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

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

## EXPLANATION OF THE AGRICULTURAL COMMODITY PROCESSING FACILITY INVESTMENT TAX CREDIT

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

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

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

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

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

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

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

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

Information provided to the Political Subdivision Taxation Committee by the Tax Department on July 29, 2015, and later amended on August 12, 2015, the number of individual income tax returns on which the credit was claimed and the total amount claimed is as follows:

- In tax year 2006, a total of $609,547 was claimed over 446 returns;
- In tax year 2007, a total of $873,368 was claimed over 441 returns;
- In tax year 2008, a total of $775,762 was claimed over 326 returns;
- In tax year 2009, a total of $499,708 was claimed over 257 returns;
- In tax year 2010, a total of $644,169 was claimed over 194 returns;
- In tax year 2011, a total of $483,389 was claimed over 137 returns;
- In tax year 2012, a total of $476,824 was claimed over 109 returns;
- In tax year 2013, a total of $252,814 was claimed over 76 returns; and
- In tax year 2014, a total of $419,217 was claimed over 66 returns.

The number of corporate income tax returns on which the credit was claimed and the total amount claimed is as follows:

- In tax year 2006, the total amount claimed cannot be disclosed due to confidentiality restrictions as the credit was claimed on fewer than five returns;
- In tax year 2007, a total of $107,825 was claimed over 5 returns;
- In tax year 2008, a total of $111,694 was claimed over 8 returns;
- In tax year 2009, a total of $96,331 was claimed over 7 returns; and
- In tax years 2010 through 2014, the total amount claimed cannot be disclosed due to confidentiality restrictions as the credit was claimed on fewer than five returns in each tax year.

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

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

1. The number of claimants;
2. The fiscal impact of the incentive;

3. Employment opportunities, business growth, or diversity in the state's economy resulting from the availability of the incentive;
4. Negative impacts created as a result of the incentive;
5. Benefits that flow to out-of-state concerns resulting from the incentive; and
6. The use of this type of incentive in other states.

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

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