey* and said similar incentives were found in 21 other states and were referred to as renaissance zone, enterprise zone, and opportunity zone incentives.

Chairman Dockter said the use of renaissance zone incentives began to decrease in 2011 but will likely begin to increase as a result of 2015 legislation.

Chairman Dockter called on the Legislative Council staff for presentation of memorandums entitled *Economic Development Tax Incentive Study - Internship Program Credit*, *Economic Development Tax Incentive Study - Workforce Recruitment Credit*, and *Economic Development Tax Incentive Study - New Jobs Credit From Income Tax Withholding*. The Legislative Council staff said the background memorandums provide a description of the incentives, the perceived goals of the Legislative Assembly in enacting or amending the provisions of the incentives, and the data and testimony necessary to conduct a review of the incentives. She also reviewed a memorandum entitled *Incentives Fostering Employee Training, Recruitment, and Internship Programs - Multistate Survey* and said this is another multistate survey that covers more than one incentive due to the specific and targeted nature of the incentives offered in North Dakota.

In response to a question from Representative Klemin, Mr. Dever said the combined fiscal impact for fiscal years 2014 and 2015 for the new jobs credit from income tax withholding represents the amount of income tax withheld and transferred into the new jobs training fund.

Chairman Dockter called on the Legislative Council staff for presentation of a memorandum entitled *Economic Development Tax Incentive Study - Geothermal, Solar, Wind, and Biomass Energy Device Tax Credit*. The Legislative Council staff said the background memorandum provides a description of the incentive, the perceived goals of the Legislative Assembly in enacting or amending the provisions of the incentive, and the data and testimony necessary to conduct a review of the incentive. She also reviewed a memorandum entitled *Geothermal, Solar, Wind, and Biomass Energy Device Tax Credit - Multistate Survey* and said similar incentives were found in eight other states.

In response to a question from Senator Cook, Mr. Walstad said there would not be any incentives on the list the committee is reviewing that were only previously available on the now eliminated long form.

Chairman Dockter called on the Legislative Council staff for presentation of a memorandum entitled *Economic Development Tax Incentive Study - Certified Nonprofit Development Corporation Investment Credit*. The Legislative Council staff said the background memorandum provides a description of the incentive, the perceived goals of the Legislative Assembly in enacting or amending the provisions of the incentive, and the data and testimony necessary to conduct a review of the incentive. She said this credit provides an example of a credit that was previously available to individual income taxpayers filing the long form but was not longer available to individuals after the long form was eliminated in 2009. She also reviewed a memorandum entitled *Certified Nonprofit Development Corporation Investment Credit - Multistate Survey* and said the incentives summarized in this multistate survey include any incentives that provide a credit for contributions into a fund that in turn provides resources for economic development in small communities. She said many of the incentives listed in the multistate survey mirror the federal new markets credit.

In response to a question from Senator Mathern, the Legislative Council staff said the fiscal impact of this credit could not be determined during the 1989 legislative session.

In response to a question from Representative Klemin, the Legislative Council staff said a corporation must apply to the Secretary of State to be certified as a nonprofit development corporation. She said she is not aware of how many nonprofit development corporations are currently certified in North Dakota but could request that information from the Secretary of State.

Chairman Dockter called on the Legislative Council staff for presentation of a memorandum entitled *Impact of Income Tax Rate Reduction or Elimination on Unused Tax Credits*. The Legislative Council staff reviewed the memorandum and noted it is rather brief as the provision of any additional information would be merely speculative and beyond her scope of expertize to provide. She said the committee may wish to invite someone from the business community to speak if additional information is requested regarding potential impacts to a business's financial statements.

In response to a question from Representative Klemin, the Legislative Council staff said hypothetically, if a taxpayer knew an income tax rate reduction or elimination was imminent, a taxpayer could sell or transfer any unused credits prior to that occurrence. She said whether or not a credit can be transferred is specified within the language of each statute. She said the research expense tax credit is currently the only credit that can be transferred.

Committee Discussion

Mr. Walstad said the committee has eight specific questions it needs to address in regard to each of the 18 incentives selected for review this interim. He said the committee should remain focused on the specific directives that need to be addressed pursuant to statute.

The Legislative Council staff said of the 21 incentives identified in the statutorily mandated list provided in Section 54-35-24, the committee has selected 14 of these incentives to study during this interim and has also selected an additional four incentives from a discretionary list of incentives provided by the Department of Commerce and the Tax Department. She said the committee has received a background memorandum on each of the 18 selected incentives which describes the operation of each incentive, the legislative history relating to the creation of each incentive and any subsequent changes, and fiscal information provided by the Tax Department and the Department of Commerce. She said the committee has also reviewed the multistate surveys relating to each of the incentives. She said if the committee completes its study of each of the 18 incentives selected for review this interim there will be seven incentives remaining on the statutorily mandated list for review over the following two interims.

In response to committee discussion regarding the potential to reduce the number of incentives selected for review this interim, Chairman Dockter said the committee will begin receiving testimony on a portion of the selected incentives at the next committee meeting and see how much time that process consumes before making any revisions to the list of incentives that have been selected.

Representative Klemin said it may be appropriate to draft a bill to repeal the incentives that are not being used or that are being claimed by very few taxpayers.

Chairman Dockter directed the Legislative Council staff to prepare a bill draft to repeal the sections of law relating to those incentives as a means to initiate dialogue from any interested parties that may wish to retain those incentives.

Senator Cook agreed that a bill draft would be an effective means to encourage interested parties to provide testimony regarding the use or effectiveness of various incentives. He said the committee should make a diligent effort to ensure that the public is aware of the incentives the committee will be reviewing so that all parties have adequate notice to appear and the ability to voice any comments or concerns.

In response to a suggestion by Mr. Walstad, Chairman Dockter instructed the Legislative Council staff to prepare some form of checklist to assist the committee in tracking its progress in addressing each of the eight statutorily provided questions suggested for the assessment of each of the 18 selected incentives.

Tax Department

Chairman Dockter called on Commissioner Rauschenberger for presentation of information regarding the correlation between declining individual and corporate income tax rates and the use of income tax credits. Commissioner Rauschenberger said the Legislative Council staff did a good job of covering the carryforward information so he will not repeat those details. He said income tax rates are currently at 50 percent of what they were in 2008. He said in addition to rate changes, there are other reasons for fluctuations in the use of credits. He said a fluctuation in the use of the agricultural commodity processing facility credit was seen with the influx of ethanol and biofuel plants. He said the creation of those plants resulted in increased utilization of the credit. He said fluctuations can also be seen in the seed capital and angel fund investment tax credits. He said additional restrictions placed on the seed capital investment tax credit in recent years resulted in decreased use of that credit. He said the annual $500,000 limitation on that credit has not been reached for a number of years. He said the angel fund investment credit, on the other hand, has become more widely used as that credit does not carry as many limitations. He said the fact that at any given time about half of the corporations in North Dakota do not have any tax liability is also a factor in the amount credits are utilized. He said the elimination of the financial institutions tax in 2013 has potentially increased the market for certain credits as banks that were previously unable to claim a credit may now be able to as they are now part of the regular income taxpayer base.

Chairman Dockter called on Mr. Becker for presentation of information (Appendix N) regarding the procedure for tracking transferable tax credits and the type of information that is collected. Mr. Becker said the handout provided reflects a report that was prepared by the Tax Department in July 2014, for the interim Taxation Committee. He said the handout illustrates the statistics the Tax Department had on the angel fund investment tax credit at that time. He said the transfer feature attached to the angel fund credit was only available for 2 years and expired at the end of 2012. He said details regarding any transfers that were made were provided on the report. He said the only credit that currently carries a transferability feature is the research expense tax credit. He said not every businesses that has earned a research credit can take advantage of the transfer feature. He said the business must first be certified by the Department of Commerce as a qualified research and development company which means the business must be a primary sector business with annual gross revenue of less than $750,000 that first conducted research in this state after 2006. He said if those requirements are met, the business can transfer up to $100,000 worth of credits, but the credits can only be transferred once. He said if a transfer is made, both the business making the transfer and the business receiving the credits must jointly complete a schedule prescribed by the Tax Department that identifies the taxpayers, the date of the transfer, the amount transferred, and the amount received by the transferor if the sale was for value. He said both parties must allow the Tax Department to contact either party in order to properly administer the credit. He said the same procedure was used to track angel fund credits for the 2 years that credit was allowed to be transferred. He said to date there have been no transfers of the research expense tax credit.

In response to a question from Senator Cook, Mr. Becker said the term transfer is inclusive of both the sale of credits or any gifting of credits.

In response to a question from Representative Headland, Mr. Becker said the proceeds from the sale of credits are taxable to North Dakota. He said there is a specific statute that provides that any proceeds from the sale of credits by a multistate corporation must be reported and allocated to North Dakota and taxed in North Dakota.

Mr. Becker said the committee also requested information regarding the manner in which various tax credits are claimed by passthrough entities and the procedure for claiming tax credits when multiple credits may apply. He said passthrough entities include entities like partnerships, S corporations, and limited liability companies that do not pay income tax on the business entity level but rather pass any profits, deductions, or credits through to their owners who pick those profits or credits up on their individual income tax returns. He said the language for passing through credits to the individual level is fairly standard and requires credits to be calculated at the entity level and then passed through to the entity's owners based on the owner's respective interests in the entity. He said in the case of a partnership having two owners that share profits and losses equally, the credit would be split evenly between the two owners. He said the procedure for claiming credits when a taxpayer may qualify for multiple credits is laid out in administrative rule and provides that any credits that do not have a carryback or carryforward feature should be claimed first, followed by any credits that only have a carryback feature, and then credits having a carryforward feature should be claimed last. He said, essentially, the rule provides that a taxpayer must be allowed to claim credits in the order that is most beneficial to the taxpayer.

In response to a question from Representative Klemin, Mr. Becker said a taxpayer could claim multiple tax credits in the same year so long as the taxpayer has enough tax liability.

In response to a question from Mr. Walstad, Mr. Becker said there would not be any instances where a taxpayer could qualify for two different credits based on the same investment or use of money. He said most credits contain language prohibiting a taxpayer from claiming any other deductions or credits using the same investment or money.

Senator Mathern asked if there were any administrative difficulties the Tax Department was aware of in relation to the incentives the committee will be reviewing and asked if the Tax Department would consider suggesting any administrative revisions as the committee considers making any policy revisions. Mr. Becker said he would take this question back to the Tax Department and pass any recommendations along to the committee.

Department of Commerce

Chairman Dockter called on Mr. Paul Lucy, Director, Economic Development and Finance Division, Department of Commerce, regarding information (Appendix O) on the process of becoming a qualified business for purposes of the agricultural commodity processing facility investment tax credit and the number of qualified businesses located in this state. Mr. Lucy said the reason for the credit is to incentivize investment in agricultural commodity processing facilities. He reviewed the amount of the credit and the qualifications a company must meet to be certified as an agricultural commodity processing facility. He said the Department of Commerce reviews applications and verifies that each business's state of origin is North Dakota, the business was organized in this state after December 31, 2000, and the business is in compliance with any state security laws. He said the principals of the business are also contacted so the Department of Commerce can gain a better understanding of the activities the business intends to undertake and how those activities relate to the processing of agricultural products in this state. He said followup letters are sent to each applicant stating whether their applications have been approved or denied. He said copies of these letters are also provided to the Tax Department, along with the reporting forms each business needs to be aware of in order to allow investors to access the credit. He said 23 businesses have been certified under the program since its inception. He said each business is certified for a 4-year period and may qualify for one additional certification.

In response to a question from Representative Hogan, Mr. Lucy said he could supply the committee with a list of the 23 companies that have received certification.

In response to a question from Representative Klemin, Mr. Lucy said it would be possible for a business incorporated prior to December 31, 2000, to dissolve and reorganize as a separate entity after that date and still qualify for certification if all other requirements were met.

COMMITTEE DISCUSSION AND DIRECTIVES

Chairman Dockter said the next meeting will likely be a two-day meeting held toward the end of January or the beginning of February. He said the committee may need to play it by ear to see how much of the agenda is devoted to the social services financing study depending on when the next working group meeting is held. He said the committee needs to ensure it has enough time to do its due diligence in reviewing both the social services study and the incentive study.

Senator Mathern encouraged the committee to place both topics on the agenda each time the committee meets to continue to drive the issues forward.

Chairman Dockter said he will keep an open line of communication between the working group and the committee and try to ensure that items pertaining to the social services study and the incentive study are placed on each agenda.

No further business appearing, Chairman Dockter adjourned the meeting at 2:45 p.m.

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Emily L. Thompson
Counsel

ATTACH:15