

VOLATILITY OF STATE REVENUE SOURCES - BACKGROUND MEMORANDUM

Section 35 of House Bill No. 1015 ([Appendix A](#)) directs the Legislative Management to study the volatility of state revenue sources. The study must include the volatility of the tax base and revenue sources, including ongoing expenditures. The study also must include consideration of the volatility and sustainability of elementary and secondary education funding, including the general fund, common schools trust fund, and foundation aid stabilization fund. The study must include an assessment of the ending fund balances in the general fund, budget stabilization fund, and foundation aid stabilization fund; the adequacy of the foundation aid stabilization fund relative to revenue sources; and an analysis of the other trust funds. The study must include historical revenue for all years for which quality data is available.

STATE REVENUE SOURCES FOR THE GENERAL FUND

The sources of ongoing tax and fee revenues for the general fund are--sales and use tax, motor vehicle excise tax, individual income tax, corporate income tax, insurance premium tax, cigarette and tobacco tax, oil and gas gross production tax, oil extraction tax, coal conversion tax, gaming tax, wholesale liquor tax, mineral leasing fees, interest income, and departmental collections.

Sales and Use Gross Receipts Tax

North Dakota imposes a sales tax on the gross receipts of retailers. The tax is paid by the purchaser and collected by the retailer. The purchase price of tangible personal property purchased outside of the state for storage, use or consumption within the state is subject to a use tax. In addition, tangible personal property not originally purchased for use in North Dakota is subject to a use tax based upon its fair market value at the time it was brought into the state. Credits are allowed for sales and use taxes paid to other states. Several exemptions apply. The sales and use taxes are levied as follows:

- 3 percent rate on the gross receipts from retail sales of new mobile homes.
- 3 percent sales tax surcharge on each motor vehicle rental contract for a period of fewer than 30 days, provided the gross vehicle weight of the motor vehicle is 10,000 pounds or less.
- 5 percent general rate on the gross receipts from retail sales of tangible personal property, communication services, magazines and other periodicals sold over the counter, cigarettes and tobacco products, and admission to recreation activities; from the rental of hotel, motel, and bed and breakfast accommodations for periods of less than 30 consecutive days; from the leasing of tangible personal property; and from the rental of motor vehicles for periods less than 30 days.

Motor Vehicle Excise Tax

The purchase price of any motor vehicle purchased or acquired, either within or outside of North Dakota, for use on the streets or highways of this state is subject to a motor vehicle excise tax if the vehicle is required to be registered in North Dakota. The motor vehicle excise tax is 5 percent of the purchase price (the sale price less any trade-in amount). If the vehicle is acquired by means other than purchase, the tax is 5 percent of the fair market value. When a motor vehicle weighing less than 10,000 pounds is leased for at least 1 year, the motor vehicle excise tax is 5 percent of the lease consideration. All other leased vehicles are taxed at 5 percent of the purchase price. North Dakota excise tax is due on the fair market value of the motor vehicle when it enters North Dakota to be registered for use. North Dakota allows credit for any excise tax paid on a motor vehicle in another state if that state allows a reciprocal credit.

Distribution of Sales, Use, Gross Receipts and Motor Vehicle Excise Tax Revenue

Revenue collected from the sales, use, farm machinery gross receipts, alcoholic beverage gross receipts, and motor vehicle excise taxes is divided between the general fund and the state aid distribution fund. The formula is 43.5 percent times 1 percent divided by general sales tax rate times net collections.

Individual Income Tax

Every resident of North Dakota who has a federal income tax filing requirement is required to file a North Dakota income tax return. Every nonresident who has a federal income tax filing requirement and derives income from North Dakota (except interest and dividends from nonbusiness sources, pensions and annuities) is required to file a North Dakota income tax return. There are exceptions for certain Native Americans, interstate transportation employees, Minnesota and Montana residents, and military personnel and their spouses. Individual tax rates vary depending on filing status ([Appendix B](#)). Collections are deposited in the general fund.

Corporate Income Tax

Every corporation engaged in business in North Dakota or having sources of income in North Dakota must file a North Dakota corporation income tax return. North Dakota taxable income is that portion of a corporation's apportionable income which is derived from, or attributable to, sources within North Dakota and a corporation whose activity is conducted both within and without North Dakota is an apportioning corporation. North Dakota taxable income is computed by multiplying the apportionable income by an apportionment factor. Collections are deposited in the general fund.

Effective for tax years beginning after December 31, 2014, North Dakota corporation income tax is determined by applying the following rates to North Dakota income:

Taxable Income	Rate
Up to \$25,000	1.41%
\$25,000 to \$50,000	3.55%
Over \$50,000	4.31%

Corporations electing the water's edge filing method are subject to an additional 3.5 percent surtax on North Dakota taxable income.

Insurance Premium Tax

Every insurance company licensed to do business in North Dakota is subject to a premium tax on the gross amount of its annual premiums, membership fees, and policy fees received from North Dakota policyholders. The premium tax rate is 2 percent for life insurance and 1.75 percent for accident, health, property, casualty, and surplus lines of insurance. A company domiciled in another state may be charged retaliatory tax--the tax rate of the home state--if the rate in the home state is higher than North Dakota's applicable premium tax rate. A minimum \$200 annual filing fee is required provided the total tax liability of an entity required to pay tax is less than \$200. Collections from this tax must be deposited in the insurance tax distribution fund under North Dakota Century Code Section 18-04-04.1 but not in an amount exceeding one-half of the biennial amount appropriated for distribution under Section 18-04-05 and Chapter 23-46 in any fiscal year. Collections from this tax exceeding the sum of the amount deposited in the insurance tax distribution fund are deposited in the general fund.

Cigarette and Tobacco Tax

The cigarette tax is levied at two different tax rates. Cigarettes weighing less than three pounds per thousand are taxed at 22 mills per cigarette or \$0.44 for a common package of 20, and \$0.55 for a package of 25. Cigarettes weighing more than three pounds per thousand are taxed at 22.5 mills per cigarette. Roll-your-own cigarette tobacco is taxed at the cigarette rate. One cigarette equals .09 ounces of roll-your-own tobacco. Sales of bulk roll-your-own cigarette tobacco are converted to taxable cigarettes. Wholesalers pay the tax and for administrative compensation, wholesalers who file and pay on time may deduct 1.5 percent of the tax due, up to a maximum of \$100 per month. Collections are deposited as follows--\$0.03 of the \$0.44 per package are distributed to the cities based on population and the remainder goes to the general fund. Of the \$0.55 on the larger packages, \$0.0375 is distributed to the cities with the remainder to the general fund.

Oil and Gas Gross Production Tax

Oil is taxed at a rate of 5 percent to the gross value at the well of all oil produced, except royalty interest in oil produced from a state, federal, or municipal holding and from an interest held by an organized Indian tribe. The gross production tax on gas is an annually adjusted flat rate per thousand cubic feet (mcf) of all nonexempt gas produced in the state. The annual adjustments are made according to the average producer price index for gas fuels. Rates through June 30, 2017, are as follows:

Time Period	Tax Rate
July 1, 2014 through June 30, 2015	\$.0982
July 1, 2015 through June 30, 2016	\$.1106
July 1, 2016 through June 30, 2017	\$.0601

Oil Extraction Tax

The oil extraction tax is levied on the extraction of oil from the earth. The tax rate is 5 percent of the gross value of crude oil at the well. For a well that is located both outside of the Bakken and Three Forks Formations as well as 10 miles or more outside of an established field that includes the Bakken or Three Forks Formation, the rate is reduced to 2 percent for the first 75,000 barrels of oil during the first 18 months after completion.

Distribution of Oil and Gas Tax Revenue

Attached is the [Oil and Gas Tax Revenue Allocation Flowchart](#) showing the allocations of oil and gas tax revenue.

Coal Conversion Tax

The coal conversion tax is imposed on the operator of a coal conversion facility, defined to include any coal-fired electric generating unit with a capacity of 10,000 kilowatts or more and any coal gasification facility. The tax is in lieu of property taxes on the facility, but the land on which the facility is located remains subject to local property taxes. The coal conversion tax for an electric generating facility is imposed at a rate of .65 mill times 60 percent of the installed capacity of the facility times the number of hours in the taxable period and an additional tax of .25 mill per kilowatt-hour of electricity produced for sale. For coal gasification plants, the tax is imposed at the greater of 4.1 percent of gross receipts or 13.5 cents per 1,000 cubic feet of synthetic natural gas produced for sale. Coal conversion tax revenues are allocated 15 percent to the producing county and 85 percent to the general fund.

Gaming Tax and Pari-Mutuel tax

A gaming tax is levied each quarter on the total gross proceeds from games of chance conducted by licensed organizations. "Gross proceeds" means all cash and checks received from conducting games. Collections are deposited into the general fund. The gaming tax rates are as follows:

Total Quarterly Gross Proceeds	Rate
\$0 to \$1,500,000	1.00%
Exceeding \$1,500,000	\$15,000 + 2.25% of any amount over \$1,500,000

A pari-mutuel tax is levied upon total wagers placed on race performances through live, simulcast, and account wagering. A tax of 2 percent is imposed on live wagers of which one-half of 1 percent is deposited in the general fund and a tax of 2 percent is imposed on simulcast and account wagering of which one-sixteenth of 1 percent is deposited in the general fund.

Wholesale Liquor Tax

The tax on liquor and beer is a privilege tax imposed on all alcoholic beverage wholesalers doing business in North Dakota. In addition, direct shippers, microbrew pubs, brewer taprooms, domestic wineries and domestic distilleries pay the taxes on alcoholic beverages made by those facilities and sold directly to consumers. A pub, winery, or distillery may not engage in any wholesaling activities. Collections are deposited into the general fund. The amount of the tax is determined by the type of beverage and the gallonage sold by a wholesaler. The tax rate schedule is as follows:

Beverage Type	Rate Per Wine Gallon
Beer in bulk containers	\$0.08
Beer in bottles and cans	\$0.16
Wine (less than 17% alcohol), including sparkling wine	\$0.50
Wine (17% to 24% alcohol)	\$0.60
Distilled spirits	\$2.50
Alcohol	\$4.05

Other Revenues

Other ongoing general fund revenues include the following:

- **Mineral leasing fees** - Mineral leasing and royalty revenue shared between the state and federal government on federal lands within the state. State revenues are shared equally with the counties in which the minerals are located.
- **Interest income** - Interest income is received on the investment of certain state funds.
- **Departmental collections** - Are fees received by agencies which are deposited into the general fund.

Attached is a history of general fund tax collections ([Appendix C](#)) and the [Estimated Revenue Sources and Distributions for Major State Funds for the 2017-19 Biennium](#) showing the major state funds and revenues sources.

ELEMENTARY AND SECONDARY EDUCATION FUNDING SOURCES

General Fund

The 2017 Legislative Assembly appropriated \$2,015,904,163, of which \$1,409,357,258 is from the general fund for state school aid. The following table is a history of funding from the general fund appropriated for state school aid to the Department of Public Instruction:

Biennium	General Fund
2009-11	\$1,098,077,143
2011-13	\$1,223,111,478
2013-15	\$1,695,374,000
2015-17	\$1,668,257,237
2017-19	\$1,409,357,258

Common Schools Trust Fund
Money Deposited in the Common Schools Trust Fund
Select Constitutional Provisions

Article IX, Section 1

This section provides that the following money must be deposited in a permanent trust fund, known as the common schools trust fund, and used to support the common schools of the state:

- All proceeds relating to public lands granted to the state by the federal government for the support of the common schools.
- All proceeds relating to property acquired by the state through escheat (property reverting to the state in the absence of legal heirs).
- All gifts, donations, and other property acquired by the state for the support of the common schools.
- The proceeds of all bonuses relating to the leasing of coal, gas, oil, or other mineral interests relating to common schools lands.

This section was included in the original Constitution of North Dakota enacted in 1889. In 1982 the section was amended to provide that bonuses relating to the leasing of coal, gas, oil, or other mineral interests relating to common schools lands were to be deposited in the common schools trust fund. In 2006 Measure No. 1, approved by voters, removed the reference to bonuses related to leasing and provided that revenues earned by a perpetual trust fund must be deposited in the fund.

Article IX, Section 5

This section provides that in all sales of common schools lands, the state must retain the mineral interests. Leases may be executed for the extraction and sale of the minerals.

This section was included in the original Constitution of North Dakota enacted in 1889. As originally enacted, the section prohibited the sale of common schools lands that were "coal lands" and did not address other minerals. In 1960 the section was amended to its current form which allows the sale of lands containing minerals, but requires that the state retain the mineral interests. Minerals are defined to include oil, gas, coal, cement materials, sodium sulphate, sand and gravel, road material, building stone, chemical substances, metallic ores, uranium ores, and colloidal or other clays.

Article X, Section 24

This section provides that 10 percent of oil extraction tax revenue must be deposited in the common schools trust fund.

This section was enacted in 1994 through voter approval of Measure No. 1 (1993 Senate Concurrent Resolution No. 4011). In November 2016 voters approved 2015 Senate Concurrent Resolution No. 4003, which provided for a constitutional amendment to Section 24. The amendment allows the Legislative Assembly to appropriate or transfer the principal balance of the foundation aid stabilization fund in excess of 15 percent of the general fund appropriation for state school aid for the most recently completed biennium for education-related purposes and simplifies other language in the section. However, the amendment does not change deposits to the fund or limit the balance in the common schools trust fund, which has not been changed since enactment.

Select Century Code Provisions

Section 47-30.1-23

This section provides that all funds received by the state under the Uniform Unclaimed Property Act, except amounts deducted for the payment of claims and certain administrative costs, must be deposited in the common schools trust fund.

Section 54-27-25

This section, which was enacted by the 1999 Legislative Assembly, creates a tobacco settlement trust fund to be used to deposit tobacco settlement money received by the state. Forty-five percent of the tobacco settlement money received under subsection IX(c)(1) of the Master Settlement Agreement and deposited in the tobacco settlement trust fund must be transferred to the common schools trust fund and become a part of the principal of the fund. In House Bill No. 1012 (2017), the Legislative Assembly amended Section 54-27-25 to suspend transfers from the tobacco settlement trust fund to the common schools trust fund during the 2017-19 biennium and increase transfers from the tobacco settlement trust fund to the community health trust fund from 10 to 55 percent of the tobacco settlement revenues deposited in the tobacco settlement trust fund.

The Legislative Assembly, in 2015 Senate Bill No. 2003, amended Section 54-27-25 related to the tobacco settlement trust fund to provide the principal and interest of the fund may be appropriated to the Attorney General for the enforcement of the Master Settlement Agreement and any disputes with the agreement. Appropriations made to the Attorney General for enforcement of the Master Settlement Agreement reduce the amount available for transfer from the tobacco settlement trust fund to the common schools trust fund.

Investment of the Common Schools Trust Fund

Section 15-03-04 provides that the Board of University and School Lands is to apply the prudent investor rule in investing the permanent funds under its control, including the common schools trust fund. The prudent investor rule means that in making investments, the board is to exercise the same judgment and care that an institutional investor of ordinary prudence, discretion, and intelligence exercises in the management of large investments entrusted to it.

Attached is the [*Analysis of the Common Schools Trust Fund for the 2015-17 and 2017-19 Bienniums*](#).

Foundation Aid Stabilization Fund

The foundation aid stabilization fund was created in 1994 when the voters of North Dakota approved a constitutional amendment--now Section 24 of Article X of the Constitution of North Dakota--to provide that 20 percent of oil extraction tax revenue be allocated as follows:

- 50 percent (of the 20 percent) to the common schools trust fund; and
- 50 percent (of the 20 percent) to the foundation aid stabilization fund.

In November 2016, voters approved 2015 Senate Concurrent Resolution No. 4003, which amended the Constitution of North Dakota to allow the Legislative Assembly to appropriate or transfer the principal balance of the foundation aid stabilization fund in excess of 15 percent of the general fund appropriation for state school aid for education-related purposes.

Prior to December 8, 2016, the principal of the foundation aid stabilization fund was only available upon order of the Governor to offset foundation aid reductions made by executive action due to a revenue shortfall. Section 54-44.1-12 provides that the Director of the Budget may order an allotment to control the rate of expenditures of state agencies. This section provided that an allotment must be made by a specific fund and all departments and agencies that receive money from a fund must be allotted on a uniform percentage basis, except that appropriations for foundation aid, transportation aid, and special education aid may only be allotted to the extent that the allotment can be offset by transfers from the foundation aid stabilization fund. In 2017 the Legislative Assembly approved Senate Bill No. 2272 and House Bill No. 1155 which amended Section 54-44.1-12 to provide any reductions to the general fund appropriation to the Department of Career and Technical Education for grants to school districts due to allotment are offset by funding from the foundation aid stabilization fund. Senate Bill No. 2272 also created a new section to Chapter 54-27 indicating that state school aid includes general fund appropriations for state school aid, transportation aid, and special education aid in the Department of Public Instruction, as well as general fund appropriations for career and technical education grants to school districts and area centers in the Department of Career and Technical Education.

Section 24 of Article X of the Constitution of North Dakota provides that the interest income of the foundation aid stabilization fund must be transferred to the general fund on July 1 of each year. However, the State Treasurer's office allocates the interest income to the general fund on a monthly basis. For the period July 1, 2015, through February 28, 2017, \$494,313 of interest from the foundation aid stabilization fund has been deposited in the general fund.

In February 2016 the Governor issued a 4.05 percent budget allotment and in March 2016, \$71,758,143 was transferred from the foundation aid stabilization fund to the Department of Public Instruction to offset state school aid, transportation, and special education reductions as a result of the general fund budget allotment. In

August 2016 the Governor issued another 2.5 percent budget allotment and an additional transfer of \$44,295,150 was made from the foundation aid stabilization fund to the department later that month. Senate Concurrent Resolution No. 4003 (2015), approved by voters in November 2016, amended Section 24 of Article X of the Constitution of North Dakota to allow the Legislative Assembly to appropriate or transfer the principal balance of the foundation aid stabilization fund in excess of 15 percent of the general fund appropriation for state school aid for the most recently completed biennium for education-related purposes. House Bill No. 1013 (2017) provides \$295 million from the foundation aid stabilization fund for state school aid during the 2017-19 biennium, of which \$185 million is considered one-time funding. In addition, the Legislative Assembly in 2017 appropriated one-time funding for other educational purposes totaling \$82,795,150, including \$75,000,000 for transfers to the school construction loan fund.

Attached is the [Analysis of the Foundation Aid Stabilization Fund for the 2015-17 and 2017-19 Bienniums](#).

Budget Stabilization Fund

The budget stabilization fund was established by the 1987 Legislative Assembly in House Bill No. 1596. Major provisions include:

- Section 54-27.2-01 establishes the budget stabilization fund and provides any interest earned on the balance of the budget stabilization fund must be retained in the fund. The section originally provided any money in the fund in excess of 10 percent of the general fund budget, as approved by the most recently adjourned Legislative Assembly, must be deposited in the general fund. The 2011 Legislative Assembly approved House Bill No. 1451 which decreased the maximum balance allowed in the fund from 10 to 9.5 percent of the general fund budget approved by the most recently adjourned Legislative Assembly. The 2017 Legislative Assembly approved House Bill No. 1155 which increased the maximum balance allowed in the fund from 9.5 to 15 percent of the general fund budget approved by the most recently adjourned Legislative Assembly.
- Section 54-27.2-02 provides any amount in the general fund at the end of a biennium in excess of \$65 million must be transferred to the budget stabilization fund.
- Section 54-27.2-03 provides the Governor may order a transfer from the budget stabilization fund to the general fund if the Director of the Office of Management and Budget projects a general fund revenue shortfall. The section originally limited the transfer to the difference between an amount 2.5 percent less than the original legislative general fund revenue forecast and the revised forecast prepared by the Office of Management and Budget. House Bill No. 1155 (2017) revised the section to allow for transfers from the budget stabilization fund to the general fund as follows:

After general fund allotments totaling at least 3 percent have been made under Section 54-44.1-12, the Governor may order a transfer of up to an amount equal to 3 percent of general fund appropriations;

After the previous transfer has been made and an additional 1 percent general fund budget allotment has been made, the Governor may order a transfer of up to 2 percent of general fund appropriations;

After the previous transfer has been made and an additional 1 percent general fund budget allotment has been made, the Governor may order a transfer of up to 3 percent of general fund appropriations; and

After the previous transfer has been made and an additional 1 percent general fund budget allotment has been made, the Governor may order a transfer of any remaining funds in the budget stabilization fund.

The amount of transfers from the budget stabilization fund to the general fund may not exceed the difference between the original and revised general fund revenue forecasts less general fund allotments made under Section 54-44.1-12. For purposes of the transfers, total general fund allotment percentages must be based on allotments made after any allotment exemption granted by the Director of the Budget.

The August 2016 special legislative session, authorized the Director of the Office of Management and Budget to transfer up to \$572,485,452 from the budget stabilization fund to the general fund to provide for a positive balance in the general fund on June 30, 2017. The Office of Management and Budget made this transfer during the 2015-17 biennium. The 2017 Legislative Assembly in House Bill No. 1152 provides for the deposit of up to \$75 million of the state share of oil and gas tax collections into the budget stabilization fund each biennium. The entire \$75 million amount is anticipated to be deposited into the fund during the 2017-19 biennium.

Attached is the [Analysis of the Budget Stabilization Fund for the 2015-17 and 2017-19 Bienniums.](#)

PROPOSED STUDY PLAN

The following is a proposed study plan for the committee's consideration:

1. Identify significant revenue sources.
2. Review long-term trends and the impact of policy changes.
3. Review fund analysis for the general fund, budget stabilization fund, common schools trust fund, and foundation aid stabilization fund.
4. Analyze the causes of revenue volatility.
5. Assess the adequacy and reliability of funding sources used for elementary and secondary education.
6. Develop recommendations and prepare any necessary legislation.
7. Prepare a final report.

ATTACH:3