North Dakota Legislative Council

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ECONOMIC DEVELOPMENT TAX INCENTIVE STUDY - AUTOMATION TAX CREDIT

Pursuant to North Dakota Century Code Section 54-35-26, enacted in 2015, a variety of economic development tax incentives must be reviewed by a Legislative Management interim committee once in each 6-year review cycle. The study is aimed at ensuring 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, the outcome of past reviews of the incentive, and the data and testimony required to conduct an effective analysis of the incentive.

EXPLANATION OF THE AUTOMATION TAX CREDIT

Section 57-38-01.36 provides for an income tax credit for purchases of manufacturing machinery and equipment for the purpose of automating a manufacturing process in this state to improve job quality and increase productivity. The incentive is available to any income taxpayer certified by the Department of Commerce as a primary sector business. A primary sector business is defined in Section 1-01-49 as a business that employs knowledge or labor to add value to a product, process, or service that results in the creation of new wealth. The credit is equal to 20 percent of the cost of the manufacturing machinery and equipment purchased in the taxable year for purposes of automating a manufacturing process to improve job quality and increase productivity. Qualified expenditures for purchases of manufacturing machinery and equipment used to calculate the automation tax credit may not be used to calculate any other income tax deduction or credit allowed under Chapter 57-38.

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

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

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

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

The credit is available through December 31, 2022.

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

Provisions regarding an automation tax credit first appeared in Senate Bill No. 2055 (2011), 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 Senate Bill No. 2057 (2011). Senate Bill No. 2057, codified at Section 57-38-01.33, 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 changes made to Section 57-38-01.33 occurred through the passage of House Bill No. 1106 (2013) and Senate Bill No. 2340 (2015). House Bill No. 1106 streamlined the lengthy description of a passthrough entity by providing a definition of the term at the outset of the income tax chapter. Senate Bill No. 2340 expanded the credit to include purchases of manufacturing machinery and equipment acquired through a lease-purchase agreement. Senate Bill No. 2340 also reduced the aggregate amount of credits allowed for all taxpayers from $2 million per calendar year to $500,000 per calendar year for years 2016 and 2017, and allowed any unused credits to be carried forward to the next calendar year. The credit was further modified by Senate Bill No. 2340 to provide a method to prorate the credits among all qualified claimants if the cap is reached. Senate Bill No. 2340 included a sunset provision indicating the tax credit was effective for the first 3 taxable years beginning after December 31, 2014. No additional legislation was passed to extend the automation tax credit in Section 57-38-01.33 prior to the expiration date.

Following the expiration of Section 57-38-01.33, provisions regarding an automation tax credit were revisited in House Bill No. 1040 (2019), and ultimately passed in a form substantially similar to the credit formerly available under Section 57-38-01.33. The 21st century manufacturing workforce incentive, codified at Section 57-38-01.36, provides a similar income tax credit of 20 percent of the cost of the manufacturing machinery and equipment purchased in the taxable year for purposes of automating a manufacturing process. However, distinctions exist between the automation tax credit under the expired Section 57-38-01.33 and the automation tax credit provided in Section 57-38-01.36. These distinctions include additional taxpayer reporting requirements demonstrating improved job quality or increased productivity and a $1 million limit on the aggregate amount of credits available in each calendar year. The credit also includes a sunset provision, indicating the credit will be available only for the first 4 taxable years beginning after December 31, 2018.

Upon a review of the legislative history relating House Bill No. 1040, the Legislative Assembly's perceived goals related to the continuation of an automation tax credit in the form of the 21st century manufacturing workforce incentive were consistent with the Legislative Assembly's goals when establishing the former version of the automation tax credit under Section 57-38-01.33. The Legislative Assembly emphasized the credit is to be used to incentivize improvement of job quality and increased productivity in the industry.

PAST REVIEW OF THE AUTOMATION TAX CREDIT

The automation tax credit was last reviewed by the 2015-16 interim Political Subdivision Taxation Committee. During the course of its study, the committee learned the credit was set to expire at the end of 2017. The committee received information from representatives of the Department of Commerce indicating all $2,000,000 in available credits were awarded in calendar years 2013 and 2014, and $978,957 in credits were awarded in calendar year 2015 for a total amount of $4,978,957 awarded to 23 companies over the 3-year period.

The committee considered a bill draft to eliminate the sunset date attached to the automation tax credit under Section 57-38-01.33. The committee received comments from representatives of the Economic Development Association of North Dakota and the Greater Fargo/Moorhead Economic Development Corporation in support of the bill draft. Testimony in favor of continuing the credit highlighted success stories related to businesses using the automation tax credit and noted the credit is particularly important during times in which businesses face challenges recruiting and retaining a skilled workforce. The committee also received testimony expressing a desire to see the yearly amount of the credit restored to the $2 million threshold. Some committee members questioned whether economics drive a company's decision to automation more so than the availability of a tax incentive. The committee recommended legislation to eliminate the sunset date attached to the automation tax credit, which failed to pass during the 2017 legislative session.

DATA AND TESTIMONY REQUIRED TO CONDUCT AN EFFECTIVE ANALYSIS OF THE AUTOMATION 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; and
5. Out-of-state impacts resulting from the incentive.

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

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