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ROLL NUMBER

DESCRIPTION

2045

2005 SENATE FINANCE AND TAXATION

SB 2045

2005 SENATE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. SB 2045

Senate Finance and Taxation Committee

☐ Conference Committee

Hearing Date January 11, 2005

Tape Number	Side A	Side B	Meter #
# 1	X		5.0 - 16.5
Committee Clerk Signature Sharon Renfrow			

Minutes: All committee members present.

SEN. URLACHER: Called the meeting to order and opened the hearing on SB 2045.

JOHN WALSTAD: of Legislative Council appeared neutral and to explain the bill and gave a handout of the portion of the interim tax committees report that is relevant to this bill draft, stating a lot of what you are seeing is the same language with regard to the tax haven issue. Mr. Bucks described to the interim committee a number of ways that corporations are aggressively trying to avoid (legally avoid) not evade, but avoid paying state income taxes and one of those methods is to create layers of pass through entities, sort of like laundering money legally for income tax purposes. Running money through a bunch of different entities to spread that income to some other location and one of the problems that exist is that when a pass through entity exists and distributes income, that income may go from ND all over the world. The problem with that is that those recipients all over the world have a ND income tax liability from receiving that ND source income but it becomes very difficult to track them down and collect that tax. What this bill does is give those pass through entities an option if they are distributing ND source income, they are optioned to comply with this is; to file a composite income tax return on behalf of those nonresident members and pay tax at the highest marginal rate for what we used to call our short form or 2) to withhold ND income tax at that high short form rate on payments that they make to those out of state entities. Its a compliance provision that is intended to reduce some of the opportunity to avoid validly employed ND income taxes and to avoid having to force the Tax Commissioner to track down those people all over the world.

SEN. URLACHER: So those funds aren't coming back to us?

ANSWER: some of those tax payers do file a ND return and pay the tax as they should, some don't or some don't know they should be doing it

SEN. WARDNER: So what happens here is they withhold at the highest level and remit to State Tax Dept. If the individual entity feels they have a refund coming to get it back. And is there any other burden on the company that is doing the withholding or extra work?

ANSWER: Yes, and feels it may create a little more accounting work for them but doesn't know how big a burden that will be.

JOE BECKER: ND Tax Dept. Noted that the companies operating in ND it is possible that they have employees here who are already in a withholding mode so perhaps it an additional task for them. If they don't have employees here, they may not bee- withholding and this would be a requirement for them.

SEN. COOK: If I was an individual living in SD and a recipient of dollars from ND, does ND have the same right to come to me in SD , what jurisdiction do you have to go down there and recover those.

ANSWER: our jurisdiction is based on the fact that they have income that is source in this state, they have contact sufficient for us to require them to file. Generally that means the income is either coming from their own personal services they performed in the state or could be from property located in the state or business operation of some sort in the state. So that gives us the jurisdiction.

SEN. COOK: so I'm clear, the fact that they do not live in the state does not in any way limit your jurisdiction.

ANSWER: That's correct.

SEN. BERCIER: noted there is no fiscal note, so the state is not losing any money, it would basically speed up the collection.

ANSWER: correct.

JOE BECKER: noted as far as the fiscal note goes, it is presuming that we have companies that are operating here that are in fact filing their own partnership or s-corporate firms in that where we are going to require them now to make sure that their owners who may live outside the state are filing and paying with us. So if there are some entities that we don't know about, then I've got the compliance problem for us already.

SEN. WARDNER: question on filing a composite return and if that means they withhold then at the end of the year and file a composite return for those people.

JOE BECKER: The central concept of the bill is the withholding concept that we've been talking about, it did get rolled in with our existing composite filing statute. And what it is saying to the entity is "we are asking you to withhold from your nonresident individual members, if you don't like that you can go down our composite filing road". What that means is where it passed through entity with nonresident owners, that entity can file a single individual tax return which we call a composite and you can roll all of your individual nonresident members into it and that saves them a lot of administrative and other costs in filing with our state and multiple states for any number of members. So basically we get one individual return for any number of their members and that satisfies all those members individual income tax filing and payment requirements. Under that composite routine they do have to pay at the highest rate though, that's the trade off.

NO OPPOSITION or further testimony. The hearing was closed.

SEN. TOLLEFSON made a motion for DO PASS, seconded by Sen. Wardner. No further discussion.

SEN. URLACHER: noted that Sen. Cook was out testifying at another hearing and will be allowed to give his vote on the bill when he returns if he decides to vote.

Roll call vote taken. 5-0-1, roll call vote left open for Sen. Cook. Sen. Tollefson will carry the bill.

Sen. Cook cast his yes vote which made the vote unanimous of 6-0-0 for DO PASS.

FISCAL NOTE

Requested by Legislative Council
12/17/2004

Bill/Resolution No.: SB 2045

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.*

SB 2045 allows pass-through entities to file a composite return on behalf of its nonresident shareholders, and requires income tax withholding for certain nonresident shareholders. While the bill does not alter the tax liability of the nonresident shareholders, enactment of SB 2045 may result in a speed up the payment of the liability. This may result in a slight positive fiscal impact in an amount that 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	**Agency:**	Office of Tax Commissioner
Phone Number:	328-3402	**Date Prepared:**	01/10/2005

Date: 1-11-05
Roll Call Vote #: 1

2005 SENATE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. *SB 2045*

Senate **Finance and Taxation** Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number

Action Taken Do Pass

Motion Made By Sen. Tollefson Seconded By Sen. Wardner

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

Total (Yes) 6 No 0

Absent 0

Floor Assignment Sen. Tollefson

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

REPORT OF STANDING COMMITTEE

SB 2045: Finance and Taxation Committee (Sen. Urlacher, Chairman) recommends **DO PASS** (6 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING). SB 2045 was placed on the Eleventh order on the calendar.

2005 HOUSE FINANCE AND TAXATION

SB 2045

2005 HOUSE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. **SB 2045**

House Finance and Taxation Committee

☐ Conference Committee

Hearing Date **February 14, 2005**

Tape Number	Side A	Side B	Meter #
1	**X**		**1.1**
Committee Clerk Signature	Janice Stein		

Minutes:

REP. WES BELTER, CHAIRMAN Called the committee hearing to order.

JOHN WALSTAD, LEGISLATIVE COUNCIL Introduced the bill. See attached copy of interium committee report. The report gives the reasons for having a corporate income tax and examining the decline in corporate income tax revenue. Mr. Walstad went on to explain how this bill would work.

REP. BELTER Last session, we reduced the corporate tax but less companies either used the water's edge formula or other tax reasons, does this bill affect that?

JOHN WALSTAD This bill does not affect that, under the law that existed prior to last session, a corporate entity electing the water's edge method had to give up something, and the something they gave up, was their federal income tax deduction in North Dakota. That was a significant deduction. Last session, that deduction was eliminated for corporations, and the rates were reduced to be approximately revenue neutral. We peeled about three percentage points off the corporate income tax rate, and eliminated that deduction. What a water's edge entity now gives up, is that lower rate.

REP. SCHMIDT What if that company you are talking about is in Minnesota, did we lose $585,000, because that is what the fiscal note is, because they were in Minnesota, or out of the country, Cayman Islands, for instance?

JOHN WALSTAD The fiscal note you are looking at is for the next bill. The fiscal note on this bill, is probably positive, but it can't be estimated. These entities in this bill, could be domiciled any place, but if they have income in North Dakota, and that income is being paid out to North Dakota nonresidents, that is where the compliance problem comes in.

REP. IVERSON Related to Paragraph 3, line 16, page 2, talks about the withholding income tax at the highest rate for the individual, what if those individuals aren't taxed at the highest rate, what happens to the difference of that money?

JOHN WALSTAD They will be withheld at the highest rate, at the end of the tax year, they will have to file a North Dakota income tax return, and at that point, it will be determined what rate they actually will be taxed, if it is a lower rate, then the rate they withheld, they will get a refund, to bring them down to what their actual tax rate would be.

REP. CONRAD Is this a model bill multi state is putting out?

JOHN WALSTAD That is correct. This is what the multi state tax commission has concluded will help states to deal with these situations where that income is being thrown all over the world and then the state has to try and track it down.

With no further testimony, the hearing was closed.

COMMITTEE ACTION

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

REP. CONRAD Second the motion. **Motion carried.**

13 yes 0 no 1 absent

REP. WRANGHAM Was given the floor assignment.

Date: 2-14-05
Roll Call Vote #: 1

2005 HOUSE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. SB 2045

House FINANCE & TAXATION Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number

Action Taken Do Pass

Motion Made By Rep. Nicholas Seconded By Rep. Conrad

Representatives	Yes	No	Representatives	Yes	No
BELTER, WES, CHAIRMAN	✓				
DROVDAL, DAVID, V-CHAIR	✓				
BRANDENBURG, MICHAEL	✓				
CONRAD, KARI	✓				
FROELICH, ROD	A				
GRANDE, BETTE	✓				
HEADLAND, CRAIG	✓				
IVERSON, RONALD	✓				
KELSH, SCOT	✓				
NICHOLAS, EUGENE	✓				
OWENS, MARK	✓				
SCHMIDT, ARLO	✓				
WEILER, DAVE	✓				
WRANGHAM, DWIGHT	✓				

Total (Yes) 13 No 0

Absent 1

Floor Assignment Rep. Wrangham

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

REPORT OF STANDING COMMITTEE

SB 2045: Finance and Taxation Committee (Rep. Belter, Chairman) recommends **DO PASS** (13 YEAS, 0 NAYS, 1 ABSENT AND NOT VOTING). SB 2045 was placed on the Fourteenth order on the calendar.

2005 TESTIMONY

SB 2045

SB 2045
John Walstad

Committee Consideration - Corporate Income Tax

Revenue Decreases

The committee examined reasons for the nationwide decline in corporate income tax revenues. One factor is slowing of the national economy in recent years. North Dakota corporate income tax collections are reduced because of recent federal corporate income tax reductions, including allowing accelerated depreciation and enhanced opportunities to carry back net operating losses. Corporations choose filing methods that will reduce overall tax liability, including electing to file under the water's edge filing method. In North Dakota the number of corporations choosing the water's edge filing election has increased from 30 to 276 in 13 years. In North Dakota numerous corporations have become eligible for taxation as a financial institution. Financial institution taxes are substantially equivalent in terms of tax liability but five-sevenths of financial institutions' taxes are distributed to counties, so there is a fiscal impact to the state general fund. A growing drain on corporate income tax revenues is the fact that businesses may organize in other business forms such as limited liability companies or partnerships, which allows an entity to avoid corporate income taxes. Another factor receiving nationwide scrutiny is the effect of corporate income tax shelters.

The Tax Department conducts audits on approximately 5 to 6 percent of corporate income tax returns. The focus of audit activity is generally on more complex returns of corporations doing business across state and national boundaries.

The committee examined detailed information on the effect of passthrough entities on corporate income tax revenues. Examples of passthrough entities include subchapter S corporations, partnerships, limited liability companies, limited liability partnerships, and master limited partnerships. The income or loss of these entities is passed through directly to owners of the entities and is not subject to corporate income taxes. There is a tax incentive to avoid corporate income taxes by choosing to do business as a passthrough entity rather than as a corporation. Over the past 10 years, passthrough entity filings in North Dakota have steadily increased while corporate filings have declined.

The Multistate Tax Commission has a working group considering issues relating to passthrough entities. The working group recommended legislation to states to require a passthrough entity to either file a composite income tax return or withhold income tax on the share of income of the entity distributed to each nonresident member. Nonresident members are subject to North Dakota income taxes on passthrough entity income earned in North Dakota, but there is a compliance problem under current law to identify nonresident members and collect taxes due.

Multistate Tax Commission

The executive director of the Multistate Tax Commission addressed the committee regarding corporate income tax issues. It was stated that the creation and continued existence of state corporate income taxes is due to weaknesses of other tax types in addressing the corporate business form. A tax on income was viewed as fairer than other tax types because it taxes knowledge, patents, and other intangibles. It would be impractical to tax corporate earnings at the shareholder level because shareholders may reside in other states or countries or may be other corporations. The rationale for taxing corporate business activity is that states provide services to benefit businesses. The corporate income tax serves as a necessary companion to individual income taxes so income transfers to corporations cannot be used to avoid individual income taxes. Corporate income taxes are better suited than other tax types to fairly tax the new economy.

and distorts business investment choices. Too many individuals and corporations are able to avoid corporate income taxes. The corporate income tax may be viewed as a double layer of taxation because income taxed at the corporate level is again subject to taxation at the individual level after distribution to shareholders.

It is important for states to observe principles to promote equity and make corporate income taxes work in practice. Income must be fully and fairly reported in reasonable relation to where that income is earned. The means of determining where multistate entity income is earned should be consistent among states.

States must recognize corporate income tax realities. Corporate income taxes have declined as a percentage of revenues for all states from approximately 9.7 percent in 1980 to 4.9 percent in 2002. Effective corporate income tax rates have declined from approximately 8.96 percent in the 1980s to 5.92 percent in 2001. A variety of factors have contributed to the decline in state corporate income tax revenues as a share of state tax collections. Changes in federal corporate income tax laws affect states due to the piggyback nature of state corporate income taxes on the federal corporate income tax structure. Federal preemption of state authority to tax some activities has caused some companies to restructure to take advantage of federal law protection. There has clearly been an increase in aggressive tax planning by corporations aimed at reducing state corporate income taxes. State policy choices on business incentives and economic development have reduced corporate income taxes for qualifying corporations. There has been a substantial shift to forms other than corporations for doing business, such as limited liability companies and similar business structures, including the creation of layers of corporate and noncorporate entities to reduce or avoid the impact of corporate income taxes.

The Multistate Tax Commission conducted a tax shelter study as an attempt to measure the degree to which income reporting for corporations does not reflect the place income was earned. One of the conclusions of the study was an estimate that states lost $8 billion to $12 billion in 2001 due to two or three categories of tax shelters. This represents a loss of approximately one-third of total state corporate income tax collections. It appears the primary method of sheltering corporate income is shifting income to a nontaxable location or tax haven or using other methods to avoid federal corporate income taxes.

It was recommended that combined reporting, including requiring information on tax haven activities, would improve corporate income tax administration. Montana enacted a 2003 law requiring that a water's edge report must include information on tax havens. It was recommended that states develop nexus rules on doing business which are consistent with how corporate income is apportioned. Uniformity among states would reduce incentives to shift income. A concerted effort should be made to curb tax sheltering and income shifting at the state and federal levels.

The Multistate Tax Commission working group also investigated the use of passthrough entities to avoid corporate income taxes. Traditional corporate forms of doing business which are subject to corporate income taxes are rapidly declining as a percentage of business organizations and as a percentage of business income. It has become clear that states need to take action to address growing use of passthrough entities. States need effective and simplified systems of ensuring proper reporting of passthrough entity income, which requires composite return and withholding requirements. It is necessary for state tax systems to address tax sheltering that employs layers of passthrough entities or single-member limited liability companies within corporations.

The committee recommends Senate Bill No. 2045 to require passthrough entities, such as S corporations, partnerships, trusts, limited liability companies, and limited liability partnerships, to choose between the options of filing a combined report in North Dakota or withholding North Dakota income taxes on distributions to nonresident members of the passthrough entity. The estimated fiscal impact of the bill is an increase in general fund revenue of approximately $500,000 per biennium.