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ROLL NUMBER

DESCRIPTION

1108

2005 HOUSE FINANCE AND TAXATION

HB 1108

2005 HOUSE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. **HB 1108**

House Finance and Taxation Committee

☐ Conference Committee

Hearing Date **January 10, 2005**

Tape Number

1

Side A

x

Side B

Meter #

25

Committee Clerk Signature

Janie Stein

Minutes:

RICK CLAYBURGH, STATE TAX COMMISSIONER Testified neither in support or opposition of the bill. See attached written testimony.

REP. BELTER Referred to the fiscal note, which didn't have any dollars on it.

RICK CLAYBURGH Stated the fiscal note is zero.

REP. BELTER Stated his understanding of the federal legislation, will be a reduction in taxes for corporations.

RICK CLAYBURGH Without this bill, corporations would enjoy a reduction in state income tax.

REP. BELTER What type of corporations.

RICK CLAYBURGH It would be domestic activities of production. The list could be quite voluminous, some of it is still being interpreted, we are still trying to get our hands around the

fiscal impact of the legislation. Our best estimate would be in the range of ten to fifteen million dollars a biennium.

REP. BELTER If we pass this piece of legislation, and other states are not doing likewise, then do we not put our state in a situation where our business climate deteriorates, from the tax perspective?

RICK CLAYBURGH Depending on how it is interpreted, there is that potential. Wisconsin, Minnesota and Montana, have already decoupled from the treatment. At this point, there are other states, looking at this.

MARY LOFTSGARD, STATE TAX DEPARTMENT, Also commented in regard to the states who are planning to decouple.

REP. BELTER When you use the word "decouple" are you saying these states are passing legislation so that their revenues are not affected by the federal act or are affected?

RICK CLAYBURGH My use of the term "decoupling" would mean that the state would not be impacted by acts of Congress. Similiar to what we did when we decoupled on the individual income tax and created the new ND1 form. Had we not decoupled, that would have had an impact on the individual income tax to the range of about twenty seven million dollars. That is the issue.

DENNIS BOYD, MDU RESOURCES GROUP, INC. Testified in opposition of the bill. He gave a history of the MDU Group in North Dakota. He stated this bill seeks to nullify a tax benefit passed by Congress in October, 2004, and in effect after January 1, 2005, disallowing a deduction allowed on your federal forms for North Dakota corporate income tax dollars.

Mr. Boyd submitted a handout regarding the Internal Revenue Code "199 income attributable to domestic production activities.

He stated he found it disappointing, at a time when the governor and the legislature, are doing everything possible to spur economic development, this legislation appears to deny a tax incentive to certain segments of the economy which offer great potential for economic growth and development in North Dakota. As you know, Montana Dakota Utilities is trying very hard to build an electric generating station in southwestern North Dakota. It is also no secret that several out-of-state sites are also under consideration, including two sites in South Dakota, which has no corporate income tax. Passage of this bill is actually, a disincentive for MDU or any other utility company to build in North Dakota. This bill is an incentive to build elsewhere.

REP. KELSH If this bill passed, you would still be able to take advantage of the federal credit?

DENNIS BOYD That is correct.

REP. WEILER Before we had testimony that there is no fiscal note, if we pass this bill, will it cost the state money?

DENNIS BOYD I am not sure, how the fiscal note was compiled. There is no income there now.

REP. BRANDENBURG Looking at the energy situation in the midwest area, the competition to attract this type of business into this state, would this type of legislation deter some of those people from coming here?

DENNIS BOYD In our opinion, it is actually a disincentive to locate here. We could locate in South Dakota, Milbank and Mobridge, are the two sites in South Dakota, which we are considering. There is no corporate income tax in South Dakota.

REP. BELTER Currently, that is the situation. If this bill were not passed, it would give you more of an incentive to come here instead of South Dakota?

DENNIS BOYD It would be an additional benefit.

REP. NICHOLAS What do you anticipate the amount of tax to be if you do locate here?

DENNIS BOYD I don't know, we are looking at an investment in a generating plant, which could be anywhere from two hundred to two hundred and fifty million dollars.

REP. NICHOLAS So we are already at a competitive disadvantage because we have a corporate income tax.

DENNIS BOYD That is correct.

With no further testimony, the hearing was closed.

2005 HOUSE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. **HB 1108**

House Finance and Taxation Committee

☐ Conference Committee

Hearing Date **January 25, 2005**

Tape Number	Side A	Side B	Meter #
1		X	4.5

Committee Clerk Signature

Minutes:

COMMITTEE ACTION

REP. HEADLAND Made a motion for a **do pass**.

REP. IVERSON Second the motion. **MOTION CARRIED**

7 Yes 2 No 5 Absent

REP. BRANDENBURG Was given the floor assignment.

FISCAL NOTE
Requested by Legislative Council
03/18/2005

Amendment to: HB 1108

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.*

2003-2005 Biennium		2005-2007 Biennium		2007-2009 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.*

2003-2005 Biennium			2005-2007 Biennium			2007-2009 Biennium		
Counties	Cities	School Districts	Counties	Cities	School Districts	Counties	Cities	School Districts

2. Narrative: *Identify the aspects of the measure which cause fiscal impact and include any comments relevant to your analysis.*

HB 1108 with Senate Amendments addresses recent federal legislation that will impact the state's corporate income tax. The first subdivision of Section 1 of the bill requires the add-back of a recently enacted federal deduction, and will, if enacted, hold the corporation income tax relatively constant as contained in the baseline forecast. The second subdivision of Section 1 of the bill will be slightly revenue positive, but the amount cannot be determined.

Section 2 reduces the top corporation income tax rate from 7% to 6.5% effective beginning with tax year 2007. The negative fiscal impact of this provision is beyond the current forecast and therefore, cannot be estimated.

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, of the effect on the biennial appropriation for each agency and fund affected and any amounts included in the executive budget. Indicate the relationship between the amounts shown for expenditures and appropriations.*

Name: Kathryn L. Strombeck
Phone Number: 328-3402

Agency: Office of Tax Commissioner
Date Prepared: 03/21/2005

FISCAL NOTE
Requested by Legislative Council
12/22/2004

Bill/Resolution No.: HB 1108

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.*

2003-2005 Biennium		2005-2007 Biennium		2007-2009 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.*

2003-2005 Biennium			2005-2007 Biennium			2007-2009 Biennium		
Counties	Cities	School Districts	Counties	Cities	School Districts	Counties	Cities	School Districts

2. Narrative: *Identify the aspects of the measure which cause fiscal impact and include any comments relevant to your analysis.*

HB 1108 addresses recent federal legislation that will impact the state's corporate income tax. The first subdivision in the bill requires the add-back of a recently enacted federal deduction, and will, if enacted, hold the corporation income tax relatively constant as contained in the baseline forecast. The second subdivision in the bill will be slightly revenue positive, but the amount cannot be determined.

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, of the effect on the biennial appropriation for each agency and fund affected and any amounts included in the executive budget. Indicate the relationship between the amounts shown for expenditures and appropriations.*

Name: Kathryn L. Strombeck
Phone Number: 328-3402

Agency: Office of Tax Commissioner
Date Prepared: 01/07/2005

1-25-05
11 Vote #: 1

BILL/RESOLUTION NO. *HB 1108*

Committee

Legislative Council Amendment Number

Do

Pass

Rep. Hendlund

Rep. Iverson

Yes

No

Yes No

Yes

No

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10

✓

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Rep Brandenburg

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

REPORT OF STANDING COMMITTEE (410)
January 26, 2005 4:19 p.m.

Module No: HR-17-1140
Carrier: Brandenburg
Insert LC: . Title: .

REPORT OF STANDING COMMITTEE

HB 1108: Finance and Taxation Committee (Rep. Belter, Chairman) recommends DO PASS (7 YEAS, 2 NAYS, 5 ABSENT AND NOT VOTING). HB 1108 was placed on the Eleventh order on the calendar.

2005 SENATE FINANCE AND TAXATION

HB 1108

2005 SENATE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. **HB 1108**

Senate Finance and Taxation Committee

☐ Conference Committee

Hearing Date **March 1, 2005**

Tape Number	Side A	Side B	Meter #
#1	X		0.5 - 38.8

Committee Clerk Signature



Minutes:

CHAIRMAN URLACHER CALLED THE COMMITTEE TO ORDER AND OPENED THE HEARING ON HB 1108.

RICK CLAYBURGH: State Tax Commissioner appeared in favor of the bill with written testimony stating HB 1108 will decouple ND from the corporate treatment that occurs or it decouples ND from the treatment that corporations will receive based on the American Jobs Creation Act of 2004. The purpose of this bill is to maintain the status quo of ND corporate income taxes, also from the stand point in the policy standpoint that if there will be positive tax treatment for corporations, should that not be an issue driven by the ND Legislature instead of by Congress. That was more why the House passed the bill not only because of the revenue impact but felt that it should be up to ND policy makers to decide what tax treatments will be for corporations or individuals in the State of ND. It should not be something that is passed through

because of federal action by Congress deciding what the tax treatment for a State tax source should be. So that is the reason the bill is in front of you.

SEN. URLACHER: how will this relate to other states? Are they making the adjustments as well?

ANSWER: the back page of my testimony, our neighboring states of MN and MT have introduced or anticipating introduction of legislation that will decouple them from the Federal treatment.

SEN. EVERY: what's a foreign sales corporation, does foreign mean foreign or does it mean outside of ND?

ANSWER: Mean outside of the United States, its specific to domestic.

SEN. TOLLEFSON; really its a states rights issue, is it not?

ANSWER: I don't want to editorialize to that extent. The reason that we put this forward is the time of the year that the legislation was enacted, we felt it was necessary as the revenue agent for the State, we had to bring this issue forward so that it wasn't a where was the tax dept. Or what happened to your tax collection.

PAM SHARP; Director of OMB appeared in support with written testimony stating this bill holds corporate income tax constant for ND. The tax break for corporations at the federal level as the result of the American Jobs Creation Act of 2004 is significant.

DENNIS BOYD: appeared on behalf of MDU Resources Group appeared in opposition with written testimony and handed out a document entitled "199 Income Attributable to domestic production activities and a Fact Sheet from the Dept. Of Treasury". HB 1108 seeks to nullify a

tax benefit for ND corporate income tax filers by requiring a Federal deduction for qualified production activities to be added back as income on the ND corporate income tax form.

SEN. URLACHER: there is a question in your opinion on computing the tax effect, as to how they arrived at the ____ effect?

ANSWER: I guess I heard a couple different numbers this morning from Pam and Rick ranging from up to 15 million dollars. When you look at the total corporate income tax collections are somewhere between 40 and 45 million annually and 15 million represent the bottom 1/3 of your total annual collection, that's hard for me to visualize or understand how a 3% deduction could translate into a 33% loss or revenue. I don't know how they compute those numbers.

SEN. WARDNER: the Federal government is going to phase this in at 3%

ANSWER: for 2 years and then 6% for 3 years and then it becomes 9% for 2010.

SEN. WARDNER: on the federal returns, you get a pretty good break there, don't you? And its off of taxable income?

ANSWER: 3% for 2 yrs, 6% for 3 yrs and then the 9%. That's my understanding

DAVE MACIVER: ND Chamber of Commerce: appeared in opposition stating this committee last session was in my eyes that got us from 10 ½ , the perceived 10 ½ to 7% and I believe very strongly that that was one of the best economic moves that we made in a long long time for the economic development of this state. This bill really does go the other direction. What happens to us when all of a sudden SD says to that legislation, MN says no and we say yes, all of a sudden we are again at a disadvantage for economic development in this state.

SEN. WARDNER: if this bill was not to pass, would we be able to instead of put the effective rate @ 7% for corporations, would we be able to write it at 6 ½ because of the federal legislation that's been put in place.

ANSWER: your right, I'm not the right one to ask that.

RON NESS: ND Petroleum Council appeared in opposition stating it seems to me like we are decoupling when we want to decouple but we're really coupled to the federal system. So if we're going to cherry pick the times when we decouple from what the Federal tax system says, are we going to do this if they come up with a tax increase as well? Maybe this all needs to be part of a bigger study and we need to determine what impact it would have what other states are going to do. Let's not be the first ones out of the box and lets see what type of impact this is going to have on the states whether its that negative or not that negative. And if we're going to decouple, then lets work at decoupling instead of just decoupling when we want to decouple on certain issues.

SEN. WARDNER: when an oil company comes in to do business in ND, I know they look at our oil, but what about do they take a look at the corporate income tax when they come here to do business.

ANSWER; yes they do.

SEN. TOLLEFSON: there seems to be some question as to that 15 million dollar figure, a loss apparently if we did not decouple, could you enlighten us a little bit about that, in a thumbnail sketch without getting too detailed, how do we calculate that?

RICK CLAYBURGH: I'd like to respond to a couple of issues, first of all Mr. Chairman I'd like to set the record straight, no time has the tax dept. Or I as Tax Commission have ever said

that this legislation is going to cost up to 40 million dollars. We have been very conservative in trying to come up with an estimate of the impact of this legislation. No body knows for sure yet because all the rules are not adopted.

I would also like to set the record straight that it is not the Tax Dept's decision to say lets decouple for the benefit of the State or decouple when its a detriment to the State, but not to decouple when its to the benefit to the State. The reason we brought this legislation forward was because of the huge amount of unknown about the impact of the legislation and the rules not totally being adopted yet. A number of states have estimated that they believe that this legislation will impact their corporate income tax base up as high as 22% of their base reducing the base. To answer Sen. Tollefson's question, we believe somewhere between 3 and 15 million dollars is the impact from the standpoint of what it is, 1 ½ to 7 million dollars a year, we don't know though what the total impact is.

SEN. TOLLEFSON: pursue that a little bit, maybe we're early on this bill, maybe we should wait or study it.

ANSWER: that's fine, but you have to understand the impact is going to occur next year because it applies to the tax year.

SEN. TOLLEFSON: but we don't know what the impact will be though.

ANSWER: we don't know precisely what the impact will be. The whole purpose of this legislation is to give a heads up to the Legislature of the potential impact.

SEN. URLACHER: can it be passed with an assumption of certain things happening, can we amend it to a point of if other information takes affect why we can go forward?

ANSWER; what the bill does now, if the bill is passed as it stands there is certainty, it maintains the status quo in the State of ND associated around this legislation.. This is a vehicle here to address the issue that at one time states ____ could have an impact of about 20 to 22 percent of their corporate income tax paid and we don't believe its that drastic in ND.

SEN. WARDNER: your projection of 3 to 15 million is that for the next biennium when its at 3%, is that where its at?

ANSWER: that's based on the phase in of the percentages and again, its based on some unknowns.

SEN. WARDNER: when you get to 15 million and you talk about a 9% or are we just talking about the next biennium/

ANSWER; We're talking about the next biennium.

SEN. TOLLEFSON: I'm concerned with what was called a disincentive for corporate investment in ND and if it is truly a disincentive, then certainly we should take a long hard look at it because without corporate investment we are in big trouble. Do you consider this a disincentive?

ANSWER; from the standpoint of tax policies, probably one of the most beneficial federal changes that had a positive or negative impact on state revenue but in a round about way was positive. Was the accelerated depreciation in an expenditure allowing a positive tax treatment for capital expansion. ND is one of the few states that did this, did not decouple from that and most states decoupled from. So there is a positive economic incentive there that ND can but ND can use that, in fact, we see more companies coming to ND because of that. It would only be a disincentive from the stand point of - I don't see it as a major disincentive, does it have an

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Senate Finance and Taxation Committee

Bill/Resolution Number HB 1108

Hearing Date March 1, 2005

impact, potentially yes to companies, anything does. But for the most part, the reduction in a rate of 7% we are still now one of the lower rates or right in the average rate in the country.

Closed the hearing.

2005 SENATE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. **HB 1108**

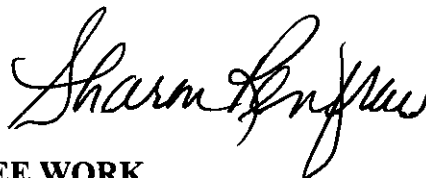
Senate Finance and Taxation Committee

☐ Conference Committee

Hearing Date **March 9, 2005**

Tape Number	Side A	Side B	Meter #
# 2	X		2.4 - 20.6

Committee Clerk Signature



Minutes:

COMMITTEE WORK

RICK CLAYBURGH: Tax Commissioner presented memorandum from Kathy Strombeck and presented some amendments. (see attached amendment)

SEN. TOLLEFSON: I personally think this is the way to go I think its kind of an image issue, it isn't that big of deal and the bill itself with the changes, we talked about with the bill itself I think its nebulous, I think its hard to, its not very definitive, to me it doesn't do anything. I think the 6 ½ % rate will provide the image if that's what were looking for (on the top).

SEN. EVERY: its the 2.3 and 4.6 are similar to the same fiscal notes on a couple of bills I provided would have crossed and those were significant, so I don't see where this is insignificant.

SEN. TOLLEFSON: I'm not saying its insignificant, I think its more definitive.

SEN. WARDNER: if you pass the bill you decouple and tax breaks that's been given doesn't flow on down to the State or to the State's businesses here. Now keep in mind they still get a federal, they get a break on their federal taxes and if we kill the bill then they would get 3%, 6%

and then 9% and I don't agree with that. And to me because this has come down, I think that if we have or we would get something out of it, 6.5 rather than 7, that's the number that would be and it would send a message that we are not a high tax state. That's what it would do, that's what we'd get out of it. Yes, corporations are gonna get a bone here, their gonna get a break of 2.3 million per year and so but there are not going to get 15 or 20 if we were to defeat this thing. I guess its a compromise and there's no question about it as Sen. Every pointed out, that money could have been used someplace else but we're again there's always room for questioning but we would hope that it would bring more business. Either being developed or it they would come here and we provide jobs for and stuff for people. Could that money have gone to help some people, yes.

SEN. EVERY: I would add to that, it would help to provide jobs from some people but we also have to think about the people that are here that already have jobs and what we do is something like this and the perception is when you go home that we just gave a break to the corporations and we did nothing to those people back home that are constantly getting on us about their property taxes and whatever burdens they have on them. We believe that the burden for the big corporations but we don't relieve any of the burden for the working class. That's the perception, that's what's going to be at some, cuz that's exactly what we're doing.

SEN. WARDNER: he's right, Mr. Chairman people will look at like that, however if businesses expand, they do pay more property taxes and if, political subs don't try to take everything, it could mean a property tax relief, but I now how that game is planned so I'm not gonna go out and say that's what's going to happen because there's too many variables out there. But it sure leaves

that option if the cities and counties would recognize that and I know in our town it is working and we're blessed in Dickinson to have so many small primary sector businesses.

SEN. URLACHER: we've been looking at methods of bringing in industry into the State to provide the jobs that we need, it's kind of been an ongoing goal and looking out for people to raise their wages. It's probably an ongoing thing that we've been attempting to do, so I hope there'd be a relationship to jobs and wages as well. We have amendments relating to the top end, federal regulations, turning it into a study, so if you feel comfortable in addressing some of those amendments or whatever.

SEN. WARDNER: If we were to put it into a study, that would mean that we would take a look at it over the interim, but the deduction would come through, wouldn't it? So they'd have 3% over the next 2 years.

RICK CLAYBURGH: the way that amendment would be put on the bill is my understanding is 1108 would just have an amendment added to it so we would decouple, the Tax Commissioner would provide information to the Legislature next biennium what the full known impact of the domestic production activity dividend was or the deduction was and at that point the Legislature could say, we should let this pass through the corporations and then the Legislature would take the motion to couple, so it would be a specific action by the Legislature saying, we want to provide a benefit, we don't want a benefit being provided by somebody outside of ND.

SEN. COOK: the way these amendments are written is that they assume we pass the bill and just tack these amendments on as a new section. The other thing we could do is hog house the bill so all it is is these amendments. This would have to be rewritten.

SEN. EVERY: I had written down that when you (Rick) testified that you had said twice that it holds corporate income tax constant and that it maintains a status quo and you just said it again. Now from what I just heard a minute ago, if we kill this bill its going to go down to 2 and 6/10ths and 4 and 1/10th and 5 and 6 1/10ths. If we pass the bill the way it is, according to when Mr. Clayburgh testified, it would corporate income taxes the way they are. So what did we just say a minute ago about lowering it to 6 ½% or whatever and that we have to do that otherwise its going to be worse.

SEN. WARDNER: I guess when we're comparing it if we were to kill the bill, your talking about pass the bill, but if we were to kill the bill on this, that's what I was comparing. If we pass the bill, it stays, everything stays just the way it is.

SEN. TOLLEFSON: if we pass the bill, it could be 3 million or 15 million to the good.

RICK CLAYBURGH: if you pass the bill, it is revenue neutral, it does not have any positive or negative impact in the State, what we do hope is status quo. Defeat of the bill would have an impact in the 05-07 biennium somewhere between 3 and 15 million dollars.

SEN. WARDNER; I don't agree with Sen. Cook on hog housing it and just killing it and putting into a study resolution. If we're going to do that then we put this on and see how that rides.

SEN. BERCIER: if we were to kill the bill, do the study, your saying that the in the next biennium between 3 and how many million would be the deficit?

RICK: somewhere between 3 and 15 million reduction in corporate income tax revenue.

SEN. WARDNER: I can handle the 2.3 buy I would have a hard time going more than that, I can defend that.

SEN. EVERY: I guess I don't know why are we trying to amend it at all. If we don't amend it then we have to re-address it in 2 years is what your saying? If we pass the bill just the way it is, as it was the day we heard testimony.

RICK: based on comment that got back to the governor's office after the hearing that day, MDU and the ND Chamber and I think Petroleum Council came in that there was strong feeling that there was a chance that the bill would be defeated and so there was discussion on about what to do to and how do we address to save the bill for the protection of the corporate income tax base and the revenue forecast. That's where discussions came up both in the House and the Senate about the possibility instead of taking the 3 to 15 million dollar hit, if the bill was killed and those businesses that were here were standing up and saying if you pass this bill your basically putting a tax increase on ND companies because we're not getting the benefit that happened at the federal level and should have been passed down to the State. So members said, instead of congress saying you know what we're going to push an impact down to you of 3 to 15 million, the concept is the Legislature decouples so we don't have to worry about that 3 or 15 million dollar impact or whatever will happen on that fair jobs creation act bill, but in doing that we're going to take credit for doing something for corporations. That was the idea of the rate reduction, the other aspect was, one of the study will take the bill as it is, hold the revenue base constant and then put a study on it and the reason its such a strange 3 to 15 million its hard to get ahold of it, not all the rules have been determined by treasury yet, so that would give the tax dept. To work with interim committee basically to say here was the net fiscal impact, heres the actual impact. The whole point is a vehicle for you guys to decide how you want to address corporate tax policy in ND.

SEN. WARDNER: I think Sen. Every makes a good point, we wouldn't need to put a study on it we could just pass it the way it is. I don't know how much studying your gonna do.

SEN. COOK: there is some confusion right now on what the fiscal note would be. We here 3 of 15 million dollars, I think that confusion will go away during the interim after we get through 1 year to a great degree and so the study would just be able to give us a clearer picture of what the fiscal note would be for the following biennium.

SEN. EVERY: the Tax Dept. Could come up with that in 2 years, I would consider them to be the experts. This thing sailed through the House apparently and nobody noticed the 3 to 15 million or didn't appear to bother them at all.

END OF DISCUSSION.

2005 SENATE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. **HB 1108**

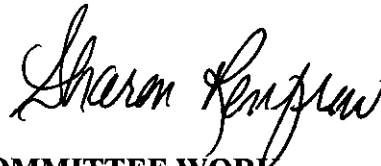
Senate Finance and Taxation Committee

☐ Conference Committee

Hearing Date **March 16, 2005**

Tape Number	Side A	Side B	Meter #
#1	X		6.1 - 25.8 46.5 - 54.4

Committee Clerk Signature



Minutes:

COMMITTEE WORK

SEN. EVERY: I had some people come and try to explain to me a little better as to what the bill would do under 3 different scenarios and presented amendments. The way I understand it is that the bill as it came out of the House, if we pass it and the Tax Commissioner was in the room and testified that it would be status quo, it would not change anything. If that's the case and we have 2 years to look at it, quite frankly everybody, nobody knows what's going to happen with this thing, what may or may not happen in the next 2 years, how its going to impact the revenues that come into the State. So the logical thing to do would be to pass the bill as it is and amend it to say that we are going to study it over the next 2 years. At the end of that 2 years when we're back here in 07, we'd be able to look at it again and know exactly where we're at as far as the impact to the revenues of the State and the Tax Dept. Would be very clear on what we should or shouldn't do and they could come in with a recommendation and say this is what we believe should or shouldn't be done and it's my opinion that they are the experts. I think this amendment

will take care of all of our concerns about corporate tax cuts or what might happen to the revenue, we won't be harmed by passing it this session, we could re-look at it next session and this will require us to look at it closely and it requires the Tax Commissioner to come in with a recommendation at the end of that period.

SEN. WARDNER: It kind of fits in here, the sheet I got from the Tax Dept., kinda tells us how this thing will probably lay out. Went through the assumption's that a taxpayer does 100% of its business in ND, there is no apportionment, there's no waters edge selection or anything like that and the federal taxable income and ND taxable income both equal a million dollars. Tax payers net equals the federal tax income and it is eligible for the section 199 deduction. It gave the corporations this tax break. I want you to remember that the first 2 years its 3% each year and then it goes to 6% each year and then after that it goes to 9%.

SEN. EVERY: the 3% would not happen in this biennium, it would happen after the 2007.

SEN. WARDNER: that's correct under your situation and under mine , we're saying that #1 is if there was no bill at all, it was just allowed, the only reason its there is for reference point. So Mr. Walstad, #1 is a reference point, #2 is as if you passed the bill forever or for the first two years under Sen. Every's proposal, it would be that for those 2 years and also under the amendments that I'm going to give that would be true too what would happen is that it would get the federal deduction of \$10,200 but there will be no deduction as far as ND income tax because his bill puts it on hold for 2 years and so does the bill with the amendments that I'm going to propose to.

However, this is where we differ, # 3 Sen. Every would say that before #3 went into the effect we would study it and make a decision, you would not allow 3 to go into effect until we've studied it

and then we'd make a decision what we were gonna do, either to continue with keeping it in effect or go to something like this.

SEN. EVERY: my argument is that at this point we don't need to panic, we do not need to change a thing until 2007. If in fact we do lower the rate now and say that it goes into effect in 2007, we are in fact lowering the corporate tax rate in 2007 and whether there is a sunset on that or not, we all know that the chances are that the likelihood is that that would never that would always remain the same at 6 ½ %, all this amendment is saying that we don't have to panic, we can take a look at it and then if that decision needs to be made then we can still make that decision and the Tax Dept. Can direct us to do that.

SEN. WARDNER: that's right. The amendments that I'm going to offer, it would delay the implementation of this until so that the taxes were collected in the next biennium and we would drop it to, the top rate is 6 ½ % and you can see what it would mean to that company as far as savings. Handed out a document on information on what the fiscal note is and what it would be. They estimate 2 million dollars a year or 4 million for the biennium, in essence that is what the tax break would be. My arguments would simply be this, that I would never want to kill the bill and let it go all the way, that wouldn't be right it would go to 9% and I can't support that. Going to 6 ½ % is a compromise, but I'm also looking at it from the standpoint that now the State all of a sudden ND is not at 7 and they dropped the 6 ½ and I see that as a benefit to our state that when companies are out there looking to possibly come to ND or to any State, all of a sudden we are not at the, we're not the highest but we're kinda right there at the top of the list, 6 ½ would put us below the range. That's really my argument.

SEN. EVERY: I would argue that if the good Senator from Dickinson were willing to concede that we don't need to do anything right now with regards to lowering corporate tax rate or the top rate until 2007, that I would be willing to concede in 2007 that if the Tax Dept. Comes in and recommends that that is what we need to do, I would be more than supportive of that. I think this is something that we need to leave to the experts and they are in the Tax dept. We have no idea today what is going to happen, its almost a wait and see thing to where we need to evaluate how this thing would go, pass the bill as amended, look at in the interim and evaluate how it went and then in 2007, the Tax Dept. Were to come to this committee, here's what we need to do and a great compromise would be this, I would be more than willing to support that, but at this time I can't.

SEN. URLACHER: over the last 3 biennium's we've looking at trying to bring it down to a point that is more attractive for business in their views. This kind of follows that pattern that the ½ % deduction, whether we will get the best return on a dollar I don't know.

SEN. EVERY: I would agree that in the last couple of sessions we have looked at how to make it attractive for these corporations to come in and looked at all the tax rates, however I'm not willing to go home and tell my folks that on the spur of the moment reduced the corporate income taxes when we did nothing to help the burden on these property owners and others that are looking for that same type of reduction in their taxes. It's going to be tough to explain and I'm not willing to do it especially when we don't need to panic and don't need to do it today, we can look at it.

SEN. WARDNER: the only thing I would say is we are hoping that as we bring companies to come here, but we're hoping that by bringing these companies in, it is going to help pay property

taxes and I know the first thing you think about is that these companies get tax exemptions for their facility, they also bring more people into the area to work and stuff. Hopefully it spreads out the tax burden and we have schools that are not full, so the infrastructure should be there.

We shouldn't have to increase on the infrastructure. If we would put this into affect now, we got 2 years where we get a head start. The fiscal note concerns me some but its not a huge fiscal note and I'm hoping that by doing this we are going to increase the revenue back into the state.

SEN. EVERY: I agree with some of that, the reality of this thing is that this is not about attracting businesses to ND in fact, we had testimony in our committee on some other bills that said that even SD cannot prove that any of the companies that did or didn't come to SD was because of their, they lowered their corporate income tax, so we don't know that it works exactly that way, I would hope that it would, but the reality is that it has nothing really to do with that and mostly to do with the companies that are already here and I'm not willing to provide corporation tax reductions for the Walmarts and Monsanto's of the world and not for the 13,500 people that I represent in district 23.

SEN. COOK: I have a question for Sen. Wardner, as I look at your 3 scenario's here, the greatest savings offered to corporate tax payers would be in scenario 3 and that is dropping the rate from 7 to 6 ½ and then passing the rest of the bill as is.

SEN. WARDNER: Correct.

SEN. COOK: and we have a fiscal note for 4 million dollars a year if we do that.

SEN. WARDNER: that is correct after this biennium is when it would kick in.

SEN. COOK; my question then is, if the fiscal note for the best scenario is for 4 million, can we assume that the fiscal note for scenario # 1 would be less that 4 million?

SEN. WARDNER: it would be that for 2 years and then after that it jumps to 6% , double and then it would triple. That's what we have to kinda go by. Sen. Every is right, the Tax Dept. Does say, ya know they gave the estimate of 3 to 15 million, so his point is well taken there but I got a feeling that its going to be on the high end. My point would be that 4 million is going to be small compared to what it would be if this bill hadn't even come through or we killed it. Which I can't support killing the bill.

SEN. EVERY; Mr. Chairman I agree wholeheartedly with that that we can't kill the bill, however this amendment that I'm going to move in a minute here, there is no fiscal note and we still can do what Rich has in mind at the end of this 2 years. We're still paying the bill, its leaving just the same way it got here from the House only it says we are going to look at and the Tax Dept.'s gonna come to us with a recommendation and that may very well be to compromise and lower it to 6 ½ % at the end of that and then if we want to vote on our 4 million dollar fiscal note we could certainly do that, so I would move the amendment 58192.0103.

SEN. URLACHER: I think since there are 2 amendments here

SEN. BERCIER: seconded the motion.

No further discussion.

ROLL CALL VOTE; 3-2-1 Motion fails.

SEN. WARDNER: handed out an amendment and explained.

SEN. WARDNER: made a **MOTION TO ADOPT THE AMENDMENTS**, seconded by Sen. Bercier.

SEN. EVERY; clarification of the 4 million dollar hit to the general fund would be beginning in 2007, correct? Yes

SEN. URLACHER: that could be changed this next session as well? That's correct

SEN. COOK: if I'm looking at it right, the way I look at this, is by passing this bill we create a tax increase corporate ND for the years 2005 - 2006 and there one, but with the amendments that are on there, we are going to offer some degree of a tax decrease or maybe even a reduction in the tax increase for the years after 2007, that's the way I see it, to me its a compromise.

SEN. EVERY: if there is a tax increase its on the federal level not the state level.

ROLL CALL VOTE: 4-1-1 **MOTION PASSES.**

SEN. WARDNER: made a **MOTION FOR DO PASS AS AMENDED**, seconded by Sen. Every.

ROLL CALL VOTE: 5-0-1 Sen. Wardner will carry the bill.

March 9, 2005

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1108

Page 1, line 3, after the semicolon insert "to provide for a study; to provide for a report to the legislative council"

Page 1, after line 14, insert:

SECTION 2. DOMESTIC PRODUCTION DEDUCTION STUDY-REPORT TO LEGISLATIVE COUNCIL. During the 2005-2006 interim, the tax commissioner shall study the effect of the domestic production deduction under section 199 of the Internal Revenue Code [26 U.S.C. 199] on North Dakota corporation income tax. The tax commissioner shall report to the sixtieth legislative assembly the impact of the deduction on corporate taxpayers and the state's revenues.

Renumber accordingly

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1108

Page 1, line 3, after the semicolon insert "to provide for a study and a report to the legislative assembly by the tax commissioner;"

Page 1, after line 14, insert:

"SECTION 2. DOMESTIC PRODUCTION DEDUCTION STUDY - REPORT TO LEGISLATIVE ASSEMBLY. During the 2005-06 interim, the tax commissioner shall study the effect of the domestic production deduction under section 199 of the Internal Revenue Code [26 U.S.C. 199] on the North Dakota income tax on corporations. The tax commissioner shall report to the finance and taxation committees of the house of representatives and senate of the sixtieth legislative assembly the impact of the deduction on corporate taxpayers and the state's revenues."

Renumber accordingly

Date: 3-16-05
Roll Call Vote #: 1

2005 SENATE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. HB 1108

Senate

Finance and Taxation

Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number

Action Taken

Move Every's Amendment

Motion Made By

Every

Seconded By

Bercier

Senators	Yes	No	Senators	Yes	No
Sen. Urlacher		✓	Sen. Bercier	✓	
Sen. Wardner		✓	Sen. Every	✓	
Sen. Cook		✓			
Sen. Tollefson					

Fails

Total (Yes)

3

No

2

Absent

1

Floor Assignment

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

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1108

Page 1, line 3, after the semicolon insert "to amend and reenact subsection 1 of section 57-38-30 of the North Dakota Century Code, relating to the imposition and rate of tax on corporations;"

Page 1, after line 14, insert:

"SECTION 2. AMENDMENT. Subsection 1 of section 57-38-30 of the North Dakota Century Code is amended and reenacted as follows:

1. a. For the first three thousand dollars of taxable income, at the rate of two and six-tenths percent.
- b. On all taxable income above three thousand dollars and not in excess of eight thousand dollars, at the rate of four and one-tenth percent.
- c. On all taxable income above eight thousand dollars and not in excess of twenty thousand dollars, at the rate of five and six-tenths percent.
- d. On all taxable income above twenty thousand dollars, and not in excess of thirty thousand dollars, at the rate of six and four-tenths percent.
- e. On all taxable income above thirty thousand dollars, at the rate of ~~seven~~ six and one-half percent."

Renumber accordingly

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1108

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- d. On all taxable income above twenty thousand dollars, and not in excess of thirty thousand dollars, at the rate of six and four-tenths percent.
- e. On all taxable income above thirty thousand dollars, at the rate of ~~seven~~ six and one-half percent."

Page 1, line 15, replace "This" with "Section 1 of this"

Page 1, line 16, after the period insert "Section 2 of this Act is effective for taxable years beginning after December 31, 2006."

Renumber accordingly

Date: 3-16-05
Roll Call Vote #: 2

2005 SENATE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. HB 1108

Senate

Finance and Taxation

Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number

Action Taken

Adopt Sen. Wardner's Amendments .07+x

Motion Made By

Wardner

Seconded By

Bercier

Senators	Yes	No	Senators	Yes	No
Sen. Urlacher	✓		Sen. Bercier	✓	
Sen. Wardner	✓		Sen. Every		✓
Sen. Cook	✓				
Sen. Tollefson					

Total (Yes)

4

No

1

Absent

1

Floor Assignment

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

Date: 3-16-05
Roll Call Vote #: 3

2005 SENATE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. HB 1108

Senate

Finance and Taxation

Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number

Action Taken

Do Pass As Amended

Motion Made By

Wardner

Seconded By

Every

Senators	Yes	No	Senators	Yes	No
Sen. Urlacher	✓		Sen. Bercier	✓	
Sen. Wardner	✓		Sen. Every	✓	
Sen. Cook	✓				
Sen. Tollefson					

Total (Yes)

5

No

0

Absent

1

Floor Assignment

Wardner

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

REPORT OF STANDING COMMITTEE

HB 1108: Finance and Taxation Committee (Sen. Urlacher, Chairman) recommends AMENDMENTS AS FOLLOWS and when so amended, recommends DO PASS (5 YEAS, 0 NAYS, 1 ABSENT AND NOT VOTING). HB 1108 was placed on the Sixth order on the calendar.

Page 1, line 3, after the semicolon insert "to amend and reenact subdivision e of subsection 1 of section 57-38-30 of the North Dakota Century Code, relating to the imposition and rate of tax on corporations;"

Page 1, underscore lines 7 through 14

Page 1, after line 14, insert:

"SECTION 2. AMENDMENT. Subdivision e of subsection 1 of section 57-38-30 of the North Dakota Century Code is amended and reenacted as follows:

- e. On all taxable income above thirty thousand dollars, at the rate of ~~seven~~ six and one-half percent."

Page 1, line 15, replace "This" with "Section 1 of this"

Page 1, line 16, after the period insert "Section 2 of this Act is effective for taxable years beginning after December 31, 2006."

Renumber accordingly

2005 TESTIMONY

HB 1108

**TESTIMONY OF THE OFFICE OF STATE TAX COMMISSIONER
BEFORE THE
SENATE FINANCE AND TAXATION COMMITTEE**

HOUSE BILL 1108

Monday, January 10, 2005

HB 1108 "decouples" North Dakota's corporate income tax from the domestic production activities deduction and extraterritorial income (ETI) exemption allowed for corporations conducting international business operations. Without going into a lot of detail regarding how these deductions are calculated, the following is a condensed version of the history of HB 1108.

The ETI was enacted after the World Trade Organization (WTO) declared foreign sales corporations (FSC) an illegal export-based subsidy. Congress then replaced FSCs with the ETI treatment. The ETI legislation was passed in a non-legislative year for us and was almost immediately challenged. We decided that, before proposing any legislation on the ETI issue, we would wait for a decision by the WTO, which again declared the ETI to be an illegal export-based subsidy. Other states, such as Oregon, Wisconsin, Minnesota, and Montana (administratively) "decoupled" from the ETI immediately.

Consequently, in the latter part of October or early November, the American Jobs Creation Act of 2004 was passed by Congress and signed by President Bush. This Act now phases-out a corporation's use of the ETI exclusion for federal income tax purposes and phases in a deduction for domestic production activities. This deduction begins at 3% of net income attributable to domestic production activity for years 2005 and 2006, 6% for taxable years 2007 through 2009, increasing to 9 percent of this income for taxable years after 2009. The deduction applies not only to domestic manufacturing but to construction engineering and architectural services related to construction projects, energy production, processing of agricultural products and a large number of other domestic activities. It is

allowed to pass-through entities, sole proprietors, coops, estates, and trusts, as well as C corps.

Because the passage of the AJCA of 2004 came too late to present to the interim taxation committee, we determined that this was an issue that should be brought to the legislature's attention. This bill as drafted affects only corporate income tax, however, I do want to point out to the Committee that the federal deduction is also available to individual income taxpayers.

If there are any questions, Mr. Chairman, I will be happy to respond to them at this time.

**TESTIMONY OF THE OFFICE OF STATE TAX COMMISSIONER
BEFORE THE
SENATE FINANCE AND TAXATION COMMITTEE**

HOUSE BILL 1108

Tuesday, March 1, 2005

HB 1108 "decouples" North Dakota's corporate income tax from the domestic production activities deduction and extraterritorial income (ETI) exemption allowed for corporations conducting international business operations. Without going into a lot of detail regarding how these deductions are calculated, the following is a condensed version of the history of HB 1108.

The ETI was enacted after the World Trade Organization (WTO) declared foreign sales corporations (FSC) an illegal export-based subsidy. Congress then replaced FSCs with the ETI treatment. The ETI legislation was passed in a non-legislative year for us and was almost immediately challenged. We decided that, before proposing any legislation on the ETI issue, we would wait for a decision by the WTO, which again declared the ETI to be an illegal export-based subsidy. Other states, such as Oregon, Wisconsin, Minnesota, and Montana (administratively) "decoupled" from the ETI immediately.

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allowed to pass-through entities, sole proprietors, coops, estates, and trusts, as well as C corps.

In our neighboring states of Minnesota and Montana, legislation has been introduced or is expected to be introduced to decouple from this federal tax deduction. Other states in which decoupling legislation is or will be introduced are New Jersey, Maryland, Massachusetts, and West Virginia.

Because the passage of the AJCA of 2004 came too late to present to the interim taxation committee, we determined this was an issue that should be brought to the legislature's attention. This bill as drafted affects only corporate income tax, however, I do want to point out that the federal deduction is also available to individual income taxpayers.

If there are any questions, Mr. Chairman, I will be happy to respond to them at this time.

Pam Sharp - OMB

Testifying in support of HB 1108.

This bill results from the American Jobs Creation Act of 2004, and holds corporate income tax constant for North Dakota.

The tax break for corporations at the federal level as the result of the American Jobs Creation Act of 2004 is significant.

If this bill is not passed, corporations would, by default, get a tax break at the state level, which could cost up to \$15 million for a two year period.

Speak to the effects of the budget if this bill is not passed. As I said, It is estimated that the effect of not passing this bill would cost up to \$15 million for a two year period for the state of North Dakota. This is a significant amount of revenue that would be taken off the table. *for services for North Dakota*

If this bill is not passed, we would require fairly severe budget cuts to balance the budget. As you know, the majority of our budget goes for education, Human Services and Corrections. If this bill is not passed, we would very likely see severe cuts in these areas.

Tax Commissioner Clayburgh is correct that if corporations are to get a tax break at the state level, it should not be by default, but should be a conscious decision to do so.

I urge your support of HB 1108 and ask that you give this bill a do pass.

Testimony on HB1108
Dennis Boyd
MDU Resources Group, Inc.
March 1, 2005

Good morning, Mr. Chairman and members of the committee. For the record, my name is Dennis Boyd, appearing on behalf of MDU Resources Group, numerous subsidiaries, and our utility division, Montana-Dakota Utilities. We are opposed to passage of HB1108, and view its passage as an unfriendly signal to the business community in North Dakota.

HB1108 seeks to nullify a tax benefit for North Dakota corporate income tax filers by requiring a Federal deduction for qualified production activities to be added back as income on the North Dakota corporate income tax form. This deduction, defined in Section 199 of the Internal Revenue Code, was passed for federal income tax filers late last fall and signed into law by President Bush on October 24, 2004, as part of the American Jobs Creation Act. It is effective for taxable years beginning after December 31, 2004.

I always get a little nervous when I see legislation which only makes reference to other sections of the Century Code, or in this case to the Internal Revenue Code, so I have attached two different copies of the explanation of Section 199. The first copy is dated January 7, 2005, and the other copy is from the Department of the Treasury, Office of Public Affairs dated January 19, 2005. The January 7 document explains Section 199 – Income attributable to domestic production activities – and it explains the federal tax benefit, as well as the domestic production activities which qualify for the deduction (page 2).

The deduction will eventually be 9% of the lesser of (A) qualified production activities income OR (B) taxable income. The federal deduction is phased in beginning with a 3% deduction in 2005 and 2006, a 6% deduction in 2007, 2008, and 2009, and a 9% deduction beginning in 2010. Of particular interest to my company are the qualified domestic production activities identified on page two of the January 7 document. On page two in Section 4, subsection A (i) III, the generation of electricity and the production of natural gas are identified as qualified production activities.

In addition the next subsection (4) (A) (ii) also qualifies all construction performed in the United States. The first page of the Department of the Treasury - Office of Public Affairs document dated January 19, 2005, defines qualified construction activities as including infrastructure needs such as roads and power lines.

A centerpiece of Governor Hoeven's State of the State address emphasized the need to assist in the building of High Voltage Transmission Lines in North Dakota. HB1169, the ND Transmission Authority Act is one of the more innovative legislative proposals to come along in several sessions. It has passed the House and will soon be before the Senate. Its sole purpose is to promote the construction of transmission lines, so we can mine more lignite, and generate more electricity for export – all activities which create good jobs and generate tax revenue to support the services we have all come to expect from our government. House Bill 1108 seems to be counterproductive to that interest.

I find it not only ironic, Mr. Chairman and members of the Committee, but also disappointing, at a time when the Governor and this Legislature are doing everything possible to spur economic development, that a legislative proposal would appear which seeks to disallow a federal incentive for North Dakota income tax filers. As recently as the last legislative session, the promoter of this legislation stood before this very committee asking you to disallow a long time deduction on the North Dakota corporate income tax form for federal taxes paid. In return the overall tax rate would be reduced to 7%. This was all in the interest of economic development. Now, two years later when another economic development tax incentive appears, the same individual is before you promoting legislation which would deny the incentive. Not only ironic and disappointing, but also inconsistent.

Energy production provides the potential for tremendous economic development in North Dakota. We are fortunate to have unlimited supplies of lignite, but unfortunately, that lignite will never be mined and developed unless somebody builds a generating plant near a mine site. In addition western North Dakota has vast reserves of oil and natural gas, and we appear to be poised to enjoy another oil boom – an oil boom which will lead to increased production of natural gas. It seems to me that we ought to be doing everything possible to develop those resources. If you believe that a rising tide lifts all boats, then the ripple effect from a new mine, a new generating plant, a new transmission line, or increased natural gas production will translate into new jobs paying good wages which generate

increased tax revenues to support services we expect from our government.

It is no secret that Montana-Dakota Utilities is trying to build a generating plant near Gascoyne, in southwestern North Dakota. Partly because of the lack of existing transmission, this plant has been scaled back from an initial 600 MW to 175 MW. In the process many economies of scale have been lost in downsizing the plant. It is also no secret that Montana-Dakota Utilities is considering other potential plant sites, two of which are located in South Dakota. I don't need to remind you that South Dakota has no corporate income tax.

In my opinion, H1108 is a DISINCENTIVE for MDU or any other investor-owned utility company to build a generating plant or transmission line in North Dakota. HB1108 is an INCENTIVE to build elsewhere. HB 1108 is an anti-business signal and its passage represents a prospective tax increase to corporate income tax filers. I respectfully ask that you give HB1108 a strong Do Not Pass recommendation.

Before I conclude my testimony, Mr. Chairman and members of the committee, I would like to relate my experience with this bill in the House and to float a "novel" idea. In the House, I believe I was the only individual to oppose HB1108. The hearing was the last bill to be heard before lunch, and as I visited with members of the House Finance and Tax committee over the noon hour, I couldn't find one committee member who was supporting the bill's passage. By the next morning, I was hard pressed to find anyone who was going to vote against the bill. To my dismay, I was informed that "someone" was indicating a potential loss of revenue that was somewhere between \$10 and \$40 million if the bill was defeated. That seemed an incredibly high number when you realize the corporate income tax generates \$40- \$45 million annually. Nonetheless, the bill passed the House easily.

If the potential loss of revenue associated with HB1108 is intolerable, let me pose a "novel" idea- i.e., a reduction of one half of one percent in the overall corporate income tax rate. Assuming \$42 million as the annual revenue from corporate income taxes at a 7% rate, then a one half of one percent reduction in the overall rate would reduce revenues by \$3 million annually. That would put the overall rate at 6.5% and would be seen as a strong economic development and a strong pro-business signal by all corporate filers, not just those filers involved in the qualified domestic production activities identified in Section 199.

That concludes my testimony, Mr. Chairman and members of the committee. My preference would be to kill HB 1108, but if that is not possible, an amendment to it which reduces the overall corporate rate to 6.5% might take some of the sting out of a bill which will otherwise be viewed as a corporate income tax increase. I would be happy to answer any questions.

DENNIS BOYD

MOV RESOURCES GROUP, INC.

§199 Income attributable to domestic production activities.
Code**Internal Revenue Code**

Caution: Code Sec. 199, following, is effective for tax. yrs. begin. after 12/31/2004.

§ 199 Income attributable to domestic production activities.**(a) Allowance of deduction.****(1) In general.**

There shall be allowed as a deduction an amount equal to 9 percent of the lesser of—

(A) the qualified production activities income of the taxpayer for the taxable year, or

(B) taxable income (determined without regard to this section) for the taxable year.

(2) Phasein.

In the case of any taxable year beginning after 2004 and before 2010, paragraph (1) and subsections (d)(1) and (d)(6) shall be applied by substituting for the percentage contained therein the transition percentage determined under the following table:

For taxable years beginning in:	The transition percentage is:
2005 or 2006	3
2007, 2008, or 2009	6

(b) Deduction limited to wages paid.**(1) In general.**

The amount of the deduction allowable under subsection (a) for any taxable year shall not exceed 50 percent of the W-2 wages of the employer for the taxable year.

(2) W-2 wages.

For purposes of paragraph (1), the term "W-2 wages" means the sum of the aggregate amounts the taxpayer is required to include on statements under paragraphs (3) and (8) of section 6051(a) with respect to employment of employees of the taxpayer during the calendar year ending during the taxpayer's taxable year.

(3) Acquisitions and dispositions.

The Secretary shall provide for the application of this subsection in cases where the taxpayer acquires, or disposes of, the major portion of a trade or business or the major portion of a separate unit of a trade or business during the taxable year.

(c) Qualified production activities income.

For purposes of this section —

(1) In general.

The term "qualified production activities income" for any taxable year means an amount equal to the excess (if any) of—

- (A) the taxpayer's domestic production gross receipts for such taxable year, over
- (B) the sum of—
 - (i) the cost of goods sold that are allocable to such receipts,
 - (ii) other deductions, expenses, or losses directly allocable to such receipts, and
 - (iii) a ratable portion of other deductions, expenses, and losses that are not directly allocable to such receipts or another class of income.

(2) Allocation method.

The Secretary shall prescribe rules for the proper allocation of items of income, deduction, expense, and loss for purposes of determining income attributable to domestic production activities.

(3) Special rules for determining costs.

(A) In general. For purposes of determining costs under clause (i) of paragraph (1) (B), any item or service brought into the United States shall be treated as acquired by purchase, and its cost shall be treated as not less than its value immediately after it entered the United States. A similar rule shall apply in determining the adjusted basis of leased or rented property where the lease or rental gives rise to domestic production gross receipts.

(B) Exports for further manufacture. In the case of any property described in subparagraph (A) that had been exported by the taxpayer for further manufacture, the increase in cost or adjusted basis under subparagraph (A) shall not exceed the difference between the value of the property when exported and the value of the property when brought back into the United States after the further manufacture.

(4) Domestic production gross receipts.

(A) In general. The term "domestic production gross receipts" means the gross receipts of the taxpayer which are derived from—

- (i) any lease, rental, license, sale, exchange, or other disposition of—
 - (I) qualifying production property which was manufactured, produced, grown, or extracted by the taxpayer in whole or in significant part within the United States,
 - (II) any qualified film produced by the taxpayer, or
 - (III) electricity, natural gas, or potable water produced by the taxpayer in the United States,
- (ii) construction performed in the United States, or
- (iii) engineering or architectural services performed in the United States for construction projects in the United States.

(B) Exceptions. Such term shall not include gross receipts of the taxpayer which are

derived from—

(i) the sale of food and beverages prepared by the taxpayer at a retail establishment, and

(ii) the transmission or distribution of electricity, natural gas, or potable water.

(5) Qualifying production property.

The term "qualifying production property" means—

(A) tangible personal property,

(B) any computer software, and

(C) any property described in section 168(f)(4) .

(6) Qualified film.

The term "qualified film" means any property described in section 168(f)(3) if not less than 50 percent of the total compensation relating to the production of such property is compensation for services performed in the United States by actors, production personnel, directors, and producers. Such term does not include property with respect to which records are required to be maintained under section 2257 of title 18, United States Code.

(7) Related persons.

(A) In general. The term "domestic production gross receipts" shall not include any gross receipts of the taxpayer derived from property leased, licensed, or rented by the taxpayer for use by any related person.

(B) Related person. For purposes of subparagraph (A), a person shall be treated as related to another person if such persons are treated as a single employer under subsection (a) or (b) of section 52 or subsection (m) or (o) of section 414, except that determinations under subsections (a) and (b) of section 52 shall be made without regard to section 1563(b).

(d) Definitions and special rules.

(1) Application of section to pass-thru entities.

(A) In general. In the case of an S corporation, partnership, estate or trust, or other pass-thru entity—

(i) subject to the provisions of paragraphs (2) and (3), this section shall be applied at the shareholder, partner, or similar level, and

(ii) the Secretary shall prescribe rules for the application of this section , including rules relating to—

(I) restrictions on the allocation of the deduction to taxpayers at the partner or similar level, and

(II) additional reporting requirements.

(B) Application of wage limitation. Notwithstanding subparagraph (A)(i), for purposes

of applying subsection (b), a shareholder, partner, or similar person which is allocated qualified production activities income from an S corporation, partnership, estate, trust, or other pass-thru entity shall also be treated as having been allocated W-2 wages from such entity in an amount equal to the lesser of—

(i) such person's allocable share of such wages (without regard to this subparagraph), as determined under regulations prescribed by the Secretary, or

(ii) 2 times 9 percent of the qualified production activities income allocated to such person for the taxable year.

(2) Application to individuals.

In the case of an individual, subsection (a)(1)(B) shall be applied by substituting "adjusted gross income" for "taxable income". For purposes of the preceding sentence, adjusted gross income shall be determined—

(A) after application of sections 86, 135, 137, 219, 221, 222, and 469, and

(B) without regard to this section.

(3) Patrons of agricultural and horticultural cooperatives.

(A) In general. If any amount described in paragraph (1) or (3) of section 1385(a) —

(i) is received by a person from an organization to which part I of subchapter T applies which is engaged—

(I) in the manufacturing, production, growth, or extraction in whole or significant part of any agricultural or horticultural product, or

(II) in the marketing of agricultural or horticultural products, and

(ii) is allocable to the portion of the qualified production activities income of the organization which, but for this paragraph, would be deductible under subsection (a) by the organization and is designated as such by the organization in a written notice mailed to its patrons during the payment period described in section 1382(d),

then such person shall be allowed a deduction under subsection (a) with respect to such amount. The taxable income of the organization shall not be reduced under section 1382 by reason of any amount to which the preceding sentence applies.

(B) Special rules. For purposes of applying subparagraph (A), in determining the qualified production activities income which would be deductible by the organization under subsection (a) —

(i) there shall not be taken into account in computing the organization's taxable income any deduction allowable under subsection (b) or (c) of section 1382 (relating to patronage dividends, per-unit retain allocations, and nonpatronage distributions), and

(ii) in the case of an organization described in subparagraph (A)(i)(II), the organization shall be treated as having manufactured, produced, grown, or extracted in whole or significant part any qualifying production property

marketed by the organization which its patrons have so manufactured, produced, grown, or extracted.

(4) Special rule for affiliated groups.

(A) In general. All members of an expanded affiliated group shall be treated as a single corporation for purposes of this section.

(B) Expanded affiliated group. For purposes of this section, the term "expanded affiliated group" means an affiliated group as defined in section 1504(a), determined—

(i) by substituting "50 percent" for "80 percent" each place it appears, and

(ii) without regard to paragraphs (2) and (4) of section 1504(b).

(C) Allocation of deduction. Except as provided in regulations, the deduction under subsection (a) shall be allocated among the members of the expanded affiliated group in proportion to each member's respective amount (if any) of qualified production activities income.

(5) Trade or business requirement.

This section shall be applied by only taking into account items which are attributable to the actual conduct of a trade or business.

(6) Coordination with minimum tax.

The deduction under this section shall be allowed for purposes of the tax imposed by section 55; except that for purposes of section 55, the deduction under subsection (a) shall be 9 percent of the lesser of—

(A) qualified production activities income (determined without regard to part IV of subchapter A), or

(B) alternative minimum taxable income (determined without regard to this section) for the taxable year.

In the case of an individual, subparagraph (B) shall be applied by substituting "adjusted gross income" for "alternative minimum taxable income". For purposes of the preceding sentence, adjusted gross income shall be determined in the same manner as provided in paragraph (2).

(7) Regulations.

The Secretary shall prescribe such regulations as are necessary to carry out the purposes of this section.

DEPARTMENT OF THE TREASURY
Office of Public Affairs

January 19, 2005

FACT SHEET:

Guidance on Section 199 – Income Attributable to Manufacturing Activities.

Overview:

On January 19, 2005, the Treasury Department and IRS issued a Notice under section 199 of the Internal Revenue Code regarding the deduction relating to income attributable to domestic production activities. The Notice provides interim guidance on which taxpayers may rely until proposed regulations are issued.

Background:

On October 22, 2004, President Bush signed into law the American Jobs Creation Act, which included a tax benefit for certain domestic production activities.

When is the provision effective?

The provision is effective for taxable years beginning after December 31, 2004.

How is the deduction computed?

For 2005, the deduction equals three percent of the lesser of: (a) taxable income derived from a qualified production activity; or (b) taxable income, for the taxable year. However, the deduction for a taxable year is limited to 50 percent of the W-2 wages paid by the taxpayer during the calendar year that ends in such taxable year. In 2010, when the deduction is fully phased-in, the three percent rate will have increased to nine percent.

What constitutes a “qualified production activity?”

The following activities are qualified production activities:

- The manufacture, production, growth, or extraction in whole or significant part in the United States of tangible personal property (e.g., clothing, goods, and food), software development, or music recordings;
- Film production (with exclusions provided in the statute), provided at least 50 percent of the total compensation relating to the production of the film is compensation for specified production services performed in the United States;
- Production of electricity, natural gas, or water in the United States;
- Construction or substantial renovation of real property in the United States including residential and commercial buildings and infrastructure such as roads, power lines, water systems, and communications facilities; or
- Engineering and architectural services performed in the United States and relating to construction of real property.

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How is taxable income derived from the manufacture, production, growth, or extraction of tangible personal property determined?

Gross receipts derived from a lease, rental, license, sale, exchange, or other disposition of tangible personal property manufactured, produced, grown, or extracted by the taxpayer in whole or in significant part within the United States are reduced by allocable costs and deductions.

What constitutes "in significant part"?

Property will be treated as manufactured by the taxpayer "in significant part" if:

- based on all of the taxpayer's facts and circumstances, the manufacturing, production, growth, or extraction activity performed by the taxpayer in the United States is substantial in nature; or
- the labor and overhead costs incurred by the taxpayer in the United States for the manufacture, production, growth, and extraction of the property are at least twenty percent of the taxpayer's total cost for the property.

For example, assume that a taxpayer purchases a small motor and various parts and materials for \$75 and incurs \$25 in labor costs at its factory in the United States to fabricate a plastic car body from the materials and to assemble a toy car. The taxpayer also incurs packaging, selling and other costs of \$2 and sells the toy car in 2005 for \$112. The toy car will be treated as manufactured by the taxpayer "in significant part" because the taxpayer's labor costs are more than twenty percent of the taxpayer's total cost for the toy car ($\$25 / (\$25 + \$75) = 25\%$). The taxpayer's domestic production activities deduction will be three percent of the taxpayer's \$10 profit on the toy car or 30¢ ($3\% * (\$112 - \$75 - \$25 - \$2)$). If the sale occurred in 2010, when the deduction is fully phased in, the deduction would be nine percent of the taxpayer's \$10 profit on the car or 90¢ ($9\% * (\$112 - \$75 - \$25 - \$2)$).

The domestic production activities deduction provides a tax savings on profits from production activities in the United States. If a taxpayer has satisfied the "significant part" test and the other requirements for the deduction, the deduction is a portion of the taxpayer's profits from domestic production and increases as those profits increase.

Are packaging, design, and development activities taken into account in applying the "significant part" test for tangible personal property?

Packaging, repackaging, labeling, and minor assembly operations are not taken into account for purposes of the "significant part" test. Thus, a taxpayer cannot qualify for the domestic production activities deduction if the taxpayer's only activities in the United States are packaging and labeling property produced outside the United States. Design and development activities also do not constitute manufacturing activities for purposes of the "significant part" test for tangible personal property because these activities produce an intangible asset (the design) rather than tangible personal property.

Is a contract manufacturer eligible for the deduction?

If one taxpayer performs manufacturing activities for another taxpayer, only the taxpayer with the benefits and burdens of ownership of the tangible personal property during the

manufacturing process will be treated as the manufacturer. As a result, only one taxpayer will be entitled to the deduction with respect to a manufacturing activity performed with respect to an item of tangible personal property.

Are there any safe harbor or de minimis rules?

Several safe harbor and de minimis rules will reduce computational and recordkeeping burdens, including:

- Simplified formulas to assist small taxpayers in determining taxable income from qualifying activities;
- De minimis rules to avoid the difficulty of making revenue and expense allocations as a result of small amounts of income from non-qualifying activities; and
- Simplified formulas for determining a taxpayer's W-2 wages.

What construction activities qualify for the deduction?

Qualifying activities include construction and substantial renovation of real property, including residential and commercial buildings and infrastructure such as roads, power lines, water systems, and communications facilities.

The statute does not provide that qualifying gross receipts for construction activities must be derived from a lease, rental, license, sale, exchange, or other disposition of the property. As a result, a taxpayer engaged in construction activities may qualify for the deduction even if the taxpayer does not have the benefits and burdens of ownership of the property being constructed. Therefore, more than one taxpayer may be regarded as constructing real property with respect to the same activity and the same construction project. For example, a general contractor and a subcontractor may both be engaged in construction activities with respect to the installation of a roof on a new building. Each taxpayer's benefit will be a percentage of its profit on its work with respect to the installation of the roof.

Gross receipts derived from the rental of real property that the taxpayer constructs are not derived from construction, but rather are income for the use or forbearance of the property. As a result, rental income for real property is not eligible for the qualified production activities deduction. Gain on the later sale of the property may qualify for the deduction if all other requirements are satisfied.

Does the preparation of food and beverages qualify for the deduction?

Food and beverages prepared at a retail establishment do not qualify for the deduction. A retail establishment is real property used in the trade or business of selling food or beverages to the public if retail sales occur at the facility. For example, a restaurant at which food and beverages are prepared, sold, and served to customers would be a retail establishment. However, the Treasury Department and IRS recognize that some retail establishments prepare food and beverages for both wholesale and retail sale. As a result, the Notice provides that even if a taxpayer's facility is a retail establishment, food or beverages prepared at the facility and sold at wholesale are not considered prepared at a

retail establishment and the taxable income related to the wholesale transactions is therefore eligible for the deduction.

How does a taxpayer compute W-2 wages for purposes of the wage limitation?

There are three alternative methods for computing W-2 wages. The first method permits a taxpayer to use the lesser of the W-2 wages reported in Box 1 or Box 5 of Forms W-2. Alternatively, there are two methods that, although more complex, provide a more precise determination of W-2 wages. The Notice provides that the W-2 wages are those wages of common law employees of the taxpayer.

What income derived from computer software is eligible for the deduction?

In general, income from a lease, rental, license, sale, exchange, or other disposition of software developed in the United States qualifies for the deduction, regardless of whether the customer purchases the software off the shelf or takes delivery of the software by downloading the software from the Internet. Computer software is not limited to software for computers and includes, for example, video game software. However, subject to certain de minimis rules, the following income does not qualify for the deduction because the income is attributable to the provision of a service and is not derived from a lease, rental, license, sale, exchange, or other disposition of the software:

- Fees for on-line use of software;
- Fees for customer support with respect to computer software;
- On-line services;
- Fees for telephone services provided in part through use of software;
- Fees for playing computer games on-line; and
- Provider-controlled online access services.

How does a partnership or S corporation compute the section 199 deduction?

The deduction attributable to the qualifying production activities of a partnership or S corporation (pass-through entity) is determined at the partner or shareholder (partner) level. As a result, each partner must compute its deduction separately. In general, each partner is allocated its share of items (including items of income, gain, loss, and deduction) allocable or attributable to qualifying production activities of the pass-through entity, along with any other items of income, gain, loss, deduction or credit of the pass-through entity. The partner must aggregate its share of the items allocable or attributable to the pass-through entity's qualified production activities, any expenses incurred by the partner directly that are allocable to the pass-through entity's qualified production activities, and items allocable or attributable to the partner's other qualified production activities to determine its qualified production activities deduction for the taxable year. Simplifying rules are provided for certain small partnerships.

How does a taxpayer allocate cost of goods sold and other deductions to qualifying production activities?

If a taxpayer cannot specifically identify the cost of goods sold, the taxpayer may use a reasonable method to determine the cost of goods sold related to the taxpayer's qualifying production activities. If the taxpayer uses a method to determine the allocable

portion of its gross receipts derived from qualifying production activities, the taxpayer must use the same method for purposes of determining the allocable cost of goods sold.

Two methods are provided for allocating deductions (other than cost of goods sold) to qualified production activities:

- Method 1, which is available to all taxpayers and generally follows existing rules applicable to taxpayers required to determine taxable income from within and outside the United States; and
- Method 2, which is available to taxpayers with average annual gross receipts (over the three prior years) of \$25,000,000 or less, provides a simplified formula that allocates deductions based on the ratio of the taxpayer's receipts derived from qualifying production activities as compared to the taxpayer's receipts from all sources.

Lastly, the Notice provides a third method for small taxpayers that allocates both cost of goods sold and all other deductions based on the same ratio applicable to Method 2. This third method is available to taxpayers with average annual gross receipts of \$5,000,000 or less and certain other small taxpayers permitted to use the cash method of accounting.

Will the Treasury Department and the IRS issue additional guidance regarding the deduction?

The Treasury Department and IRS anticipate that forthcoming proposed regulations will incorporate the rules set forth in the Notice. The Treasury Department and IRS request comments on the rules contained in the Notice and any additional guidance that should be provided in the regulations. Written comments must be received on or before March 31, 2005.

**TAX EFFECTS OF IRC CODE SECTION 199
AND HOUSE BILL 1108**

Assumptions:

Taxpayer does 100% of its business in ND (i.e., no apportionment)
 Federal taxable income (FTI) & ND taxable income both equal \$1,000,000
 Taxpayer's net income equals FTI and is all eligible for the Section 199 deduction
 Section 199 deduction then equals \$30,000 (\$1,000,000 times 3%)
 FTI then equals \$970,000

Had Section 199 not been enacted:

Federal Income Tax	\$340,000	(\$113,900 plus 34% of the amount over \$335,000)
North Dakota Income Tax	\$69,495	(\$1,595 plus 7% of the amount over \$30,000)
Total	<u>\$409,495</u>	

2005 Tax Scenarios

1) Taxpayer is NOT required to add back the Section 199 deduction for ND

		Tax Savings
Federal Tax	\$329,800	\$10,200
North Dakota Income Tax	<u>\$67,395</u>	\$2,100
Total	<u>\$397,195</u>	\$12,300

2) Taxpayer is required to addback the Section 199 deduction for ND (i.e., HB 1108)

		Tax Savings
Federal Tax	\$329,800	\$10,200
North Dakota Income Tax	<u>\$69,495</u>	\$0
Total	<u>\$399,295</u>	\$10,200

**3) Taxpayer is required to addback the Section 199 deduction for ND,
but ND rates are reduced .005% (i.e., top rate is 6.5%)**

		Tax Savings
Federal Tax	\$329,800	\$10,200
North Dakota Income Tax	<u>\$64,505</u>	\$4,990
Total	<u>\$394,305</u>	\$15,190



WICK CLAYBURGH
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<http://www.ndtaxdepartment.com>

HB1108

Memorandum

To: Chairman Urlacher
From: Kathryn L. Strombeck, Research Analyst
Date: March 9, 2005
Subject: Reduction in Corporation Income Tax Rates

A proposal to drop all existing corporate income tax rates by one-half percent is estimated to reduce state general fund revenues by -\$2.3 million per year, or -\$4.6 million for the 2005-07 biennium. If the top rate was reduced from 7% to 6.5%, leaving all other rates at the current level, the fiscal impact is estimated to be -\$2 million per year, or -\$4 million for the 2005-07 biennium.

Please contact Commissioner Clayburgh or me if you have any questions or comments. My phone number is 328-3402.