

1999 SENATE FINANCE AND TAXATION

SB 2348

1999 SENATE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. 2348

Senate Finance and Taxation Committee

Conference Committee

Hearing Date 01/27/99

Tape Number	Side A	Side B	Meter #
2,348		X	0-2257
Committee Clerk Signature <i>Shirley Wald</i>			

Minutes:

Sen Urlacker opened the hearing on 2248, A BILL RELATING TO A SALES & USE TAX EXEMPTION FOR PURCHASES OF COMPUTERS & TELECOMMUNICATIONS EQUIP. BY A NEW PRIMARY SECTOR BUSINESS.

Sen Grindberg introduces the bill. This bill would allow more incentives to buy. I encourage your support on this.

Sen Wardner If we grant exemption, sales tax from this would then come in more than take care of all the exemptions. we are priming the pump.

Brent Teiken- Sundog International Testimony submitted and attached.

Sen Wardner - How many employees does you company employ?

Brent Teiken - 18. Starting wage is \$35,000.00 yearly + benefits.

Kent Busek-Sundog - Testimony submitted and attached.

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Senate Finance and Taxation Committee

Bill/Resolution Number Sb 2348

Hearing Date 01-27-99

Kevin Cramer Economic Development, I support 2348. This is a very important bill in attracting companies to the State of ND. ND can take advantage of this bill. It is a marketing tool for us. I recommend a do pass.

Russ Staiger - President of Bis Man Development Association. Testimony submitted and attached.

Jay Johnson - GNDA I am in support of bill 2348.

Sen Urlacher - Any further testimony or opposition to Bill 2348? Closed the hearing.

DISCUSSION 1-27-99 MOTION MADE BY SEN STENEHJEM TO DO PASS AND
SECONDED BY SEN SCHOBINGER vote WAS 5 Y 2 N O ABSENT. SEN SCHOBINGER
WILL CARRY THE BILL.

FISCAL NOTE

(Return original and 14 copies)

Resolution No.: SB 2348

Amendment to: _____

Requested by Legislative Council

Date of Request: 1/20/99

1. Please estimate the fiscal impact (in dollar amounts) of the above measure for state general or special funds, counties, cities, and school districts. Please provide breakdowns, if appropriate, showing salaries and wages, operating expenses, equipment, or other details to assist in the budget process. In a word processing format, add lines or space as needed or attach a supplemental sheet to adequately address the fiscal impact of the measure.

Narrative: If enacted, SB 2348 is expected to reduce revenues by \$150,000 in the 1999-2001 biennium.

2. State fiscal effect in dollar amounts:

	1997-99 Biennium		1999-2001 Biennium		2001-03 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues			-\$138,000	-\$12,000		
Expenditures						

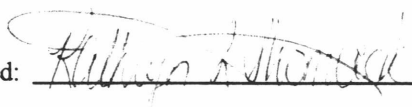
3. What, if any, is the effect of this measure on the budget for your agency or department:

- a. For rest of 1997-99 biennium: _____
(Indicate the portion of this amount included in the 1999-2001 executive budget:)
- b. For the 1999-2001 biennium: _____
(Indicate the portion of this amount included in the 1999-2001 executive budget:)
- c. For the 2001-03 biennium: _____

County, city, and school district fiscal effect in dollar amounts:

1997-99 Biennium			1999-2001 Biennium			2001-03 Biennium		
Counties	Cities	School Districts	Counties	Cities	School Districts	Counties	Cities	School Districts

If additional space is needed
attach a supplemental sheet.

Signed: 

Typed Name: Kathryn L. Strombeck

Department: Tax

Date Prepared: January 26, 1999

Phone Number: 328-3402

Date: 1-27-99
Roll Call Vote #: 1

1999 SENATE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. 2348

Senate Senate Finance and Taxation Committee

Subcommittee on _____
or
 Conference Committee

Legislative Council Amendment Number _____

Action Taken Do Pass

Motion Made By Stenehjem Seconded By Schobinger

Senators	Yes	No	Senators	Yes	No
SENATOR URLACHER	✓				
SENATOR CHRISTMANN		✓			
SENATOR SCHOBINGER	✓				
SENATOR STENEHJEM	✓				
SENATOR WARDNER	✓				
SENATOR KINNOIN	✓				
SENATOR KROEPLIN		✓			

Total (Yes) 5 No 2

Absent 0

Floor Assignment Sen. Schobinger

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

REPORT OF STANDING COMMITTEE (410)
January 28, 1999 9:19 a.m.

Module No: SR-18-1346
Carrier: Schobinger
Insert LC: . Title: .

REPORT OF STANDING COMMITTEE

SB 2348: Finance and Taxation Committee (Sen. Urlacher, Chairman) recommends DO PASS (5 YEAS, 2 NAYS, 0 ABSENT AND NOT VOTING). SB 2348 was placed on the Eleventh order on the calendar.

1999 HOUSE FINANCE AND TAXATION

SB 2348

1999 HOUSE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. SB 2348

House Finance and Taxation Committee

Conference Committee

Hearing Date March 8, 1999

Tape Number	Side A	Side B	Meter #
1	x		23.8
Committee Clerk Signature <i>Janice Stein</i>			

Minutes:

REP. RENNERFELDT, VICE-CHAIR, Opened the hearing.

SEN. TONY GRINDBERG, DIST. 41, FARGO, Introduced the bill. Explained the background of the bill and what the bill does. This bill is a sales tax exemption for manufacturing and recycling of machinery and equipment and adds primary sector business equipment such as computers and telecommunications equipment. This bill does not allow tax exemptions for replacement equipment. If you recall, there was a bill in the house that was defeated, there was an attempt to try to amend language to treat primary sector businesses and high tech service oriented businesses the same as the manufacturers. The Economic Development Association did is try to find current language to treat the high tech sectors of businesses the same as the manufacturers of farm equipment. This is what we are trying to accomplish.

Submitted written testimony from Brent Teiken, Sundog Interactive. See attached copy.

REP. RENNERFELDT How many other states have similar legislation?

SEN. GRINDBERG Most of the states around the midwest are treating this the same way.

Economic development is extremely competitive. It sends a message to the economic developers in the state of North Dakota, that the legislators want to level the playing field when they are competing for those projects.

REP. WARNER Is it necessary for the legislature to tailormake legislation just for the manufacturers?

SEN. GRINDBERG Related to a recent court case in Minnesota, I am not sure whether the legislature changed their statute to reflect that, but from the standpoint of clarifying state statute, legislatures would have to adjust accordingly.

REP. SCHMIDT Referred to the Rosenbluth Corporation, what kind of incentive did they receive when they came to North Dakota?

SEN. GRINDBERG Stated he did not know.

DALE ANDERSON, GREATER NORTH DAKOTA ASSOCIATION AND ALSO LOBBYIST

FOR THE ECONOMIC DEVELOPMENT ASSOCIATION OF NORTH DAKOTA, Testified in support of the bill. What we are really dealing with here is the primary sectors of North Dakota's economy. Many of you were involved in the passage of legislation in which the Growing North Dakota Program was introduced and the Vision 2000 discussion. The whole part of that discussion was that North Dakota needs to expand and grow in a four part economy. That four part economy is agriculture and food processing, energy, manufacturing and tourism and export services. In the manufacturing and processing area, is the high tech area, such as Great Plains Software in Fargo. We need to focus on the high tech kind of economy.

REP. BELTER We have had an increasing number of tax exemptions, as an association, has there been any thought amongst your group, which direction are we going to go, are we going to do away with our sales tax on these types of things, because every session somebody comes in and wants a tax exemption; or do we go to a lower rate and broaden our tax base?

DALE ANDERSON That is a dilemma the state faces. The important distinguish I would make in the kinds of requests being made here, is that we are talking about the primary sector of our economy. What can we do to help that growth. When you are dealing with the primary sector of the economy, you are dealing with incentives which will have the most effect.

REP. KROEBER Would there be a number of programs now within ED & F, where the businesses could take and receive assistance?

DALE ANDERSON I think the statutes outline very specifically about granting exemptions, it was my understanding that only what is in law now would be eligible.

SEN. GRINDBERG Answered, stating there are very limited programs available at ED & F, possibly the Future Fund and Development Fund, all incentives other than the Future Fund and the Bank of North Dakota, come from the local level.

RUTH STEFONOWICZ, NORTH DAKOTA EDUCATION ASSOCIATION, Testified in opposition of the bill. Oppose the bill because of tax exemptions. We are all aware that there is not enough money available to do what we should do for education, teachers and children.

With no further testimony, the hearing was closed.

COMMITTEE ACTION 3-9-99, Tape #2, Side A, Meter #22.5

REP. GROSZ Made a motion for a DO NOT PASS.

Page 4
House Finance and Taxation Committee
Bill/Resolution Number Sb 2348
Hearing Date March 8, 1999

REP. CLARK Second the motion. MOTION CARRIED.

13 Yes 1 No 1 Absent

REP. RENNER Was given the floor assignment.

Please type or use black pen to complete

Date 3-9-99
Roll call vote # 1

1999 HOUSE STANDING COMMITTEE ROLL CALL VOTES

BILL/RESOLUTION NO. SB 2348

House HOUSE FINANCE & TAX Committee

- Subcommittee on _____
- Conference Committee

} Identify or check where appropriate

Legislative Council Amendment Number _____

Action Taken Do Not Pass

Motion Made By Rep. Grosz Seconded By Rep. Rennerfeldt

Representatives	Yes	No	Representatives	Yes	No
BELTER	✓		WINRICH	✓	
RENNERFELDT	✓				
CLARK		✓			
FROELICH	A				
GRANDE	✓				
GROSZ	✓				
HERBEL	✓				
KROEBER	✓				
MICKELSON	✓				
NICHOLAS	✓				
RENNER	✓				
SCHMIDT	✓				
WARNER	✓				
WIKENHEISER	✓				

Total 13 1
(Yes) (No)

Absent 1

Floor Assignment Rep. Renner

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

DO NOT USE HIGHLIGHTER ON ANY FORMS

REPORT OF STANDING COMMITTEE (410)
March 9, 1999 4:13 p.m.

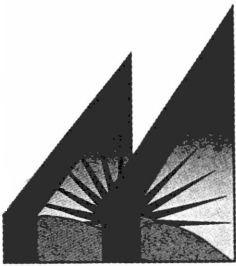
Module No: HR-42-4385
Carrier: Renner
Insert LC: . Title: .

REPORT OF STANDING COMMITTEE

SB 2348: Finance and Taxation Committee (Rep. Belter, Chairman) recommends DO NOT PASS (13 YEAS, 1 NAY, 1 ABSENT AND NOT VOTING). SB 2348 was placed on the Fourteenth order on the calendar.

1999 TESTIMONY

SB 2348



BISMARCK-MANDAN DEVELOPMENT ASSOCIATION

701-222-5530 • fax 701-222-3843 • 1-888-222-5497 info@bmda.org • www.bmda.org

January 27, 1999

To: Senate Finance and Tax Committee

From: Russell Staiger, President
 Bismarck-Mandan Development Association

Re: Support for a do pass on SB 2348

This is to confirm that the Bismarck-Mandan Development Association fully supports SB 2348 and urges a "Do Pass" vote on the proposed legislation.

In the past ten years we have seen city after city in North Dakota gain the economic benefit of attracting companies related to the telecommunications industry. This may range from a small 20 or 25 employee call center to major facilities like Aetna/US Healthcare, Sykes, Unisys, Direct Tell, Rosenbluth Travel, US Bank Administrative Center, Choice Hotels, Impact Telemarketing, ReliaStar, Contact America, Laducer & Associates and the list continues to grow.

These companies have added thousands of new jobs, millions in payroll, medical and retirement benefits and millions more in new capital investment. The result is the people who were able to find employment with one of these companies were able to stay in North Dakota. It has been a tremendous step in adding wealth to our State's economy and in slowing down the tide of out migration we have been seeing for the past several decades.

By asking for the exemption of sales and use tax on computers and peripheral equipment we are really asking for a clarification of the existing statutes which permit a similar exemption on manufacturing equipment used in primary sector businesses. This current law includes the exemption of computers used to manage the robotics used by existing major companies in North Dakota. The computers used by the telecommunications companies (which are also defined as primary sector by the State) process information into some final product just as the computers in a company like Melroe process metal parts into a finished product.

North Dakota has identified a market niche in being able to attract these information processing companies. It is a niche we are able to fill because of the completely redundant fiber optic system which blankets the State, the state of the art hardware which is in place with our major telephone service providers and because of the very positive quality work force which we are all proud of.

HIGH PLAINS • HIGH STANDARDS

400 East Broadway Avenue PO Box 2615 Bismarck, ND 58502

This exemption will help us expand that niche by helping present a lower cost of business start up for the companies looking at North Dakota. This includes those who are already here and wanting to expand, as well new companies who are interested in taking advantage of the resources we offer in North Dakota which helps them control their cost of business and remain competitive in a very competitive industry.

Approval of this legislation does not take away any existing tax revenue, it only helps attract new, quality employers in a high tech industry which will employ more North Dakotan's and pay more future corporate and personal income taxes.

It will also help keep more of our North Dakota citizens here.

Please vote a "Do Pass" on SB 2348.

Testimony regarding S.B. 2348
Senate Committee Hearing
January 27, 1999 10:00 AM
Lewis and Clark Room

Robert J. Jegen

I am testifying in support of S.B. 2348

As a business owner and entrepreneur, nothing is more important than being able to successfully operate and grow a business in a part of the world where I choose to live, and where I can raise a family knowing I don't need to worry about crime and the other problems typically associated with bigger cities. And with the advent of the Internet and World Wide Web, there stands before me an unparalleled opportunity to make this happen.

Three years ago, I, along with my business partner Chuck Duffie, left Great Plains Software and pursued a long-held dream of owning our own software development company. With only \$3,000 in the bank and one computer, we had big ideas and courageous dreams, and we knew we there was a new frontier waiting for us. We had the chance to be pioneers in a new industry. To accomplish what no one else had done in the state of North Dakota.

Three years later, I am proud to say Sundog Interactive has expanded to 18 employees and we're expecting over \$1,000,000.00 in revenues in 1999. Simply put, the only reason we have been able to expand and grow at this rapid pace is because of the ideas, innovations, commitment and hard, hard work of our employees. Nothing is more satisfying than seeing an NDSU graduate with a degree in Computer Science, stay in North Dakota, buy a new house and begin a new life. And it has been extremely rewarding to watch our business grow, and watch Sundog Interactive become a player in the new media arena. It seems our ideas and dreams have started to become a reality and the dreams and ideas are only getting bigger.

Along the way of taming this new frontier within the state of North Dakota, Sundog Interactive has become better at what we do, and as a result, gained national recognition. We are working for clients from California to New Jersey, helping them grow and improve their businesses. And in addition to improving our clients businesses, we are always searching for opportunities and advantages that will help our business grow even faster. Opportunities that would help Sundog become more profitable, that would allow us to employ more people and expand our services.

As our services expand and we become better at what we do, our employee base continues to expand as well. We are proud of the fact that our employees have graduated from local colleges and choose to remain in Fargo. We are also proud of the fact that we are able to pay them at a level that is equitable to those same positions in Minneapolis, Chicago or even Los Angles. Keeping local talent in North Dakota has been good for our company, and obviously good for the state of North Dakota's tax base.

Although North Dakota is an Ag-based state, we've all seen the effects the farm economy continues to have on this state. The bright, young adults who were once expecting to stay on the farm, or even in the state of North Dakota, are being forced to find employment elsewhere. More importantly, these same young adults that are leaving the farm and leaving the state posses the analytical thinking and problem solving skills any high tech company looks for in its employees. It is truly a shame to see these intelligent and hard-working individuals leave the state. But let's face it, the best paying jobs are not necessarily in the state of North Dakota.

Consequently, we are losing our best and brightest stars to other cities such as Minneapolis, Chicago and Sioux Falls. And with the recent population census, no one can argue the state of North Dakota continues lose residents. These are not promising indicators.

That is why I stand before you today. We have an incredible opportunity before us but we need to act soon. As unfortunate as it is, this is a very challenging time for the family farm. Additionally, technology in some cases has made it possible for manufacturing companies to reduce its workforce, forcing skill laborers to another line of work. The landscape has changed. As a state, we have done well for our ag and manufacturing-based businesses, but a new type of business has claimed its stake, and we need to recognize this not as a problem, but rather, a huge opportunity.

Technology is a vital part of our every day lives and virtually no one can survive without it. And as technology becomes an integral part of our lives, continually improving and making life easier, more and more companies are needed to handle the overwhelming demand of creating innovative products and services. And because of the limitless boundaries technology provides, there are almost no geographical restrictions for setting up a new business. What Sundog Interactive currently does in North Dakota can just as easily be done in Minnesota or California. As a business owner, the question becomes, which state will offer me the most opportunities and incentives to grow my business.

In my three years at Sundog, I have searched high and low for business/tax incentives offered by the state of North Dakota for companies like Sundog Interactive. I have found nothing. And even though we are three years old and surviving in a very competitive industry, I still consider Sundog to be a very new company. As we get bigger and attempt to expand our services to stay competitive, the need for incentives becomes even greater. With every new client and every new employee comes the purchase of new hardware and software. This, along with the brains and imaginations of our employees are the lifeblood of our business. We simply cannot survive without them. And even with the price of hardware continually dropping, in order for Sundog to stay competitive, we continually need to buy the latest hardware and software with the newest innovations. At \$3500-\$5000 per computer, this gets to be expensive. This doesn't even take into account the servers, networks and other hardware and software we need to purchase in order to operate.

These types of necessary purchases make it challenging for Sundog Interactive to expand its services and continually innovate at a critically rapid pace. In fact, given all of the other expenses that go into a start up high-tech business, at times it becomes extremely difficult. For Sundog Interactive not to be able to buy new computers and new software is the same as McDonald's not being able to buy potatoes for French-Fries. Both are essentially raw goods that are vital in producing consumer-based, end-user products and both are critical to the success of their businesses.

Because of the necessity, this is an expense Sundog Interactive has committed itself to in order to stay competitive. Sundog Interactive, like any other business, must continually purchase goods that will improve our products and services. However, unlike most business, we currently have no incentives that make operating in a worldwide market any easier. We do not have the same incentives and advantages manufacturing companies of this state currently have. We do not have same advantages or incentives agricultural-based companies currently have.

It is time we level the playing field. We need to make sure we are offering business incentives for technology-based companies. In order for this state to survive and grow, we need to give high-tech companies the same incentives that we are giving to manufactures and ag-based companies. We need to give high-tech companies the same advantages and incentives they can find in the state of Minnesota, literally one minute from Fargo. (please refer to Request for Sales and Use Tax exemption for capital equipment and software in New Media Business document). That is why I'm here and that is why I support this bill. I am passionate about Sundog, and I am passionate about watching my team members grow and I want all of this to continue to happen within the state of North Dakota. But we need to understand that it's going to take more than just getting them here, it's going to take getting them here and making sure they have reasons to stay.

As a state, let's recognize the importance of this industry and let everyone know we support high-tech companies. We need to offer incentives to start-ups and let them know the state of North Dakota is serious about not only keeping businesses here, but also retaining our best and brightest stars. We all know technology is something we can't avoid. In fact, we had better do all we can to promote it. After all, the success of North Dakota depends on it.

Respectfully yours,

Brent G. Teiken
President
Sundog Interactive

Testimony regarding S.B. 2348
Senate Committee Hearing January 27, 1999 10:00 AM
Lewis and Clark Room

I am testifying favorably on behalf of S.B. 2348.

Over the past year, the leadership of the state has indicated North Dakota has an opportunity that it has not had in the past regarding the opportunity to move forward from an economic standpoint. That opportunity is provided by the World Wide Web (the web), and the fact that the web can put North Dakota business on equal ground with any business, anywhere. With traditional forms of manufacturing, it has always been considered that North Dakota is at a disadvantage due to its location far from major markets. The web removes that disadvantage, allowing North Dakota based "hi tech" business to compete against others in the field on an even ground.

To make that "playing field" equal with other states and to encourage North Dakota to develop the "hi tech" industry, the state must provide "hi tech" incentive to allow the fledging industry to grow and prosper. This past fall Senator Kent Conrad sponsored an Information Technology Conference at Mary University in Bismarck to address how North Dakota can move forward in the "hi tech" sector. Senator Conrad presented a statistic that indicated North Dakota currently has in excess of 340 "hi tech" entrepreneurs operating.

These "hi tech" entrepreneurs are not the traditional 9-5 jobs that are the traditional processing of raw goods into processed goods and then shipped out of state. But "hi tech" companies that are able to operate in the farthest reaches of the state, working around any and all schedules. The Senator gave an example of a western North Dakota rancher that checks cattle in the morning and returns home, logs onto his computer and does medical reporting for an out of state company. The job meets two ends; provides a valuable service for an out of state company, and provides income to supplement the traditional cattle operation.

The basis of SB 2348 is not targeted to the large out of state entities, but targeted towards the development of North Dakota based "hi tech" companies that will generate new wealth for the state of North Dakota.

Why is this bill important? Over the past 6 months, I have heard North Dakota government officials consistently state North Dakota offers incentives to start and conduct ‘hi tech’ business. In actuality based on my involvement with Sundog Interactive and Mr. Teiken’s day to day operations, there is no income tax income incentive that is available to the targeted “hi tech” industry. Thus no benefit to the company that the state officials are actively attempting to attract.

Sundog Interactive could apply for an income tax exemption under the current new industry exception. Sundog has elected Sub chapter S status for federal income tax purposes. This status provides for no tax at the corporate level for state and federal purposes. For Sundog to receive a state tax incentive, they would pay considerably more in federal taxes than any benefit they would receive in state tax exemption.

In reviewing laws of other states, primarily Minnesota, it was found that if Sundog were located in Minnesota, they would be eligible for additional tax incentive. Realize, government leaders indicated North Dakota offers the same type of incentives for business to form and locate in North Dakota but none exists. As a result, SB 2348 is before you.

SB 2348 offers real incentive in that it provides incentive directly for “new hi tech” industry in the form of a sales tax exemption on computer and telecommunications equipment used in the primary sector business.

“Hi tech” is unique in that it provides high paying, high skill employment and opportunity without the high cost of starting a traditional manufacturing type industry. Sundog for example was able to start up with minimal capital investment and expand to its current 18 employees. Companies such as Sundog provide the high skill positions using computers and telecommunications equipment over the web to compete with companies worldwide. The benefit to having the “hi tech” company in North Dakota is easy to see, the wealth created says in North Dakota. This compares to traditional manufacturing or processing of raw materials in which historically the finished product is shipped out of state, or a worse case scenario the raw material shipped out of state and further processed. Business of the “hi tech” variety are not subject to these constraints.

The result is the need to grow and nurture this industry. By expanding the exemption for primary sector business to include the equipment at issue will allow more companies such as Sundog to

form and locate here. Realize the web provides the best of both worlds, North Dakota lifestyle but the opportunity to compete against business nationally without the usual limitations that North Dakota has faced.

Why the need for the incentive? State wide leadership stresses that North Dakota has incentive for this industry. In reality they don't, on behalf of Sundog, we have reviewed, requested incentives that apply and have challenged North Dakota's existing tax structure and have received no benefit as a "hi tech" leader in the state. Sundog has taken an active role in which they have sat through presentations after presentation by leadership indicating that North Dakota is on par with other states. Again this is not the case.

SB 2348 is a step in the right direction. It provides an incentive that "hi tech" business leaders such as Mr. Teiken can use in developing their business using the technology that is now available for use in the state.

Kent Busck CPA

Erde Bailey

701-239-8617

RE : Request for Sales and Use Tax exemption for capital equipment and software in New Media Business

In reply to questions regarding the current North Dakota tax environment versus other states regarding the attraction and retention of high technology industries.

Facts

Currently, North Dakota offers income tax incentives for new industries in the state. Upon initial review, Sundog Interactive would qualify for the incentives. Since Sundog is incorporated as an S corporation, and the primary shareholder is a nonresident of North Dakota, neither Sundog nor its shareholders receive a benefit from the New Industry income exemption. Additional credits and exemptions regarding income tax credit on wages paid and sales tax refunds do not apply since Sundog does not meet the criteria of a manufacturer under current North Dakota law. The manufacturing requirement is necessary for an entity to qualify for the sales and use tax incentives.

To qualify for income tax and sales tax incentives, Sundog's options are three-fold:

- 1) Elect C Corporation status in which the company would qualify for North Dakota income tax credit using the income exemption for new and expanding business. This would eliminate North Dakota income (Sundog currently does not pay North Dakota income tax as a S corporation), but the C corporation election would subject Sundog, a profitable company to higher C corporation federal taxes.
- 2) Sundog can move to Moorhead, Minnesota in which Sundog would receive not only income tax, but sales and workman compensation relief as well. Note Minnesota currently offers tax incentives in border city enterprise zones in addition to the Manufacturer's Capital Expansion Sales and Use tax refund program. Moorhead is located in one of the incentive zone areas. Currently under Minnesota law, Sundog (as noted below in the attached revenue and court case from the state of Minnesota) would qualify for sales and use tax refunds for the purchase of capital equipment used in the manufacturing process. Since Sundog is not a manufacturer under North Dakota law, but deemed a service provider, the company is subject to sales and use tax on all purchases of capital equipment. A description of equipment and software used in the company process is described below.
- 3) The third and possibly the most viable option is to change the current North Dakota definition of a manufacturer or specifically exempt from a variety of taxes a broad type of companies involved in the "hi tech" industry. Taxing authorities would be taking a large step away from the usual granting of exemptions for traditional "primary source" business, but moving forward and granting tax relief to a potentially new primary source industry. The result would make North Dakota and in Sundog's case, the city of Fargo, equitable in regards to income and sales tax purposes.

The overall approach would turn the state into "cutting edge" in regards to its taxing theory on high technology business. As the evolution of the industry will be described later, a pro active tax policy towards this industry would be well published throughout the industry. Additionally, Sundog feels this approach would lead to the creation of new industry niches, employment, companies and wealth that would not only stay within the state, but also attract more high-tech business into North Dakota.

Political Climate

The state, through both its political leadership and business development community, continually stress North Dakota's need to attract high technology industry into the state. The goal is to generate high wage positions locally, versus having state grown and educated talent leave the state for out of state "opportunities". Sundog is an example of what current leadership wants, a home grown "high-tech" state of the art industry leader. With Sundog, North Dakota has in place the "high tech" company, which is firmly established, operational, expanding and profitable. A side note, one of Sundog's owners from California was attracted to North Dakota because of another Fargo start-up software company - Great Plains Software. Within Sundog and its ownership is clear proof that the creation of viable "high tech" industry will attract talent and companies. To help do so, North Dakota must be equitable in its taxation of start up technology companies or the companies you are trying to attract will begin to leave.

Facts and circumstances relating to Sundog Interactive will be used to outline why the opportunity is available to persuade legislative leaders, the business community and the general public why the state should implement specific incentives to help in the development of a local "high tech" industry.

Sundog's Future

Sundog currently employs 18, an increase from 2 original employees less than 3 years ago. Total 1998 revenues will be approximately \$700,000 and 1998 payroll will approach \$500,000. The current long-term business plan, (which Sundog is on its third, due to the pace of industry change occurring every 12-18 months) projects growth of revenue to \$1.5 million, employment increasing to 35-40 and expected payroll of \$1.2 over the next 18 months. As discussed later, these projections are viable based on Sundog's past growth, current client base, employee base, and forward thought of company leadership and current industry relationships. The issue that Sundog must answer is where does the growth occur? Fargo, Los Angeles, Minneapolis, or somewhere in between?

Employment Trends in the Industry

Local business and political leaders attempt to point out that North Dakota labor is cheaper than Minneapolis, the east coast, west coast and other parts of the country. While in some industries this may be accurate, it does not apply in the "high tech" industry that Sundog competes. This is due to the nature of the Internet and other computer related applications. "Virtual employment" is no longer a "coast trend" but a commonplace occurrence that is happening in places such as Fargo, North Dakota.

As a result, Sundog's current employees could be employed by a much larger out-of-state company in any of the previously mentioned locations and still work from the Fargo-Moorhead area and be paid wages \$5,000 –20,000 higher than they are currently paid.

Sundog and others including Great Plains Software have had to raise salaries to compete with other locations to maintain the top talent to grow a company. While on the surface, having the employee with a high paying job is good for the state, it would appear that it would be much better for state to have the company and its employees located in-state, as with any processing industry, the wealth stays here. Currently, Sundog's top programmers earn over \$40,000/year, competitive in any area of this region.

The point is Sundog is not involved in a “traditional” manufacturing process, which the state is accustomed and has catered to in the past. Examples of “traditional” manufacturers include Melroe, Case IH or agricultural processing plants in which the employee has limited employment options outside of the plant site without physically moving. A “high-tech” employee can work anywhere and command top dollar.

Sundog is state of the art; its employees can work anywhere. If North Dakota wants to attract and retain state of the art companies it must not only play “catch up” in its treatment of this emerging industry, but it must be a fore runner and a leader.

Sundog Interactive- A History

Started approximately 3 years ago by 2 former Great Plains Software employees, Sundog’s initial business plan was focused on the development of “high end” World Wide Web (the web) websites. Great Plains had considered developing a product line in this area, but decided it did not meet its primary business objective. As a result, Brent Teiken and Chuck Duffy saw a need and an opportunity to spin off from Great Plains and become the area leader in website development.

The company was formed with no tax or business incentive. Not that there wasn’t a need for incentives, but knowledge of incentive was not available at the time of company creation. In retrospect, Sundog may have evolved differently if the company was aware of the options available, changes could have occurred in employees, equipment purchases and location.

Due to the Sundog’s foresight in regards to the changing technology arena, Sundog was able to quickly establish a reputation for web site development leadership through its use of technology, innovation and client service. Sundog’s initial client base included Great Plains Software, Melroe, RDO Equipment, MeritCare Health System and Blue Cross Blue Shield.

Over the next three years Sundog’s client list has grown to over 50, located in Illinois, North Dakota, Minnesota, Massachusetts, New York, Canada (Manitoba and Nova Scotia), Missouri, California and more recently inroads have been made on the east coast and Chicago areas.

To expand upon the client base without naming the clients themselves, Sundog’s clients include 4 publicly traded companies, industries include technology (technology companies come to Sundog for web expertise), manufacturing, service, financial, medical, among others. This client description is to show the high level of business and corporation’s Sundog’s product has been sold to, from Sundog’s Fargo headquarters.

Sundog's Evolution

As noted Sundog started as a "Website" development company. You may or may not have noticed, website development companies have sprung up throughout the region. The difference between Sundog and the others is the type of clients that Sundog has targeted and obtained. Sundog remained at the forefront by offering additional services due to requests placed on it by its clients. As noted, the industry business plan is good for at the long term 18 months. Since its origin, Sundog has changed its focus, to include not only websites, but Intranet development, multimedia and is currently moving into software application development.

The World Wide Web is open and available to everyone with Internet access. An Intranet is for the development of a company's internal web network. Thus, drawing on Sundog's existing client base in which websites were developed, Sundog has been able to go back to its existing clients and design internal web systems. This has led to additional employees, along with additional revenue growth for the company and recently the addition of spin off products.

As Sundog has been able to understand the market's technology needs, it has been able to tailor specific technology products which Sundog plans to market externally upon completion. (Question IS SOFTWARE DEVELOPMENT A MANUFACTURING PROCESS) Current ventures include the design, production and sale of industry specific software. In addition, Sundog has become a full service multi media company in which it can take "traditional" forms of media, print, radio, video, and combine and place them on compact disc, interactive video, etc. (Please see list of services in Sundog Company profile).

The processes described above is deemed a service under current law, although, in some cases a tangible product is produced. Language in the current state statute regarding Internet development is as follows: "The charge for designing customized WEB pages and placing them on the Internet is a nontaxable service. The charges are not taxable because the designer is not making a sale of tangible personal property in such services".

Sundog Interactive's Request

Over the past 3 years the company has purchased considerable amounts of computer equipment, file servers, software and other items related to product line development. A majority of the equipment and software (the terms used will be equipment going forward) have been purchased from out of state vendors over the Internet. This method of purchasing allows Sundog to comparison shop the entire marketplace, while obtaining high quality at the lowest price. As a result of this type of purchasing, many of the vendors Sundog has dealt with have not charged and remitted sales tax to the state of North Dakota. Unknowingly, while ignorance to a law is not an excuse, Sundog was not made aware of use tax requirements on the purchased equipment. As a result with a pending sales and use tax audit scheduled, Sundog is requesting an exemption on the out of state purchases of equipment for use in its business.

To properly examine Sundog's request for exemption, a number of areas in North Dakota's current statutes should be examined. Three areas will be reviewed.

- 1) Manufacturing Definition
- 2) New Industries language
- 3) Economic Expansion

The Current Law (taken directly for North Dakota Statute, no commentary added)

North Dakota Regulation, Sec. 81-04.1-01-23. **Manufacturers defined.--**

Manufacturing or agricultural **processing** is a process which produces a new article with a different form, use, and name. An agricultural commodity **processing** facility is a **manufacturing** plant that processes agricultural commodities into new products. A facility that only stores, cleans, dries, or transports agricultural commodities is not an agricultural commodity **processing** facility. The modification of articles of tangible personal property is not **manufacturing** or **processing**. For example, the creation of steel ducts or I-beams is **manufacturing** whereas the modification of steel ducts or I-beams to meet the specifications of a particular real property construction contract is not **manufacturing** or **processing**. To be considered **manufacturing** or **processing**, the raw materials must be materially altered.

By way of illustration and not of limitation, the following are manufacturers of agricultural processors: food, beverage, confectionery plants; grain mills; bakeries; textile mills; apparel makers; wood and lumber plants; furniture and fixture makers; paper product makers; printers and publishers (includes newspapers); chemical producers; leather good plants; stone, clay, glass, concrete product makers; cement and asphalt plants; metal ware makers; auto/aircraft makers; dairy processors (not producers); photo finishers (not photographers); and dental, medical, ophthalmologic labs.

By way of illustration and not of limitation, the following are not manufacturers or agricultural processors: farmers or ranchers, construction contractors, **refining** companies, artists, utilities, nurseries, restaurants, pharmacists, drycleaners, photographers, advertisement agencies, secretarial services, computer programmers, auto body shops, repair shops, radio and television stations, architects, jewelers, grain elevators, and tire retreaders or recappers.

Manufacturing machinery and equipment are exempt from sales and use taxes if the machinery or equipment:

1. Is used directly in the process of **manufacturing** tangible personal property for wholesale, retail, or lease;
2. Is used in a new **manufacturing** plant or in a physical or economic expansion of an existing plant; and
3. Is used directly in the **manufacturing** process more than fifty percent of the time the machinery or equipment is used by the manufacturer.

The **manufacturing** process begins at the point where the raw materials are first received at the plantsite and includes all direct processes prior to transporting the finished product from the plantsite. In addition, machinery and equipment used by a manufacturer to conduct research, development, and design activities qualify for the sales and use tax exemption. Examples of research, development, and design equipment include computer software and hardware used to draw, design, or plan products and machinery and equipment used to build or test prototype models.

Machinery and equipment used directly in the **manufacturing** process includes molds and dies that determine the physical characteristics of the finished product or its packaging material, computers and related equipment that directly control or measure the **manufacturing** process, and testing equipment used to measure or test product quality.

Machinery and equipment used directly in the **manufacturing** process also includes temperature or humidity control equipment necessary to maintain certain temperature or humidity levels in a limited area of the **processing** or **manufacturing** facility where either temperature or humidity must be closely regulated for the proper function or production process to occur.

Equipment or machinery used for pollution control, general heating or cooling of the facility or used to otherwise control the working environment does not qualify for the tax exemption. Also, items which are consumed or destroyed in the **manufacturing** process but which do not become a part of the finished product are not machinery and equipment and are subject to sales and use tax. Purchase of these items by a manufacturer is taxable, and suppliers shall charge sales or use tax on these items. If the items are purchased from an out-of-state supplier or if a North Dakota supplier fails to charge the tax, the North Dakota manufacturer shall report the sales or use tax directly to the North Dakota tax commissioner. Machinery and equipment not used directly in the **manufacturing** process or in agricultural **processing** include repair parts and equipment used for repairing, cleaning, or maintaining facilities research and development, or environmental control equipment required to maintain certain levels of air quality in a **manufacturing** or agricultural **processing** plant machinery, or equipment; handtools; backup or standby power supplies; computer hardware and software used to maintain inventory, production, or scheduling records; waste disposal or treatment facilities; and safety and security equipment such as fire sprinkler systems and burglar alarms.

Second;

New Industries.--

Authority:

Sec. 40-57.1-04, NDCC;

Sec. 40-57.1-07, NDCC;

Sec. 40-57.1-02, NDCC;

Sec. 40-57.1-06, NDCC;

Former Sec. 40-57.1-08, NDCC.

Rule 81-03-01.1-06, NDAC; .

Effective July 1, 1991, upon application by a project operator to the State Board of Equalization (SBE), the net income of any project (*i.e.*, any revenue-producing enterprise or combination of such enterprises, including "primary sector business" and "tourism," as defined below, and, effective July 8, 1993, the establishment or expansion of a qualifying business) may be exempt from state income tax for a period not exceeding five years from the commencement of project operations (Sec. 40-57.1-04, NDCC;). The project operator must provide notice to competitors as prescribed by the SBE and must make an application for exemption no later than one year after the commencement of project operations (Sec. 40-57.1-04, NDCC; ; Sec. 40-57.1-07, NDCC;). Effective July 8, 1993, a project operator is not eligible for the credit until the operator has satisfied all state and local tax liens.

"Primary sector business" means an individual, corporation, partnership, or association that, through the employment of knowledge or labor, adds value to a product, process, or service that results in the creation of **new** wealth (Sec. 40-57.1-02, NDCC;). "Tourism" means all tourism-related business and activities, including recreation, historical and cultural events, guide services, and unique lodging and food services that serve as destination attractions.

Requests by the manufacturer to purchase machinery and equipment without paying tax or for refunds of tax paid on machinery or equipment which qualify for exemption must be made in writing to the tax commissioner. Only the manufacturer may apply for a refund of the sales or use tax paid on exempt machinery or equipment. A request for refund must include documentation showing the amount of tax paid by the manufacturer or the contractor. The tax commissioner reserves the right to make an onsite inspection prior to granting permission to purchase qualifying machinery and equipment without paying tax or prior to approving a refund. An onsite inspection by the tax commissioner does not preclude an audit of the taxpayer's books and records.

The tax commissioner shall respond in writing to each exemption request stating whether or not the machinery or equipment qualifies for the exemption. The manufacturer may provide the approval letter to its equipment and machinery suppliers to avoid paying sales or use taxes on approved equipment. If a manufacturer purchases equipment before requesting a sales tax exemption, it shall pay all applicable sales and use taxes at the time of purchase but may apply to the tax commissioner for a refund of the taxes paid.

Tangible personal property consumed during the construction of an agricultural commodity **processing** facility or incorporated into the structure of an agricultural **processing** facility is exempt from sales and use tax. However, the contractor consuming or installing the materials shall pay the applicable sales or use taxes and the manufacturer shall apply in writing for a refund of the taxes paid by the contractor.

To receive a refund of taxes paid, the agricultural commodity processor must provide documentation showing that the contractor paid North Dakota sales or use taxes on the tangible personal property consumed during construction, or on the tangible personal property installed into the **processing** facility. The tax commissioner may request an onsite inspection of the **processing** facility before approving the refund of taxes paid by a contractor. The agricultural commodity processor may request that the refund amount be taken as a credit adjustment on its next sales and use tax return; however, the tax exemption must be approved in writing by the tax commissioner before the tax credit may be applied on a sales and use tax return. A letter from the tax commissioner stating the amount of the approved credit must be attached to the sales and use tax return on which the credit was applied. (Effective June 1, 1984; amended effective March, 1, 1990; November 1, 1991; August 1, 1994; April 1, 1995.)

And finally;

Economic expansion: "Economic expansion" means an increase in production volume, employment, or the types of products that can be **manufactured** (Sec. 57-39.2-04.3, NDCC,).

Analysis

In reviewing the above language, Sundog Interactive is clearly a primary sector business. In Sundog's view it is a primary sector business of the best kind. Sundog ships end-use intellectual property out of state (in some but not all cases), imports money back to the state of North Dakota, while providing the technology based company every politician wants located in their district. Thus, qualifying for New Industry Incentive is not an issue, because as noted earlier, the Sundog receives no benefit from them.

Where Sundog would benefit is on the exemption for sales and use tax used in the manufacturing process on equipment used in Sundog's developmental process of client products.

Based on current law above, the test that Sundog needs to pass is three-fold: (Taken from the above language)

Manufacturing machinery and equipment are exempt from sales and use taxes if the machinery or equipment:

1. Is used directly in the process of **manufacturing** tangible personal property for wholesale, retail, or lease;
2. Is used in a new **manufacturing** plant or in a physical or economic expansion of an existing plant; and
3. Is used directly in the **manufacturing** process more than fifty percent of the time the machinery or equipment is used by the manufacturer.

In reviewing the three points above, in response to number 1) if Sundog is treated as a website developer, it is providing a service, not creating tangible personal property. But realize Sundog, while its original focus was a internet website developer, it has moved beyond that focus. Nowhere in the state statutes is the issue of intranet development addressed. Note this example is being used to provide for a gray area to rule on the taxability of Sundog's equipment.

Second, in some areas, Sundog produces a physical tangible property, replacing traditional paper product. In this example, Sundog produces company annual reports on CD ROM disc that are fully interactive. If a printing company that prints the paper version of the annual report requested an exemption on new equipment to incorporate color presses, multiple printing applications and design features, our research has found the printing equipment would qualify for the sales and use tax exemption. Note the same images are used in both.

Third, a question directed to the state regarding the taxation of software companies: How are software development companies taxed on their equipment?

The second point in the previously mentioned manufacturing definition, “is used in a new manufacturing plant or the expansion of an existing plant”. Realize Sundog is not a traditional manufacturer in which people are paid \$8 an hour to assemble widgets. This is state of the art production facility in which employees are currently paid in excess of \$40,000 year. Reiterating the point, a Sundog employee is paid \$48,000 a year to match an offer from a Minneapolis company, while able to retain his Fargo home. Thus, based on an “old” definition of plant, Sundog cannot qualify because they do not have a plant, per se. However, we do employ primarily local residents who maintain residence in North Dakota, expanding the local tax base. You are cordially invited to tour the current facilities known as Sundog Interactive.

The third point of above can be easily documented. The equipment is used primarily for “high-tech” design and development.

Why Should North Dakota Consider This Issue

Sundog’s founder has been involved on panel discussions involving the issue of “high-tech” in North Dakota. A recurring question that is asked is how can the state attract “high-tech”? The answer is two fold: 1) First make the state equal, and then 2) Become a leader in administrative policy towards the industry.

Only the first issue will be addressed, since equity must be achieved before leadership.

Other States

Due to limited resources, a multi-state search was not conducted. Due to Sundog’s proximity to Minnesota, its laws on the issue were reviewed.

In the past 14 months, Minnesota has had two cases (see attached, revenue notice and court case) involving the use of the internet and signal transformation. As a result of challenges to their capital expansion equipment refund (check name) program, the Minnesota Department of Revenue and District Court have ruled that computer equipment and software are eligible for sales tax refund. The reason the state has granted a refund based on the following case is the fact to qualify as manufacturing, a product need not be tangible personal property in Minnesota. North Dakota requires this and as a result this issue arises. Based on current North Dakota law, the answer would not be the same.

Sundog understands that the mechanics of the Minnesota guidelines are different from North Dakota law, but the resulting effect in Minnesota is Sundog Interactive would not pay any sales and use tax based upon its current business operation.

The recent revenue ruling and case are provided for your review.(Actual text, no commentary)

Minnesota Revenue Notice No. 98-03. Sales and Use Tax--On-Line Data Retrieval for Capital Equipment, March 9, 1998.

Minnesota Statutes, §297A.25, subdivision 42, provides an exemption from sales and use tax for sales of capital equipment. Procedures for obtaining a refund of taxes paid on capital equipment and replacement capital equipment are found in Minnesota Statutes, §297A.15, subdivision 5. Minnesota Statutes, §297A.01, subdivisions 16 and 20, define capital equipment as equipment and machinery used by the purchaser or lessee primarily for manufacturing, fabricating, mining, or refining tangible personal property to be sold ultimately at retail, and for electronically transmitting results retrieved by a customer of an on-line computerized data retrieval system. "On-line data retrieval system" is defined in Minnesota Statutes, §297A.01, subdivision 16 (d)(9), as a system whose cumulation of information is equally available and accessible to all its customers.

Definitions

For purposes of the capital equipment refund for on-line data retrieval systems, the following definitions apply:

"Computerized system" means an electronic device or a group of hardware and software components that performs logical, arithmetical, and memory functions by manipulations of electronic or magnetic impulses. This definition includes all input, output, processing, storage, computer software, and communication facilities that are connected or related in some way and contribute to the performance of these operations.

"Customer" means a person who pays a direct consideration to another person for retrieval or access to information. In this case, "person" means a separate legal entity. Payments for services between divisions or units of a single legal entity do not constitute payments to another person.

"Data retrieval" means electronic transmission of information, knowledge, facts, concepts, or instructions that have been compiled based on the request of the customer.

"Direct consideration" means that the customer pays a fee for information requested. In situations where the information is provided both free of charge to some parties and sold to others, the system will qualify if 50 percent or more of its operating time is used to provide information to paying customers.

"Electronic transmission" means any one-way transmission or any two-way interactive transmission of sounds, signals, or other intelligence converted to like form, which effect or are intended to effect meaningful communications by electronic or electromagnetic means via wire, cable, satellite, light waves, microwaves, radio waves, or otherwise.

"Equally available and accessible" means all customers can access all information on the database.

"**Internet** access service" means the offering or provision of the storage, computer processing, and transmission of information that enables the customer to make use of resources found via the **Internet**.

"**Internet** on-line services" means the offering or provision of information, information processing, and products or services to a customer as part of a package of services that are combined with **Internet** access service and offered to the customer for a single price.

"On-line" means that a computerized system is capable of connecting with a communications network.

"Primarily" means that the software or hardware is used 50 percent or more of its operating time in a qualifying activity.

"Results" means data or information provided in a format intended to be usable by the customer.

General Requirements

To qualify for the capital equipment refund, the information within the on-line data retrieval system must be equally available and accessible to all customers. In addition, the hardware and software applications must be primarily used to support the on-line data retrieval system. To determine if a system qualifies, answer the following two questions:

1. Is all of the information in the system equally available and accessible to each customer group, or within a fee structure?
2. Do the customers pay a direct consideration for the specific information requested?

If the answer to either of the questions is "no," the equipment does *not* qualify for a capital equipment refund. If the answer to *both* of the questions above is "yes," the hardware and software components that are used primarily for supporting the on-line data retrieval system qualify for a capital equipment refund.

Examples

A research company offers its services on-line to subscribers. The database is created from information gathered from outside sources and is refined by the company through the addition of narrative comments, additional reference sources, and notations as to related topics. No other information is included on the hardware or software that supports this system. This system qualifies as capital equipment.

A provider offers varying levels of subscription services. While all information within the system is available for access, access to certain portions of the data is limited by the service level selected by the subscriber. However, each subscriber is able to participate at each service level they subscribe to without restriction. If the system meets all other criteria, this system qualifies as capital equipment.

A bank uses on-line systems to receive payroll and other payable information from their clients. The bank uses this information to debit the client's account, and generate and mail checks on behalf of the client. Each client is able to access their own bank account information through the incoming software systems, but they are not able to access accounting information for other clients. Because the data privacy provisions prevent clients from accessing all information on the system, this system does not qualify for the capital equipment exemption.

An individual buys a computer, a modem, a computerized outdoor weather information system, and software to provide a temperature and time service to people who call in. If the customer is billed a direct fee for this use (e.g., on their telephone bill), the system will qualify for the capital equipment exemption. If there is no direct charge to the customer, then the system does not qualify.

An **Internet** access service provides customers with direct access to the **Internet** for a fee. Equipment used to provide the **Internet** access service does not qualify for the capital equipment exemption.

An **Internet** on-line service charges customers a fee for access to information that the service maintains and provides access to the **Internet**. Equipment that is used primarily by the **Internet** on-line service to provide, maintain, and allow access to their own information service qualifies for the capital equipment exemption.

A business buys computers, modems and software to provide E-Mail and other on-line communications between the various divisions of the business. The divisions share the cost of the system through inter-company funds transfers to the administrative division. Equipment used to provide this service does not qualify for the capital equipment exemption because the service is limited to inter-company use.

Effective Date

This notice is effective for purchases or leases of capital equipment made on or after July 1, 1993.

Minnesota RSA 10 Limited Partnership v. Commissioner of Revenue.

Minnesota Tax Court, No. 6481, July 18, 1997

Sales and use--Taxability of persons and transactions--Capital equipment.-- A cellular communications company was entitled to a capital equipment sales and use tax exemption for computers, transmitters, antennas, receivers, and other equipment it purchased for its cellular telephone system. The company was entitled to the exemption because it was the manufacturer of a product. The company created the signal required to transmit voice or data, and the signal was the manufactured product.

MEMORANDUM

Minn. Stat. section 297A.25, subd. 42 exempts the gross receipts from the sale of capital equipment from sales and use tax. A taxpayer seeking exemption pays the tax and applies to the Commissioner of Revenue (the "Commissioner") for a refund. Minn. Stat. section 297A.15. Appellant, Minnesota RSA 10 Limited Partnership ("RSA 10"), operates a cellular telephone system in Minnesota. During the years 1990, 1991 and 1992, RSA 10 paid sales tax when it purchased computers, transmitters, antennas, receivers and other equipment (the "Equipment") for its business. It filed a timely claim for refund in July 1993. The Commissioner denied the claim and RSA 10 appealed. 1

RSA 10 raised three issues in its Appeal: (1) whether the definition of capital equipment contained in the 1993 amendments to Minn. Stat. section 297A.01, subd. 16 applies to its claim for refund; (2) if the 1993 definition does not apply, whether the sale of cellular telephone air time and communications constitutes the "manufacturing, fabricating, mining, quarrying, or refining a product to be sold at retail" within the meaning of Minn. Stat. section 297A.01, subd. 16 (1990); and (3) whether 42 U.S.C. section 1983 applies to this appeal.

We addressed the first issue on cross motions for Partial Summary Judgment in October 1995 and concluded that the 1993 amendments to Minn. Stat. section 297A.01, subd. 16 do not apply to RSA 10's claim for refund. See Minnesota RSA 10 Ltd. Partnership v. Commissioner of Revenue, Dkt. No. 6481 (Minn. Tax Ct. Order Feb. 6, 1996). The second issue is before us by stipulation and cross motions for Summary Judgment. The parties have resolved the third issue.

The parties agree that RSA 10 sells **cellular** air time and communications, i.e. the transfer and reception of mobile information ("**Cellular** Communications"), to its customers. RSA 10 uses electronics, radio frequency channels and computer technology to provide **Cellular** Communications. Specifically, RSA 10 takes a communication, whether voice or data, formats it into a digital **signal** and transmits that **signal** via radio wave to the person designated by the sender of the communication. The recipient of the communication receives a reconstruction of the communicator's voice or data. RSA 10 uses the following equipment to provide **Cellular** Communications:

- a. A cell phone, including a microcomputer, owned or leased by the customer;
- b. Transceivers, control sections, communications links, a scanning receiver, backup power supplies, a radio-frequency combiner and an antenna assembly located in a cell site building; and
- c. Master computer and software, a switching assembly, communication links, an operator terminal, various databases, backup energy sources and ancillary data storage and retrieval computers located in a building known as the mobile switching office (the "MTSO") at Osseo, Minnesota.

(The "**Cellular** Communications System" or "System"). There is no dispute that the Equipment is used in the System.

As noted above, Minn. Stat. section 297A.25, subd. 42 exempts the gross receipts from the sale of capital equipment from sales and use tax. For purposes of this motion (and pursuant to our decision on the first issue decided in this case) capital equipment is defined as follows:

Capital equipment. Capital equipment means machinery and equipment and the materials and supplies necessary to construct or install the machinery or equipment. To qualify under this definition the capital equipment must be USED BY THE PURCHASER . . . FOR MANUFACTURING, FABRICATING, . . . OR REFINING A PRODUCT TO BE SOLD AT RETAIL. . . .

Minn. Stat. section 297A.01, subd. 16 (1990) (the "1990 Capital Equipment Definition"). (Underscoring supplied.)

The issues are: (1) what do the 1990 Capital Equipment Definition words "manufacturing," "fabricating," "refining" and "product" mean?; and (2) do RSA 10's activities fit within the definitions? RSA 10 argues that the System "manufactures, fabricates or refines" **Cellular** Communications, a "product" within the meaning of the 1990 Capital Equipment Definition. The Commissioner argues that it does not. We agree with the Commissioner that the capital equipment exemption provision must be strictly construed. *Camping and Educ. Found. v. State*, 164 N.W.2d 369 (Minn. 1969).

The words "manufacturing," "fabricating," "refining" and "product" were not defined in the 1990 Capital Equipment Definition. 2 When a word or phrase is undefined we follow the general rule:

Words and phrases are construed according to rules of grammar and according to their common and approved usage; but technical words and phrases and such others as have acquired a special meaning, or are defined in this chapter, are construed according to such special meaning or their definition.

Minn. Stat. section 645.08(1). None of the words at issue are defined in Minn. Stat. ch. 645 and none are technical words. We therefore construe them according to their common and approved usage.

I. Product.

A "product" is "something produced by human or mechanical effort; a direct result; consequence"; to "produce" is "to bring forth; yield." The American Heritage Dictionary, 988 (2d college ed. 1982). RSA 10 sells an intangible, air time and the wireless transmission of voice and/or data communications. A "product" need not be tangible personal property. See *West Publ'g Co. v. Commissioner of Revenue*, Dkt. No. 5346 (Minn. Tax Ct. July 11, 1990), *aff'd* without opinion by an equally divided court, 464 N.W.2d 512 (Minn. 1991); *Tabulating Service Bureau v. Commissioner of Revenue*, 204 N.W.2d 442 (Minn. 1973), *In re Answer of Minn. Power & Light*, 182 N.W.2d 685 (Minn. 1970). 3

The Commissioner argues that RSA 10 does not produce mobile communications, it merely delivers them. We find however that the process described in the Stipulation is much more than a delivery process. RSA 10 does not process an unchanged product, it creates the **signal** required to transmit voice or data. We also find that because the output of RSA 10's System is different from the input into the System, 4 RSA 10 does not merely deliver communications.

The Commissioner also argues that RSA 10's activities are "services" and that a service cannot be a product. See Minn. Stat. section 297A.01, subd. 3(f) and section 297A.25, subd. 36. We disagree and point to decisions of the Minnesota Supreme Court in *Tabulating Service Bureau* and *In re Answer of Minn. Power & Light*. See also *West Publ'g Co.* There is no dispute that **Cellular** Communications are the direct result of RSA 10's activities. We therefore find that **Cellular** Communications are a product within the meaning of the 1990 Capital Equipment Definition.

II. Manufacturing.

The common and accepted meaning of "manufacturing" is "making something from raw materials by hand or machinery." *United Power Ass'n v. Commissioner of Revenue*, Dkt. No. 6621 (Minn. Tax Ct. Feb. 14, 1997), citing *Webster's Ninth New Collegiate Dictionary* 725 (9th ed. 1983). RSA 10 argues that: (1) manufacturing includes processing and it "processes" mobile communications; and (2) it manufactures the transmission of a communication using the voice or data provided by the sender and electronics, radio frequencies and computer technology. The Commissioner agrees that RSA 10 "processes" mobile communications but argues that "processing" is not manufacturing. The Commissioner also argues that RSA 10 does not manufacture **Cellular** Communications as that term is commonly understood.

The Minnesota Supreme Court most recently found that a material was "processed" within the meaning of Minn. Stat. section 297A.01, subd. 3 when "some discernible modification" had been made to it. *U.S. West Material Resources v. Commissioner of Revenue*, 511 N.W.2d 17, 20 (Minn. 1994). Clearly processing as it was defined in *U.S. West* is not manufacturing.

The Minnesota Supreme Court has not addressed the meaning of the word "manufacture." We do not find the cases from other jurisdictions cited by the Commissioner helpful here. The Commissioner relies most heavily upon GTE Automatic Elec. v. Director of Revenue, 780 S.W.2d 49 (Mo. 1989), a decision which rests upon the Missouri Supreme Court's determination that a product must be tangible personal property. Because, as noted above, a product need not be tangible personal property in Minnesota, the analysis relied on by the Missouri Court is not useful.

We are persuaded that RSA 10 manufactures **Cellular** Communications as that term is commonly understood when it uses radio frequencies, computers (machines) and electronics to transmit and create a product. We therefore need not decide whether RSA 10 "fabricates" or "refines" a product.

We grant RSA 10's motion for Summary Judgment.

K.D.

1 RSA 10 is one of five similarly situated partnerships which have appealed denials of claims for refund. See Tax Court Docket numbers 6478, 6479, 6480 and 6482. The Commissioner and the other partnerships agree that those appeals will be resolved in a manner consistent with the resolution of this case.

2 The Legislature adopted definitions in 1994.

3 Because we so stated in our initial Order Granting Partial Summary Judgment and for purposes of this motion only, the Commissioner accepts our holding that a "product" need not be tangible personal property. See, Minnesota RSA 10 Ltd. Partnership v. Commissioner of Revenue, Dkt. No. 6481 (Minn. Tax Ct. Order Feb. 6, 1996) at 6.

4 See Stipulation at para. 9.

CONCLUSION

-Based on the current status of North Dakota political and economic leaders desire to attract “hi tech” industry into the state.

-Based on the current non-guidance in law regarding a “new media” company,

-Based on the fact that Sundog operates in a variety of capacities other than website development,

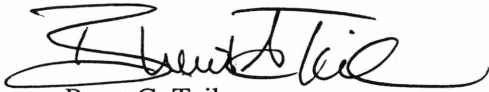
-Based on the fact the company is at a junction deciding whether to hire additional employees and where to employ them,

-Based on the fact computer equipment if used in the manufacturing process qualifies for the exemption,

-Based on the fact Sundog would qualify for sales tax refund if it were a Minnesota based company on the equipment in question,

Sundog Interactive respectfully requests that a review for sales and use tax exemption on its equipment be conducted and granted.

Sincerely

A handwritten signature in black ink, appearing to read "Brent G. Teiken". The signature is fluid and cursive, with a large initial "B" and "T".

Brent G. Teiken
President
Sundog Interactive

submitted by
Sen. Grindberg

Testimony regarding S.B. 2348
House Committee Hearing
March 8, 1999 9:30 AM

I am testifying in support of S.B. 2348

As a business owner and entrepreneur, nothing is more important than being able to successfully operate and grow a business in a part of the world where I choose to live, and where I can raise a family knowing I don't need to worry about crime and the other problems typically associated with bigger cities. And with the advent of the Internet and World Wide Web, there stands before me an unparalleled opportunity to make this happen.

Three years ago, I, along with my business partner Chuck Duffie, left Great Plains Software and pursued a long-held dream of owning our own software development company. With only \$3,000 in the bank and one computer, we had big ideas and courageous dreams, and we knew we there was a new frontier waiting for us. We had the chance to be pioneers in a new industry. To accomplish what no one else had done in the state of North Dakota.

Three years later, I am proud to say Sundog Interactive has expanded to 19 employees and we're expecting over \$1,000,000.00 in revenues in 1999. Simply put, the only reason we have been able to expand and grow at this rapid pace is because of the ideas, innovations, commitment and hard, hard work of our employees. Nothing is more satisfying than seeing an NDSU graduate with a degree in Computer Science, stay in North Dakota, buy a new house and begin a new life. And it has been extremely rewarding to watch our business grow, and watch Sundog Interactive become a player in the new media arena. It seems our ideas and dreams have started to become a reality and the dreams and ideas are only getting bigger.

Along the way of taming this new frontier within the state of North Dakota, Sundog Interactive has become better at what we do, and as a result, gained national recognition. We are working for clients from California to New Jersey, helping them grow and improve their businesses. And in addition to improving our clients businesses, we are always searching for opportunities and advantages that will help our business grow even faster. Opportunities that would help Sundog become more profitable, that would allow us to employ more people and expand our services.

As our services expand and we become better at what we do, our employee base continues to expand as well. We are proud of the fact that our employees have graduated from local colleges and choose to remain in Fargo. We are also proud of the fact that we are able to pay them at a level that is equitable to those same positions in Minneapolis, Chicago or even Los Angeles. And these are not data entry jobs earning \$7.00/hour - these are highly skilled, highly paid professional positions commanding anywhere from \$30,000 to \$45,000.00 per year.

Keeping local talent in North Dakota has been good for our company, and obviously good for the state of North Dakota's tax base. In fact, if you consider the \$22,500.00 of yearly tax revenue Sundog Interactive contributes to the state, the \$1,500.00 we would save in yearly tax credits seems a mere pittance. More importantly, Sundog's tax revenue is currently about a third of the yearly total cost of this bill to the state of North Dakota. It becomes easy to see that it would be of greater benefit to the state to attract other companies like Sundog, rather than giving them a reason to leave and set up shop in Minnesota or South Dakota. The question we must ask is not what the cost of this legislation will be, but rather, what is the cost to the future of our state if it doesn't pass.

Although North Dakota is an Ag-based state, we've all seen the effects the farm economy continues to have on this state. The bright, young adults who were once expecting to stay on the farm, or even in the state of North Dakota, are being forced to find employment elsewhere. More importantly, these same young adults that are leaving the farm and leaving the state possess the analytical thinking and problem solving skills any high tech company looks for in its employees. It is truly a shame to see these intelligent and hard-working individuals leave the state. But let's face it, the best paying jobs are not necessarily in the state of North Dakota. Consequently, we are losing our best and brightest stars to other cities such as Minneapolis, Chicago and Sioux Falls. And with the recent population census, no one can argue the state of North Dakota continues to lose residents. These are not promising indicators.

Couple this with the fact that there are approximately 350,000 Information Technology job positions currently open. Let's be forward thinking as a state and instead of watching these bright and talented young people leave our state for high paying high tech jobs in other states, let's convince the high tech companies to bring their businesses to North Dakota by offering tax incentives like this. This, along with other incentives, might just give start-ups, and even expanding companies, enough incentive to come to North Dakota - and our brightest enough incentive to stay.

That is why I stand before you today. We have an incredible opportunity before us but we need to act soon. As unfortunate as it is, this is a very challenging time for the family farm. Additionally, technology in some cases has made it possible for manufacturing companies to reduce its workforce, forcing skill laborers to another line of work. The landscape has changed. As a state, we have done well for our ag and manufacturing-based businesses, but a new type of business has claimed its stake, and we need to recognize this not as a problem, but rather, a huge opportunity.

Technology is a vital part of our every day lives and virtually no one can survive without it. And as technology becomes an integral part of our lives, continually improving and making life easier, more and more companies are needed to handle the overwhelming demand of creating innovative products and services. And because of the limitless boundaries technology provides, there are almost no geographical restrictions for setting up a new business. What Sundog Interactive currently does in North Dakota can just as easily be done in Minnesota or California. As a business owner, the question becomes, which state will offer me the most opportunities and incentives to grow my business.

In my three years at Sundog, I have searched high and low for business/tax incentives offered by the state of North Dakota for companies like Sundog Interactive. I have found nothing. And even though we are three years old and surviving in a very competitive industry, I still consider Sundog to be a very new company. As we get bigger and attempt to expand our services to stay competitive, the need for incentives becomes even greater. With every new client and every new employee comes the purchase of new hardware and software. This, along with the brains and imaginations of our employees are the lifeblood of our business. We simply cannot survive without them. And even with the price of hardware continually dropping, in order for Sundog to stay competitive, we continually need to buy the latest hardware and software with the newest innovations. At \$3500-\$5000 per computer, this gets to be expensive. This doesn't even take into account the servers, networks and other hardware and software we need to purchase in order to operate.

These types of necessary purchases make it challenging for Sundog Interactive to expand its services and continually innovate at a critically rapid pace. In fact, given all of the other expenses that go into a start up high-tech business, at times it becomes extremely difficult. For Sundog Interactive not to be able to buy new computers and new software is the same as McDonald's not being able to buy potatoes for French-Fries. Both are essentially raw goods that are vital in producing consumer-based, end-user products and both are critical to the success of their businesses.

Because of the necessity, this is an expense Sundog Interactive has committed itself to in order to stay competitive. Sundog Interactive, like any other business, must continually purchase goods that will improve our products and services. However, unlike most business, we currently have no incentives that make operating in a worldwide market any easier. We do not have the same incentives and advantages manufacturing companies of this state currently have. We do not have same advantages or incentives agricultural-based companies currently have.

It is time we level the playing field. We need to make sure we are offering business incentives for technology-based companies. In order for this state to survive and grow, we need to give high-tech companies the same incentives that we are giving to manufactures and ag-based companies. This is not a matter of introducing new legislation, it is a matter of redefining current legislation and making it equitable and fair for all primary sector businesses. In my opinion, Sundog Interactive should be eligible to receive the same tax credits when it buys a computer that other manufacturers and primary sector businesses are already receiving.

Additionally, we need to give high-tech companies the same advantages and incentives they can find in the state of Minnesota, literally one minute from Fargo. (please refer to **Request for Sales and Use Tax exemption for capital equipment and software in New Media Business** document). That is why I'm here and that is why I support this bill. I am passionate about Sundog, and I am passionate about watching my team members grow and I want all of this to continue to happen within the state of North Dakota. But we need to understand that it's going to take more than just getting them here, it's going to take getting them here and making sure they have reasons to stay.

As a state, let's recognize the importance of this industry and let everyone know we support high-tech companies. We need to offer incentives to start-ups and let them know the state of North Dakota is serious about not only keeping businesses here, but also retaining our best and brightest stars. We all know technology is something we can't avoid. In fact, we had better do all we can to promote it. After all, the success of North Dakota depends on it.

Respectfully yours,



Brent G. Teiken

President

Sundog Interactive