MICROFILM DIVIDER

OMB/RECORDS MANAGEMENT DIVISION
SFN 2053 (2/85) 5M

GREAT SEAL STATE OF NORTH DAKOTA

ROLL NUMBER

DESCRIPTION

2084

2007 SENATE FINANCE AND TAXATION

SB 2084

2007 SENATE STANDING COMMITTEE MINUTES

Bill/Resolution No. **SB 2084**

Senate Finance and Taxation Committee

☐ Check here for Conference Committee

Hearing Date: January 15, 2007

Recorder Job Number: # 1063

Committee Clerk Signature	Sharon Renfrow

Minutes:

Sen. Urlacher: called the committee to order and opened the hearing on SB 2084.

Donita Wald from the Tax Dept. appeared in support of the bill with written testimony. (See attached)

Sen. Cook: the retirement investment, is that something that is available to any tax paying citizen on their income tax form and if so, how does it work?

Ms. Wald: it's available to everyone who's able to direct where their retirement monies are being invested

Sen. Tollefson: it would have to be self generated retirement program and controlled by the individual to qualify for any kind of a tax credit.

Ms. Wald: if you were beneficiary of that plan and you were directing where those invested dollars would go, you would be eligible.

Sen. Horne: to me it means that as the state were putting more infridgment on the non owner of the business to invest in this is trying to get outside investors rather than inside investors.

Ms. Wald: Yes. I wanted to let the committee know is that there is a currently a 2 ½ million dollar cap on the program and that a proposal has been advanced in the House, HB 1027 to increase that to 5 million. This would be for a calendar year and we hit it once.

Paul Lucy: from the Dept. of Commerce appeared in support stating we've had many discussions with the Tax Dept. in drafting the wording for that bill and we just want to say that we are in support. Small Business Administration has a number of different statistics that they put out every year and they talk about the number of businesses that the years in which the number of business supply and typically they said the business by the 6th year is only about to 35 to 40% that are surviving from when they started and the reason that they put the number one reason why company's couldn't _______ are not successful is based on the amount of money that they could secure from investors. This particular tax cut is a nice tool for the State of ND to get more investments into those businesses to help them be more successful. It's a boost for ND.

No opposition on the bill. The hearing was closed

2007 SENATE STANDING COMMITTEE MINUTES

Bill/Resolution No. **SB 2084**

Senate Finance and Taxation Committee

☐ Check here for Conference Committee

Hearing Date: January 16, 2007

Recorder Job Number: # 1167

Committee Clerk Signature	Sharon Renfrow

Minutes:

Sen. Urlacher called the committee to order to do action on SB 2084.

Sen. Oehlke made a MOTION for DO PASS, seconded by Sen. Tollefson.

Sen. Oehlke: noted that this goes hand in hand with SB 2081 and is very similar.

Sen. Cook: we presently have 2 ½ million dollar cap and this is raising it to 5 million, why isn't that reflected in the fiscal note?

Committee tried getting ahold of Donita Wald from the Tax Dept. for an explanation. No luck. Further discussion on what was in the written testimony or on the fiscal note as to possibly why there was no fiscal effect.

Sen. Cook stated he felt comfortable with voting and would get ahold of the Tax Dept. later.

7-0-0. Sen. Oehlke will carry the bill.

Meeting adjourned.

FISCAL NOTE

Requested by Legislative Council
12/27/2006

Bill/Resolution No.: SB 2084

1A. **State fiscal effect:** *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

	2005-2007 Biennium		2007-2009 Biennium		2009-2011 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues						
Expenditures						
Appropriations						

1B. **County, city, and school district fiscal effect:** *Identify the fiscal effect on the appropriate political subdivision.*

2005-2007 Biennium			2007-2009 Biennium			2009-2011 Biennium		
Counties	Cities	School Districts	Counties	Cities	School Districts	Counties	Cities	School Districts

2A. **Bill and fiscal impact summary:** *Provide a brief summary of the measure, including description of the provisions having fiscal impact (limited to 300 characters).*

SB 2084 simplifies the certification of qualified businesses and the calculation of the seed capital investment tax credit provisions.

B. **Fiscal impact sections:** *Identify and provide a brief description of the sections of the measure which have fiscal impact. Include any assumptions and comments relevant to the analysis.*

There will be some acceleration of the tax credits claimed by the removal in this bill of the requirement that only one-third of the available tax credits can be claimed in a given year. The rate at which the tax credit is computed, and the annual amount of credit allowed to a taxpayer remain the same. The bill specifies provisions for qualifying investments from a retirement plan that can result in a tax credit for the plan participant under certain circumstances. It is not possible to determine the fiscal impact of these provisions.

3. **State fiscal effect detail:** *For information shown under state fiscal effect in 1A, please:*

A. **Revenues:** *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*

B. **Expenditures:** *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*

C. **Appropriations:** *Explain the appropriation amounts. Provide detail, when appropriate, for each agency and fund affected. Explain the relationship between the amounts shown for expenditures and appropriations. Indicate whether the appropriation is also included in the executive budget or relates to a continuing appropriation.*

Name:	Kathryn L. Strombeck	**Agency:**	Office of Tax Commissioner
Phone Number:	328-3402	**Date Prepared:**	01/12/2007

Date: 1-16-07

Roll Call Vote #: 1

2007 SENATE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. SB2084

Senate Finance & Tax Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number

Action Taken DO Pass

Motion Made By Sen Oehlke Seconded By Sen. Tollefson

Senators	Yes	No	Senators	Yes	No
Sen. Urlacher	✓		Sen. Anderson	✓	
Sen. Tollefson	✓		Sen. Horne	✓	
Sen. Cook	✓		Sen. Triplett	✓	
Sen. Oehlke	✓				

Total (Yes) 7 No 0

Absent 0

Floor Assignment Sen. Oehlke

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

SB 2084: Finance and Taxation Committee (Sen. Urlacher, Chairman) recommends **DO PASS** (7 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING). SB 2084 was placed on the Eleventh order on the calendar.

2007 HOUSE FINANCE AND TAXATION

SB 2084

2007 HOUSE STANDING COMMITTEE MINUTES

Bill/Resolution No. SB 2084A

House Finance & Taxation Committee

☐ Check here for Conference Committee

Hearing Date: 2/21/07

Recorder Job Number: 3524

Committee Clerk Signature DPenrose

Minutes:

Rep. Belter: We will open the hearing on SB 2084. Clerk read title.

Donnita Wald, ND Office of State Tax Commissioner: (see attached testimony #1).

Rep. Owens: I understand about the beginning end dates for the four years, then you talk about recertifying. Will the recertification be for four years, and then it's over after those 8 years.

Donnita Wald: That's correct.

Rep. Pinkerton: How many dollars are available for the program, do you know.

Donnita Wald: Yes, I do. This program started out initially not being used at all. Then in the 2003 session, the legislature made some changes to try to make it more of an attractive program, that they set a $2.5 million dollar per biennium cap on this program. What happened was that the program took off and in May, 2004 we met that $2.5 million dollar cap. Since then the program has been working quite well and since 2002, there's been about $10 million dollars available in tax credit that haven't been used because of the tax liability.

Rep. Pinkerton: Can the tax credits be sold or traded.

Donnita Wald: No, carry forward only.

Rep. Pinkerton: I didn't see the carry forward position numbers.

Donnita Wald: It is on page 3, lines 1-3.

Rep. Belter: You said that there was a $2.5 million cap on it, but there's been $10 million in credits. But you've not been able to use those credits because of not having the income.

Donnita Wald: No, since that $2.5 million, the legislature has allowed $2.5 million per year now, and I know in HB 1027, they're proposing to increase that to $5 million dollars per year.

Rep. Headland: When you are using your investment in an IRA for your seed capital, I am assuming that everything stays the same as far as cashing in that IRA, I understand that some IRA's are taxable, are they not, and is it the ROTH that you don't owe tax on when you cash it in. If you cash in your IRA you're still going to have that tax to pay on the IRA.

Donnita Wald: This does not change the tax attributes of both types of retirement plans; it simply allows them to invest.

Rep. Pinkerton: Is there a tax deferred benefit of the IRA.

Donnita Wald: A lot of those IRA plans or investment plans are self-directed by the owner of the plan, and they can direct where those assets are going. Once they get that tax-payer IRA invested in that, hopefully it will grow their IRA, but it also gives them a tax credit on their income tax return for that year. So it's not necessarily building up the plans, it's just giving them a tax credit, if they direct their investments to this qualified plan.

Rep. Pinkerton: If you have an IRA and you use it as a seed capital investment, it accumulates tax credit. That tax credit can be used by that individual for their IRA, this would make it so there is a much greater chance that it could be used then because it would allow, there is something in here that if you have more than 50% of income comes from seed capital that is deferred.

Donnita Wald: Yes, that's correct. I see where you are going with this, where you could have someone who is a 50% owner of the business and put the funds into an IRA and direct them to invest in the business IRA, because those assets are separate from a taxpayer's dollars, and then get the credit. Is that where you were going.

Rep. Pinkerton: So is there any prevention of that, this seems to be quite a loophole.

Donnita Wald: Frankly, we had not thought of that particular loophole. We've only had two people inquire about this, they were retired individuals. It's possible that could happen. A lot of things are possible in here. Do I think it would be a big problem, probably not; but again, this is something we are just bringing forward to you? It's an issue that we have had to deal with internally, and we just brought it to the legislature to see what your thoughts were. We have no heartburn either way.

Rep. Pinkerton: Can this be dealt with a limitation or an amendment.

Donnita Wald: Yes, I'm sure.

Rep. Owens: Just to answer some of the issues that Rep. Pinkerton is bringing up. You've got traditional and Roth IRA's. They are both limited per year, so you are talking about a very miniscule credit, because what would happen is, that they could, if their income is above the traditional being tax deductible, then they could turn around and use this credit for those few people that were qualified to have 50% ownership and controlling interest in this thing. But still, the amount that they can contribute each year is very small, $2000 or $4000 dollars, is all they can contribute. If it's Roth, then they are paying taxes on that money when they put it in the Roth, so they can use the credit for that. But still, that's limited to $4,000 or $5,000 dollars. We're not talking about the amount that we see in this bill, so by default of the rules of an IRA, it's limited anyway. Also, the way I read this is, just to say, just like she stated earlier, current self-directed IRA's had to go out and buy stock. I could buy stock and forward. Well, they just want to be able to have this as an investment vehicle for the IRA, is really all this bill is doing. I don't think, even you bring up a loophole and a good point, I don't think it would take a large number of people to do this, to make this really amount to a lot of money.

Rep. Belter: To follow up, you wouldn't necessarily be limited to your annual, if you got a million dollars in your IRA and you want to take $150,000 out of your IRA and put it into one of these qualified investments per year, you could do this.

Donnita Wald: Yes, that's correct.

Rep. Pinkerton: So would this be like, there are a lot of IRA's that are a million dollars, so if you took your IRA and made an investment with that, that would qualify him, say if it were a $300,000 investment and you met all the other criteria, then you would have a tax credit up to, on a $300,000 investment, you'd have a tax credit of $150,000 and that would pass through into your individual income and you could claim that against your ordinary state income. You could claim that up to four years, so you could claim up to $40,000 a year for four years on a $300,000 investment.

Donnita Wald: Yes.

Rep. Pinkerton: Can these be accumulated together, say if they could find other people, say four other investors who are willing to self-direct an IRA, that this could be accumulated as bought the business from, then we could take the tax credit back out and it could be divvied accordingly.

Donnita Wald: I don't think so, not the way this is written. It couldn't be a pool; it has to be just your own separate self-directed account. I think it says that you have to have a separate account maintained for you and leave it, be the controller of the fund. I'm almost sure that right now, that wouldn't be possible.

Rep. Belter: Thank you. Further testimony in support.

Paul Lacy, Director of Economic Development & Finance, ND Dept. of Commerce: Our role in this bill is to present it to you in the areas of certification and recertification of businesses that would qualify for the tax credit. I just wanted to let you know that we were in discussions with the Tax Dept. about the changes that were being made to this tax credit and our support of them as they are in the bill. I'm here to lend our support.

Rep. Weiler: What are a couple of examples of businesses that this would qualify for?

Paul Lacy: Are you looking for a specific business name or just a business in general.

Rep. Weiler: Just business in general, what types of businesses.

Paul Lacy: A primary sector business would be a company that is generating new wealth, typically marketing a product or service outside the state of ND. Typically in the case of a seed capital tax credit, it would be a company that is adding some new technology or something to their business. So if a company was going to be an R&D firm, that is developing microelectronics, and they provided engineering services to companies around the country, they would qualify for this credit.

Rep. Belter: Thank you. Further testimony in support. Testimony in opposition. I received a note from Wade Moser, and he had said that he had been working with you to possibly put some amendments on either 2083 or 2084. Are you familiar with what is transpiring here?

Donnita Wald: Yes, I am familiar with those amendments. I have been working with that and Mr. Moser, indirectly, I guess. Those amendments deal with the Ag. Commodity Investment Tax Credit Program, 20-83 is just a statutory audit change. If there was going to be a vehicle to put those amendments on, SB 2081, which I referred to in my testimony, which specifically dealt with Ag Commodities that would be the better vehicle.

Rep. Belter: Thank you. Testimony neutral. We will close the hearing.

2007 HOUSE STANDING COMMITTEE MINUTES

Bill/Resolution No. SB 2084B/C

House Finance & Taxation Committee

☐ Check here for Conference Committee

Hearing Date: 2/26/07

Recorder Job Number: 3878 & 3880

Committee Clerk Signature DPenrose

Minutes:

Rep. Belter: We will take a look at SB 2084. Is this comparable to what we just talked about. Any amendments suggested?

Rep. Headland: We did talk about changes to subsection 5. We thought there might be some funny business going on, the fact that we weren't sure that we had a handle on it.

Rep. Belter: That was discussed, but it is all that same language that is in the other bill.

Rep. Drovdal: That means they could take the retirement plan for their employees and stick it in an investment, is that what is going on there.

Rep. Owens: No, it would not. It says it has to be self-directed. No that would not be the case. The individual, like me, has to manage my 401k, and I can choose for part of my 401k, if I have that noted, to go into one of these, but the company couldn't do it with a pension fund.

Rep. Belter: We were just discussing 2084.

(Reopened later in the same session).

Rep. Belter: What are the committee's wishes in regard to SB 2084?

Rep. Grande: I move a Do Pass.

Rep. Owens: Second.

Rep. Belter: Any discussion.

Rep. Pinkerton: Does this have a sunset clause on it.

Rep. Belter: No, it does not. It certainly could. Most of these bills, such as this, are looked at every session.

Rep. Drovdal: Is that $250,000 a year or $250,000 and then it have all gone. Is it 10 businesses a year or 10 businesses total and then it's gone?

Donnita Wald: Ten businesses a year have to be certified; right now there are two operating under the Ag program.

Rep. Belter: Then there is a sunset, it's just that you run out of credits for that year.

Donnita Wald: The taxpayer has a $250,000 lifetime, $50,000 a year.

Rep. Wrangham: Maybe somebody can refresh my memory, I have a note here that says loophole that has not been solved before.

Rep. Pinkerton: After talking to the Tax Dept., it is fairly self-limiting. Certainly you can't get a tax credit on money that you didn't pay the tax on.

Rep. Belter: Clerk will call the roll.

9 YES 0 NO 5 ABSENT DO PASS CARRIER: Rep. Schmidt

Date: 2-26 pm
Roll Call Vote #: 2084 C

2007 HOUSE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO.

House Finance & Tax Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number

Action Taken Do Pass

Motion Made By Rep Grande Seconded By Rep. Owens

Representatives	Yes	No	Representatives	Yes	No
Chairman Belter	✓		Rep. Froelich	—	—
Vice Chairman Drovdal	✓		Rep. Kelsh	—	—
Rep. Brandenburg	—	—	Rep. Pinkerton	✓	
Rep. Froseth	✓		Rep. Schmidt	✓	
Rep. Grande	✓		Rep. Vig	—	—
Rep. Headland	✓				
Rep. Owens	✓				
Rep. Weiler	—	—			
Rep. Wrangham	✓				

Total (Yes) 9 No 0

Absent 5

Floor Assignment Rep. Schmidt

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

SB 2084: Finance and Taxation Committee (Rep. Belter, Chairman) recommends **DO PASS** (9 YEAS, 0 NAYS, 5 ABSENT AND NOT VOTING). SB 2084 was placed on the Fourteenth order on the calendar.

2007 TESTIMONY

SB 2084

Testimony Of the Office of State Tax Commissioner Before The Senate Finance And Taxation Committee

Senate Bill 2084

January 15, 2007

Chairman Urlacher, members of the Senate Finance and Taxation Committee, I am Donnita Wald, Legal Counsel for the Office of State Tax Commissioner and I am here today on behalf of the Commissioner to testify in support of Senate Bill 2084.

Background

This bill, relating to the Seed Capital Investment Tax Credit program, and its companion bill, Senate Bill 2081 (relating to the Agriculture Commodity Processing Facility Investment Tax Credit program) were introduced by the Tax Commissioner to address administrative issues encountered by our Department and the Department of Commerce since the inception of these two programs. The Tax Department consulted with the Commerce Department during the drafting of this bill and incorporated changes to clarify the qualified business certification requirements that are administered by the Commerce Department.

Reasons for Proposed Changes

The amendments are made for the following reasons:

(1) The multiple layers of limitations in the calculation of the tax credit, combined with the present statutory language, have been a source of confusion for businesses certified under the program and the investing taxpayers, and have prompted challenges to the Tax Department's interpretation and application of the tax credit statute.

(2) Clearer and stronger language is needed with respect to the certification of businesses and its importance to the eligibility of the credit, including a prescribed limit on the amount of time a businesses maintains its qualified status under the program.

(3) Potential investment funds are to be found in retirement plans, such as IRA's and deferred compensation plans. Investors in these plans would like to direct some of those funds to qualified businesses under the program. The statute does not define a qualified investment and so it has not been clear whether or not the investment of funds from a retirement plan would qualify a taxpayer for the credit.

(4) Current law provides that a taxpayer whose full-time professional activity is the operation of the business is not entitled to the credit. This language has prompted questions from businesses because they do not understand who it is intended to include. This also has required

the Tax Department to make subjective determinations, based on various facts and circumstances, regarding who is and is not entitled to the credit.

EXPLANATION OF THE BILL

Section 1- Certification of Qualified Businesses. This section of the bill amends the statute relating to the certification of businesses for qualification in the Seed Capital Investment Tax Program.

The first change to the certification process is on found on page 1, lines 21-20. Since inception of the program, the Department of Commerce administratively certified a business for a set period of time. Because many businesses are unable to meet its capitalization needs before the certification expiration date, they have sought to be "recertified" under the program. The proposed recertification process limits a qualified business to one recertification and requires that a request for recertification must be made before the original certification period ends.

New language also requires the issuance of a certification letter that clearly sets out the beginning and ending dates of the certification period, and limits the certification period to no more than 4 years (page 2, lines 3-7). We believe this new language, in conjunction with the new language clarifying that an investment must be made on or after the effective date set out in the certification letter (page 3, lines 14-15) will eliminate any confusion on the part of qualified businesses and potential investors as to whether an investment will qualify for the tax credit.

Section 2 – Eligibility for and Calculation of the Tax Credit. Section 2 of the bill amends N.D.C.C. § 57-38.5-03, which contains the tax credit calculation and defines who is eligible for the credit. These changes simplify the tax credit calculation by removing the multiple layers of limitations on the tax credit and revising the current language.

The current tax credit is 45% of the amount invested by the taxpayer (page 2, lines 20-22 and 23-24), with a maximum annual credit of $112,500 (which equals $250,000 of investment dollars) (page 2, lines 25-28). The change to the maximum annual limitation only changes the focus of the limitation from the amount of dollars invested to the credit. This mirrors the language in the Agriculture Commodity

Investment program and does not change the amount of credit to which the investing taxpayer is entitled.

The limitations we propose being removed are found on lines 30-31. These limitations restrict the amount of credit an investor can claim each year to 1/3 of the available credit. In the past few years, these limits have raised many questions from both investors and qualified businesses, particularly with respect to the calculation of the amount to be used to calculate the unused credit carryforward and these limits impact on the statewide credit ceiling of $2.5 million. Removal of these tax credit limits does not change the total amount of the credit to which the taxpayer is entitled, only its timing. We believe the proposed changes will remove any uncertainty that exists and improve program administration.

On page 3, lines 10-13, is the creation of subsection 5 (page 3, line 12-15), which allows investments made by retirement plans to be eligible for the tax credit if a separate account is maintained for the plan participant and the participant directly controls investment of the account's assets.

Finally, we propose a more objective test for determining whether a taxpayer is not qualified to obtain the tax credit. We propose that disqualification for the credit be determined by looking at the amount of income the taxpayer derives from the qualified business. We propose changing the language to an income-based test - if more than 50% of the taxpayer's income is derived from the business in the year of the investment, the taxpayer cannot claim the credit. This change will remove the Department from having to make subjective determinations about the taxpayer's full-time professional activity and provide consistency in this provision's application.

CONCLUSION

Many of these same changes are being proposed for the Agriculture Commodity Processing Facility Investment Tax Credit program in Senate Bill 2081. The Office of State Tax Commissioner believes the changes we propose today will improve the Seed Capital Investment Tax Credit by providing certainty to businesses seeking investors and to those potential investors, as well as improving administration of the program. The Tax Commissioner respectfully requests that you give favorable consideration to Senate Bill 2084.

Seed capital business investment tax credit program

Reflects changes made by the 2005 North Dakota Legislature

Law provision	Summary
Overview of program	The purpose of this program is provide an incentive to invest in a qualified business that generates new wealth in North Dakota. The incentive is a nonrefundable income tax credit (dollar-for-dollar offset against the tax liability) for making an investment in the qualified business. To participate in this program, a business must apply to the North Dakota Commerce Department's Division of Economic Development and Finance to be certified as a qualified business. The entire amount of the investment for which a tax credit is allowed must be expended by the qualified business for plant, equipment, research and development, marketing and sales activity, or working capital.
Legislative history	Location in Code: N.D.C.C. Chapter 57-38.5. Created: 1993 (Session Law 1993, chapter 560). Amended: 1997 (S.L. 1997, ch. 495); 2001 (S.L. 2001, chs. 488 and 528); 2003 (S.L. 2003, ch. 18); and 2005 (S.L. 2005, ch. 151).
Definition of qualified business	A "qualified business" is a business that: • Is a for-profit corporation, partnership, limited liability company, limited liability partnership, joint venture, or a satellite operation that is a for-profit corporation; • Is in compliance with North Dakota's securities laws; • Hires North Dakota residents to fill the majority of its employment positions in North Dakota; • Has its principal office and conducts the majority of its business (except sales activity) in North Dakota, or has a significant operation in North Dakota that has (or projects to have) more than 10 employees or $150,000 of annual sales; • Generates "new wealth," which generally means sales to customers outside North Dakota, or to customers in North Dakota if availability of the product is limited; • Relies on innovation, research, or the development of new products and processes in its plans for growth and profitability; and, • Is neither an agricultural commodity processing facility nor a real estate investment trust.
Certification	A business must apply to and be certified by the ND Commerce Department's Division of Economic Development and Finance as meeting the qualifications of a "qualified business."
Use of investment monies by qualified business	The investment monies must be expended for plant, equipment, research and development, marketing and sales activity, or working capital.

Eligible taxpayers	• Individual (on Form ND-1 or Form ND-2) • Estate (on Form 38, Schedule 1 or 2) • Trust (on Form 38, Schedule 1 or 2) • Partnership (see Note) • Regular ("C") corporation (on Form 40) • S corporation (see Note) • Limited liability company (see Note) **Ineligible taxpayer:** A taxpayer in the above list is not eligible for the credit if the taxpayer owns a controlling interest (over 50%) in the qualified business or operates the qualified business on a full-time professional basis. This ineligibility extends to the taxpayer's spouse, parent, sibling, or child (or spouse of a sibling or child). ***Note:*** *If the taxpayer is a partnership, S corporation, or limited liability company (treated like a partnership), the credit is determined at the passthrough entity level and passed through to the entity's owners in proportion to their ownership interests. In addition, a trust may either claim the tax credit or pass it through to its beneficiaries.*
Rate of tax credit	45%
Maximum tax credit per taxpayer per tax year	$112,500 ***Note:*** *The equivalent investment amount is $250,000 ($112,500 divided by 45%).*
Cumulative limit on amount of tax credits allowed per taxpayer for all tax years	Not applicable; there is no cumulative limit on tax credits allowed to a taxpayer.
Other limitations/conditions on tax credit	• In any tax year, a taxpayer may claim no more than one-third of the total allowable tax credit attributable to the investments made in a given tax year. • Investment must remain in qualified business for at least 3 years.
Carryover of unused tax credit	4-year carryover
Lifetime limit on amount of eligible investments a qualified business may receive	$500,000, for businesses certified on or after January 1, 2005.[1]
Limit on tax credits allowed under the program for all tax years	$2.5 million for each calendar year.[2]
Administrative provisions	• Within 30 days after receiving an investment, the qualified business must complete an investment reporting form prescribed by the Office of State Tax Commissioner. A copy of the form must be filed with the Office of State Tax Commissioner and the Commerce Department's Division of Economic Development and Finance. • If the Office of State Tax Commissioner determines that either the taxpayer or the qualified business has misrepresented anything in the application for certification, or fails to satisfy any condition of the law, the credit will be disallowed and must be paid back with applicable penalty and interest.

[1] This limit does not apply to businesses that were certified as a qualified business before January 1, 2005, whose certification period (or extended certification period) did not expire before January 1, 2005.

[2] Credit not used in a calendar year are not carried over to the next calendar year

Seed Capital Investment Tax Credit Program— Summary of investments and credits for all years

Prepared by: Joseph J. Becker, North Dakota Office of State Tax Commissioner
January 11, 2007

Calendar year	Number of investments	Number of investors	Total amount invested [1]	Eligible amount of investment	Allowable credits
2002	22	22	$ 990,710.00	$ 790,710.00	$ 237,213.00
2003	178	163	2,328,020.39	2,328,020.39	1,047,609.18
2004 [2]	622	583	18,937,689.36	17,093,239.51	5,644,539.99
2005	268	213	12,981,102.81	5,555,555.56	2,500,000.00
2006	89	33	1,427,306.76	1,427,306.76	642,288.05
Total	1,179	- [3]	$ 36,664,829.32	$ 27,194,832.22	$ 10,071,650.22

1 The investment figures shown only reflect investments reported under the program by the qualified seed capital businesses. Only investments eligible for the tax credit are required to be reported.

2 A $2.5 million ceiling on the tax credits was in place for years prior to 2005. That ceiling was reached on May 25, 2004. The 2005 legislature enacted legislation authorizing a retroactive tax credit for those 2004 investments that did not qualify for the tax credit because of the $2.5 million ceiling. The retroactive tax credit was allowed at the rate of 30 percent for investments made in agricultural commodity processing facilities, and at the rate of 45 percent for all other investments. The figures shown in the above table for 2004 break down as follows:

Non-retroactive investments	122	138	$ 2,656,191.87	$ 2,700,395.16	$ 1,215,177.82
Retroactive investments—					
30 percent	448	410	$ 15,532,705.04	$ 13,649,451.90	$ 4,094,835.57
45 percent	52	35	748,792.45	743,392.45	334,526.60
Subtotal	500	445	$ 16,081,497.49	$ 14,392,844.35	$ 4,428,362.17
Total for 2004	622	583	$ 18,937,689.36	$ 17,093,239.51	$ 5,644,539.99

3 Some investors made more than one investment and invested in more than one year.

SB 2084
#1 2-21-07

Testimony—

House Finance and Taxation Committee

Senate Bill 2084

February 21, 2007

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Chairman Belter, members of the House Finance and Taxation Committee, I am Donnita Wald, Legal Counsel for the Office of State Tax Commissioner and I am here today on behalf of the Commissioner to testify in support of Senate Bill 2084.

BACKGROUND

This bill, relating to the Seed Capital Investment Tax Credit program, and its companion bill, Senate Bill 2081 (relating to the Agriculture Commodity Processing Facility Investment Tax Credit program) were introduced by the Tax Commissioner to address administrative issues encountered by our Department and the Department of Commerce since the inception of these two programs. The Tax Department consulted with the Commerce Department during the drafting of this bill and incorporated changes to clarify the qualified business certification requirements that are administered by the Commerce Department.

REASONS for Proposed CHANGES

The amendments are made for the following reasons:

(1) Clearer and stronger language is needed with respect to the certification of businesses and its importance to the eligibility of the credit, including a prescribed limit on the amount of time a businesses maintains its qualified status under the program.

(2) The multiple layers of limitations in the calculation of the tax credit, combined with the present statutory language, have been a source of confusion for businesses certified under the program and the investing taxpayers, and have prompted challenges to the Tax Department's interpretation and application of the tax credit statute.

(3) Potential investment funds are to be found in retirement plans, such as IRA's and deferred compensation plans. Investors in these plans would like to direct some of those

funds to qualified businesses under the program. The statute does not define a qualified investment and so it has not been clear whether or not the investment of funds from a retirement plan would qualify a taxpayer for the credit.

(4) Current law provides that a taxpayer whose full-time professional activity is the operation of the business is not entitled to the credit. This language has prompted questions from businesses because they do not understand who it is intended to include. This also has required the Tax Department to make subjective determinations, based on various facts and circumstances, regarding who is and is not entitled to the credit.

Explanation of the Bill

Section 1- Certification of Qualified Businesses. This section of the bill amends the statute relating to the certification of businesses for qualification in the Seed Capital Investment Tax Program.

The first change to the certification process is on found on page 1, lines 21-20. Since inception of the program, the Department of Commerce administratively certified a business for a set period of time. Because many businesses are unable to meet its capitalization needs before the certification expiration date, they have sought to be "recertified" under the program. The proposed recertification process limits a qualified business to one recertification and requires that a request for recertification must be made before the original certification period ends.

New language also requires the issuance of a certification letter that clearly sets out the beginning and ending dates of the certification period, and limits the certification period to no more than 4 years (page 2, lines 3-7). We believe this new language, in conjunction with the new language clarifying that an investment must be made on or after the effective date set out in the certification letter (page 3, lines 14-15) will eliminate any confusion on the part of qualified businesses and potential investors as to whether an investment will qualify for the tax credit.

Section 2 – Eligibility for and Calculation of the Tax Credit. Section 2 of the bill amends N.D.C.C. § 57-38.5-03, which contains the tax credit calculation and defines who is eligible for the credit. These changes simplify the tax credit calculation by removing the multiple layers of limitations on the tax credit and revising the current language.

The current tax credit is 45% of the amount invested by the taxpayer (page 2, lines 20-22 and 23-24), with a maximum annual credit of $112,500 (which equals $250,000 of investment dollars) (page 2, lines 25-28). The change to the maximum annual limitation only changes the focus of the limitation from the amount of dollars invested to the credit. This mirrors the language in the Agriculture Commodity Investment program and does not change the amount of credit to which the investing taxpayer is entitled.

The limitations we propose being removed are found on lines 30-31. These limitations restrict the amount of credit an investor can claim each year to 1/3 of the available credit. In the past few years, these limits have raised many questions from both investors and qualified businesses, particularly with respect to the calculation of the amount to be used to calculate the unused credit carryforward and these limits impact on the statewide credit ceiling of $2.5 million. Removal of these tax credit limits does not change the total amount of the credit to which the taxpayer is entitled, only its timing. We believe the proposed changes will remove any uncertainty that exists and improve program administration.

On page 3, lines 10-13, is the creation of subsection 5 (page 3, line 12-15), which allows investments made by retirement plans to be eligible for the tax credit if a separate account is maintained for the plan participant and the participant directly controls investment of the account's assets.

Finally, we propose a more objective test for determining whether a taxpayer is not qualified to obtain the tax credit. We propose that disqualification for the credit be determined by looking at the amount of income the taxpayer derives from the qualified business. We propose changing the language to an income-based test - if more than 50% of the taxpayer's income is derived from the business in the year of the investment, the taxpayer cannot claim the credit. This change will remove the Department from having to make subjective determinations about the taxpayer's full-time professional activity and provide consistency in this provision's application.

CONCLUSION

Many of these same changes are being proposed for the Agriculture Commodity Processing Facility Investment Tax Credit program in Senate Bill 2081. The Office of State Tax Commissioner believes the changes we propose today will improve the Seed Capital Investment Tax Credit by providing certainty to businesses seeking investors and to those potential investors, as well as improving administration of the program. The Tax Commissioner respectfully requests that you give favorable consideration to Senate Bill 2084.