ECONOMIC DEVELOPMENT TAX INCENTIVE STUDY - AUTOMATION 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 automation 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 AUTOMATION TAX CREDIT

Section 57-38-01.33 provides for an income tax credit for purchases of manufacturing machinery and equipment for the purpose of automating a manufacturing process in this state. The incentive is available to any income taxpayer certified by the Department of Commerce as a primary sector business. A primary sector business is defined as a business that employs knowledge or labor to add value to a product, process, or service that results in the creation of new wealth. The credit is equal to 20 percent of the cost of the manufacturing machinery and equipment purchased in the taxable year for purposes of automating a manufacturing process. Qualified expenditures for purchases of manufacturing machinery and equipment used to calculate the automation tax credit may not be used to calculate any other income tax deduction or credit allowed under Chapter 57-38.

For purposes of Section 57-38-01.33, qualifying manufacturing machinery and equipment means new or used automation and robotic equipment. A qualifying purchase of manufacturing machinery and equipment includes items acquired under a capital lease, but only for the taxable year in which the lease was executed. For purposes of calculating the credit, items acquired under a capital lease will be valued at fair market value at the time the lease was executed. The credit must be claimed in the taxable year in which the manufacturing machinery and equipment was purchased and the amount of the credit claimed may not exceed the taxpayer's income tax liability. Any credit amount exceeding a taxpayer's liability may be carried forward to each of the five succeeding taxable years.

For calendar year 2015, the aggregate amount of credits allowed may not exceed $2 million. For calendar years 2016 and 2017, the aggregate amount of credits allowed may not exceed $500,000 in each calendar year. Any credits left unclaimed at the end of a calendar year may be carried forward for dispersal in the succeeding calendar year. If a claim for credits is made in excess of the statutorily available amount, the Tax Commissioner shall prorate the available credits among all claimants. If a taxpayer entitled to the credit is filing a consolidated return, the taxpayer may claim the credit against the aggregate North Dakota tax liability of all corporations included on the consolidated return. A passthrough entity entitled to the credit must be considered the taxpayer for purposes of the credit and the amount of credit allowed must be determined at the passthrough entity level.

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

PERCEIVED GOALS OF THE LEGISLATIVE ASSEMBLY IN CREATING OR ALTERING THE AUTOMATION TAX CREDIT

Provisions regarding an automation tax credit first appeared in 2011 Senate Bill No. 2055, which failed to pass. Senate Bill No. 2055 contained provisions for an automation credit and a lean manufacturing credit and was advanced by the 2009-10 interim Workforce Committee as a result of the committee's study of technology-based entrepreneurship and economic development best practices. The language creating the automation tax credit was ultimately amended into and passed in 2011 Senate Bill No. 2057, which created a corporate and individual income tax credit for purchases of manufacturing machinery and equipment used to automate a manufacturing process. The credit was equal to 20 percent of the costs incurred and the aggregate amount of credits allowed for all taxpayers was capped at $2 million in any calendar year. The credit was made effective for the future tax years of 2013 through 2015. Upon a review of the legislative history relating to both bills, the perceived goals of the Legislative Assembly in creating this credit were to allow North Dakota manufacturing businesses to remain competitive, to advance the manufacturing sector, and to foster continued production in a labor constrained environment. The estimated fiscal effect of the automation credit could not be determined during the 2011 legislative session.

The only other change made to Section 57-38-01.33 occurred through the passage of 2013 House Bill No. 1106. The bill 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.

DATA AND TESTIMONY REQUIRED TO CONDUCT AN EFFECTIVE ANALYSIS OF THE AUTOMATION TAX CREDIT

The interim Political Subdivision Taxation Committee identified various items of data and testimony which would need to be collected to effectively analyze the automation tax credit. The following list identifies the information the committee sought to collect and the receipt of that information throughout the course of the 2015-16 interim.

1. The number of claimants and the fiscal impact of the incentive.
   - Information (Appendix A) provided to the Political Subdivision Taxation Committee by the Tax Department on December 2, 2015, indicated the number of individual income tax returns on which the credit was claimed and the total amount claimed is as follows:

     In tax year 2013, a total of $778,244 was claimed over 49 returns; and

     In tax year 2014, a total of $554,060 was claimed over 37 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 2013, no claims for the credit were made; and

     In tax year 2014, the total amount claimed cannot be disclosed due to confidentiality restrictions as the credit was claimed on fewer than five returns.
2. The use of similar incentives in other states.
   - Incentives similar to this state's automation tax credit (Appendix B) were found in seven other states.
3. Employment opportunities, business growth, or diversity in the state's economy resulting from the availability of the incentive.
   - Information (Appendix C) pertaining to this item was provided by the Department of Commerce on September 13, 2016.
4. Negative impacts created as a result of the incentive.
   - The committee did not receive information pertaining to negative impacts created as a result of the incentive.
5. Benefits that flow to out-of-state concerns resulting from the incentive.
   - The committee did not receive information pertaining to benefits that flow to out-of-state concerns resulting from the incentive.
6. Testimony from interested parties.
   - The following parties provided testimony in support of retaining the automation tax credit.

     The Economic Development Association of North Dakota (Appendices D and E).

     Mr. Mark Vaux, Executive Vice President, Greater Fargo/Moorhead Economic Development Corporation.
   - Testimony was not received from parties in opposition to retaining the automation tax credit.

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