2013 HOUSE FINANCE AND TAXATION

HB 1105

2013 HOUSE STANDING COMMITTEE MINUTES

House Finance and Taxation Committee
Fort Totten Room, State Capitol

HB 1105
January 15, 2013
Job #17232

☐ Conference Committee

Committee Clerk Signature Mary Brucker

Explanation or reason for introduction of bill/resolution:

A Bill relating to the expiration of federal income tax treatment of the long-term capital gain and qualified dividend income tax exclusion.

Minutes:

Attached testimony #1, 2, 3

Chairman Belter: Opened hearing on HB 1105.

Vice Chairman Headland: Introduced bill. In North Dakota currently our qualified dividends are taxed with a rate reduction of 30%. That is going to carry forward because of the compromise at the federal level in the fiscal cliff negotiations where they decided not to change the way the dividends are taxed at the federal level and tax them as ordinary income. I think we still should pass this bill and I think it is needed because moving forward we have no idea what the federal government will decide to do with dividends. In the past our president has stated he would like to see dividends taxed as ordinary income. I think the federal government is in need and searching for revenues. If this bill were to pass and the situation would arise where that would become reality our dividends tax structure in North Dakota would change. It would change from a 30% reduction to in this bill a 20% reduction but it would be broadened to all dividends, not only qualified dividends.

Chairman Belter: Further testimony?

Joseph Becker, North Dakota Office of State Tax Commissioner: See attached testimony #1.

Chairman Belter: Further testimony in support?

Carlee McLeod, President of the Utility Shareholders of North Dakota: See attached testimony #2.

Dr. Bruce McCollom: See attached testimony #3 in support.

Chairman Belter: Further testimony to 1105? Any opposition to 1105? Any neutral testimony to 1105? If not we will close the hearing on HB 1105.

2013 HOUSE STANDING COMMITTEE MINUTES

House Finance and Taxation Committee
Fort Totten Room, State Capitol

HB 1105
January 23, 2013
Job #17613
☐ Conference Committee

Committee Clerk Signature Mary Brucker

Explanation or reason for introduction of bill/resolution:

A Bill relating to the expiration of federal income tax treatment of the long-term capital gain and qualified dividend income tax exclusion.

Minutes:

Attached amendments #1

Vice Chairman Headland: Let's take a look at HB 1105.

Representative Dockter: Made a motion for DO PASS.

Representative Trottier: SECONDED.

Representative Marie Strinden: Can someone give me a real quick rundown on this?

Vice Chairman Headland: This is a bill that is going to allow the state to centrally reduce the rates of their qualified dividend if the federal government decides to tax as ordinary income. It's a change that may not be needed with current federal law but if in midstream when we're not in session they change we would have legislation in place where citizens would not receive that tax increase.

ROLL CALL VOTE: 12 YES 1 NO 1 ABSENT: MOTION CARRIED FOR DO PASS. Representative Owens will carry HB 1105.

FISCAL NOTE
Requested by Legislative Council
12/24/2012

Bill/Resolution No.: HB 1105

1 A. **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.*

	2011-2013 Biennium		2013-2015 Biennium		2015-2017 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues						
Expenditures						
Appropriations						

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

	2011-2013 Biennium	2013-2015 Biennium	2015-2017 Biennium
Counties			
Cities			
School Districts			
Townships			

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

HB 1105 will provide for the continuance of a state dividend exclusion for individuals in a tax year in which the special tax treatment of qualified dividends under federal tax law is repealed. Currently, the state exclusion is dependent on the special treatment under federal tax law.

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

Section 1 of HB 1105 amends the provision allowing North Dakota resident individuals an income tax deduction equal to 30% of qualified dividends as defined under federal income tax law. Under federal law, qualified dividends generally consist of dividends from U.S. domestic corporations and certain foreign corporations, which are taxed at the lower tax rate applicable to a long-term capital gain. The special treatment of qualified dividends under federal law was set to expire at the end of 2012. HB 1105 was introduced to preserve the state dividend exclusion in the event Congress did not extend the special treatment of qualified dividends beyond 2012. However, to address administrative concerns associated with the proper separation of qualified dividends from nonqualified dividends for state purposes only, the 30% exclusion rate would be reduced to 20% but would be allowed against all taxable dividends reported for federal income tax purposes. With the indefinite extension of the special tax treatment of qualified dividends under federal tax law by the recently enacted American Taxpayer Relief Act, the current state exclusion equal to 30% of qualified dividends also is indefinitely extended. Therefore, if enacted, HB 1105 is expected to have no fiscal impact for the 2013-15 biennium. Note: If enacted, and if the special tax treatment of qualified dividends under federal tax law is repealed or made ineffective for any tax year, the 20% exclusion calculation provided in HB 1105 is expected to result in an exclusion amount for all taxpayers that is estimated to be similar to that under current law. There will be variances among individual taxpayers.

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

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

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

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

Name: Kathryn L. Strombeck
Agency: Office of Tax Commissioner
Telephone: 328-3402
Date Prepared: 01/03/2013

Date: 1-23-13
Roll Call Vote #: 1

2013 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 1105

House Finance and Taxation Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number ______

Action Taken: ☒ Do Pass ☐ Do Not Pass ☐ Amended ☐ Adopt Amendment

☐ Rerefer to Appropriations ☐ Reconsider

Motion Made By R. Dockter Seconded By R. Trottier

Representatives	Yes	No	Representatives	Yes	No
Chairman Wesley Belter	—		Rep. Scot Kelsh	✓	
Vice Chairman Craig Headland	✓		Rep. Steve Zaiser		✓
Rep. Matthew Klein	✓		Rep. Jessica Haak	✓	
Rep. David Drovdal	✓		Rep. Marie Strinden	✓	
Rep. Glen Froseth	✓				
Rep. Mark Owens	✓				
Rep. Patrick Hatlestad	✓				
Rep. Wayne Trottier	✓				
Rep. Jason Dockter	✓				
Rep. Jim Schmidt	✓				

Total (Yes) 12 No 1

Absent ~~0~~ 1

Floor Assignment R. Owens

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

REPORT OF STANDING COMMITTEE

HB 1105: Finance and Taxation Committee (Rep. Belter, Chairman) recommends **DO PASS** (12 YEAS, 1 NAYS, 1 ABSENT AND NOT VOTING). HB 1105 was placed on the Eleventh order on the calendar.

2013 SENATE FINANCE AND TAXATION

HB 1105

2013 SENATE STANDING COMMITTEE MINUTES

Senate Finance and Taxation Committee
Lewis and Clark Room, State Capitol

HB 1105
3/18/2013
Job Number 20066

☐ Conference Committee

Committee Clerk Signature Angela Rittenhuis

Explanation or reason for introduction of bill/resolution:

A BILL for an Act to amend and reenact subdivision d of subsection 2 of section 57-38-30.3 of the North Dakota Century Code, relating to the expiration of federal income tax treatment of the long-term capital gain and qualified dividend income tax exclusion; and to provide an effective date.

Minutes:

Testimony Attached

Chairman Cook opened the hearing on HB 1105.

Joe Becker, Tax Department, gave some background and reasons for HB 1105.

Senator Oehlke - The Feds decided not to do anything now, how soon could that change?

Joe Becker - How soon could congress change this? The way things are going, I'm not sure.

Senator Oehlke - It could be before we meet again in 2 years though, right?

Joe Becker - Yes it could.

Chairman Cook - I assume then subsection 2 of the bill on page 1 is amendments that the House put on?

Joe Becker - The bill is as it was introduced.

Chairman Cook - We don't have to change it to make it contingent on congress changing something?

Joe Becker - As the bill is drafted it's going to leave our law as it is, if congress does nothing to change their treatment of qualified dividends then this will have no effect. If congress would make a change and treat qualified dividends as ordinary income, basically taxing it like wages, then this would kick in, in that particular year.

Chairman Cook - And the reason for that is in subsection 2.

Joe Becker - Line 21 is where the language begins that basically is stating that if congress makes a move to tax qualified dividends as regular income then the exclusion rate for state purposes would drop to 20% but we would apply to all taxable dividends.

Senator Miller - The 20% number, where did that come from?

Joe Becker - That number is our estimate of what the exclusion rate would need to be approximately because the numbers move on us, approximately what would produce the same total exclusion when applied to total dividends as opposed to current law which is allowing 30% against just qualified dividends.

Senator Miller - What are those differences in dividends?

Joe Becker - A qualified dividend is going to make up about 75-80% of old dividends that are received. Dividends that don't qualify would include such things as patronage dividends, certain foreign dividends, money market type fund payouts, and some other real technical items.

Senator Triplett - Was there any thought given when you were drafting this bill instead of changing up from 30% to 20% of all dividends instead just defining qualified dividends for state purposes and have it track the current definition of qualified dividends for federal purposes?

Joe Becker - Yes and that is the reason we went the direction we did with the bill. The concern we have is identifying qualified dividends. (9:27)

Senator Dotzenrod - The way this is organized you have subparagraph d and under that 1 and 2. Paragraph d on line 8 says reduce by 30% of. So there is a 30% number then that applies to 1 and 2. So that 30% would apply to whatever is in sub 2. It appears to me.

Joe Becker - The current law is stating there is a 30% exclusion for the first item that you mentioned in lines 9-13 which is dealing just with long term capital gains. Then lines 14-24 it would be 30% in general on qualified dividends unless federal law changes and the qualified dividend or preferential treatment under federal law is taken away. Then the new 20% in the language there will take over and replace the 30%.

Senator Triplett - Don't you think then that it would make sense drafting wise that when you got to the if on line 21 that you would back that out of the sub 2? Otherwise I think Senator Dotzenrod might be right that it could be interpreted as 20% of 30%.

Joe Becker - I can certainly double check with Council but I think that if that if statement takes over it says that the reduction under this entire subdivision d which is using 30% at this current time will now change to 20% under that condition.

Senator Dotzenrod - I just think that it is a little bit odd to have line 8 nullified down somewhere in text further down. You get the impression reading it that well you've got d and anything under that 30% is going to apply.

Joe Becker - It is up to the committee in terms of how to proceed. In terms of the public's understanding of it, we wouldn't be left with the law, the forms would be revised to present this to them. If this change would take affect then what you will see on the tax return is there will be a 20% rate showing up there rather than the 30% so it wouldn't be hidden to the public in that sense.

Chairman Cook - I know it's up to this committee but we want to make sure that we all understand it the way you are and I think that is where the question comes from.

Joe Becker - I will visit with Council.

Carlee McLeod, Utility Shareholders of North Dakota - See attached testimony 2.

Chairman Cook closed the hearing on HB 1105.

2013 SENATE STANDING COMMITTEE MINUTES

Senate Finance and Taxation Committee
Lewis and Clark Room, State Capitol

HB 1105
4/5/2013
Job Number 20924

☐ Conference Committee

Committee Clerk Signature	Angela Rittmiller

Explanation or reason for introduction of bill/resolution:

A BILL for an Act to amend and reenact subdivision d of subsection 2 of section 57-38-30.3 of the North Dakota Century Code, relating to the expiration of federal income tax treatment of the long-term capital gain and qualified dividend income tax exclusion; and to provide an effective date.

Minutes:

Chairman Cook opened discussion on HB 1105.

Chairman Cook - We passed HB 1250 out. What HB 1105 is intended to do, first off it dealt with a change to the internal revenue code that is no longer needed.

Donnita Wald, Tax Department verified it is indeed no longer needed.

Chairman Cook explained that the fiscal note is much larger than intended.

Senator Burckhard - I'll move a **Do Not Pass**.

Seconded by **Senator Dotzenrod**.

Roll Call Vote 6-0-1

Carried by **Senator Burckhard**.

FISCAL NOTE
Requested by Legislative Council
12/24/2012

Bill/Resolution No.: HB 1105

1 A. **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.*

	2011-2013 Biennium		2013-2015 Biennium		2015-2017 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues						
Expenditures						
Appropriations						

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

	2011-2013 Biennium	2013-2015 Biennium	2015-2017 Biennium
Counties			
Cities			
School Districts			
Townships			

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

HB 1105 will provide for the continuance of a state dividend exclusion for individuals in a tax year in which the special tax treatment of qualified dividends under federal tax law is repealed. Currently, the state exclusion is dependent on the special treatment under federal tax law.

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

Section 1 of HB 1105 amends the provision allowing North Dakota resident individuals an income tax deduction equal to 30% of qualified dividends as defined under federal income tax law. Under federal law, qualified dividends generally consist of dividends from U.S. domestic corporations and certain foreign corporations, which are taxed at the lower tax rate applicable to a long-term capital gain. The special treatment of qualified dividends under federal law was set to expire at the end of 2012. HB 1105 was introduced to preserve the state dividend exclusion in the event Congress did not extend the special treatment of qualified dividends beyond 2012. However, to address administrative concerns associated with the proper separation of qualified dividends from nonqualified dividends for state purposes only, the 30% exclusion rate would be reduced to 20% but would be allowed against all taxable dividends reported for federal income tax purposes. With the indefinite extension of the special tax treatment of qualified dividends under federal tax law by the recently enacted American Taxpayer Relief Act, the current state exclusion equal to 30% of qualified dividends also is indefinitely extended. Therefore, if enacted, HB 1105 is expected to have no fiscal impact for the 2013-15 biennium. Note: If enacted, and if the special tax treatment of qualified dividends under federal tax law is repealed or made ineffective for any tax year, the 20% exclusion calculation provided in HB 1105 is expected to result in an exclusion amount for all taxpayers that is estimated to be similar to that under current law. There will be variances among individual taxpayers.

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

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

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

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

Name: Kathryn L. Strombeck

Agency: Office of Tax Commissioner

Telephone: 328-3402

Date Prepared: 01/03/2013

Date: 4-5-13
Roll Call Vote #: 1

2013 SENATE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 1105

Senate Finance & Taxation Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number ____________

Action Taken: ☐ Do Pass ☒ Do Not Pass ☐ Amended ☐ Adopt Amendment

☐ Rerefer to Appropriations ☐ Reconsider

Motion Made By Senator Burckhard Seconded By Senator Dotzenrod

Senators	Yes	No	Senator	Yes	No
Chariman Dwight Cook	X		Senator Jim Dotzenrod	X	
Vice Chairman Tom Campbell	X		Senator Connie Triplett	X	
Senator Joe Miller					
Senator Dave Oehlke	X				
Senator Randy Burckhard	X				

Total (Yes) 6 No 0

Absent 1

Floor Assignment Senator Burckhard

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

REPORT OF STANDING COMMITTEE

HB 1105: Finance and Taxation Committee (Sen. Cook, Chairman) recommends **DO NOT PASS** (6 YEAS, 0 NAYS, 1 ABSENT AND NOT VOTING). HB 1105 was placed on the Fourteenth order on the calendar.

2013 TESTIMONY

HB 1105

#1

Testimony—
House Finance and Taxation Committee
House Bill 1105

January 15, 2013

Prepared by Joseph Becker, Auditor III/Research Specialist
North Dakota Office of State Tax Commissioner
Phone: 328-3451; e-mail: jjbecker@nd.gov

Good morning, Chairman Belter and Members of the Committee:

Introduction

For the record, my name is Joseph Becker, and I'm here on behalf of the North Dakota Office of State Tax Commissioner (Tax Department).

House Bill 1105 is an individual income tax bill. It proposes to change the law allowing an individual to exclude 30 percent of qualified dividend income in calculating North Dakota taxable income.

Background

The qualified dividend exclusion was added to North Dakota tax law in 2009 in a bill sponsored by Representative Headland. It has its roots in federal income tax law that gives preferential tax treatment to qualified dividend income. Under federal law, qualified dividends are taxed at a rate that is lower than the tax rates applicable to other types income. For North Dakota purposes, an exclusion from income was adopted in lieu of a lower tax rate, and the federal definition of qualified dividends was adopted, to simplify the law as much as possible.

In general, qualified dividends are payments by domestic and certain foreign corporations out of current or accumulated earnings and profits to shareholders who hold the stock for a specified period of time.

Reason for bill

The special treatment of qualified dividend income under federal tax law is part of the Bush-era tax cuts that were set to expire at the end of 2012. Not knowing how Congress was going to act in this regard, the Tax Department drafted this bill in anticipation of a potential administrative problem that would present itself if the special treatment of qualified dividends under federal tax law expired.

The qualified dividend exclusion under North Dakota tax law is dependent on the definition of qualified dividends under federal tax law and, more importantly, the separate reporting of qualified dividends currently required under federal tax law. Expiration of the federal provisions covering qualified dividend reporting would have presented a problem for both taxpayers and the Tax Department with respect to proper identification of dividends eligible for the state exclusion.

The immediate concern and necessity for this bill no longer exist in light of the recent enactment of the passage of the American Tax Relief Act. The federal legislation effectively makes the special treatment of qualified dividends under federal tax law "permanent" until Congress acts to repeal it. Therefore, the Committee may choose to not move forward with any solution at this time and revisit it at a future legislative session should the issue reappear. Or, the Committee may choose to pass this bill to put into place the proposed mechanism that would take effect should Congress repeal the special treatment of qualified dividends at a future date.

Explanation of bill

If passed, this bill would not alter the current 30 percent exclusion for qualified dividends as long as federal tax law taxes qualified dividends at a tax rate that is lower than the regular tax rates applicable to ordinary income. However, in any tax year in which federal tax law taxes all dividends, qualified or unqualified, at the ordinary income tax rates, the exclusion rate under North Dakota tax law would decrease to 20 percent and apply to all dividend income.

The 20 percent exclusion rate was chosen because it is expected to yield an exclusion amount for all taxpayers that is estimated to be similar to the total amount excluded under current law. There will be variances among individual taxpayers, however, as the ratio of qualified to nonqualified dividends will differ from taxpayer to taxpayer, and from year to year.

Fiscal impact

This bill is expected to have no fiscal impact for the 2013-2015 biennium.

Conclusion

This bill originated with the Tax Department and therefore has the Tax Commissioner's favor. However, the Tax Commissioner would not have a concern if the Committee deems it unnecessary to move ahead with a solution at this time.

USND

Utility Shareholders of North Dakota

#2

House Bill 1105
House Finance and Tax
Testimony in Support
January 15, 2013

Chairman Belter, members of the committee, I am Carlee McLeod, President of the Utility Shareholders of North Dakota (USND), and I come before you to testify in support of this bill.

USND represents approximately 3,000 North Dakotans who own stock in one of three investor-owned utilities operating in North Dakota: Otter Tail, Xcel Energy and Montana Dakota Utilities. Each of these companies offers dividend paying stocks, so this bill directly affects my members. The majority of our membership is comprised of retirees who depend on their investment income as a part of their retirement budget. Their income is directly impacted by any changes in the structure by which dividends are taxed.

USND supports efforts to create fairness in taxation, and as such, we support efforts to minimize the tax burden resulting from dividend income tax. Over the past few years, USND has joined with other like entities to fight to keep taxes reasonable on the federal front. This bill, as written, gives North Dakotans some comfort that state dividend taxes will remain stable despite wrangling in D.C. We support this effort.

While we support this bill in its current form, we would also support action by the committee to expand on the exclusions currently allowed in state law. Taxation at the dividend level is often viewed as patently unfair by investors. When an individual investor pays tax on dividend income, that income has already been taxed at the corporate level. When the individual investor is taxed again on that same income, the net amount left in the individual's pocket is often less than 50%. As the state looks to reform certain tax policies in an effort to provide tax relief, we encourage the expansion of these exclusions as part of the overall relief package.

One of my members, Bruce McCollom, EnD, will provide testimony and suggestions regarding amendments. Dr. McCollom is an avid investor, who at 68 years of age is retired and living on his investment income. USND offers full support to Dr. McCollom's proposal, and we encourage your consideration.

Thank you.

#3

House Bill 1105
Testimony in Support
House Finance and Tax Committee
January 15, 2013

Chairman Belter, members of the committee, my name is Bruce McCollom and I stand before you today to support House Bill 1105. I understand that the bill is drafted to be revenue neutral, but as the legislature considers a variety of tax reform possibilities, I would encourage you to expand the exemption(s) in the interest of fairness in the taxation of income from savings and investments.

Fair tax treatment of investment income becomes increasingly important as fewer workers are covered by defined benefit retirement plans and must rely only on savings, investments and social security for retirement income. Unfair tax treatment discourages saving and investing.

The fairness issues are as follows:

1. Inflation - Part of total investment income; be it interest, dividends or capital gains; is not real income at all due to inflation. But income taxes in the US at the federal level and in ND are based on nominal $ income.

2. Double taxation of corporate income - Most corporations (domestic or foreign) pay taxes on profits. These after-tax profits are either distributed to shareholders who pay tax on the dividends (eventually even dividends paid into tax deferred retirement accounts are taxed again as ordinary income when withdrawn),

#3

or they are retained, and thus contribute to the enterprise value of the corporation and shareholders pay capital gains taxes if and when they sell their shares.

3. Triple taxation of dividends paid by many foreign corporations to shareholders- Dividend taxes are withheld in the country of origin and then taxed again by the US at the federal level and by ND. Foreign dividend taxes are paid even if the stock is held in tax deferred retirement accounts.

I support the bill in its current form because of the impact as explained in the fiscal note. However, I would ask your consideration of the following amendments:

1. Increase the 30% ND qualified dividend and long-term capital gains exclusions to 100% for up to the same taxable income levels as the 0% federal rate applies ($36,250 filing single & $72,500 filing joint in 2013). Increase the 30% exemptions to 50% on higher income levels. The impact of this is to bring the ND tax treatment of qualified dividends and long-term capital gains closer to the federal.

2. Allow an exclusion from ND taxable interest income equal to the erosion of principal purchasing power of the bond, bond mutual fund or certificate of deposit over its holding period, within the tax year, as determined by the ratio of the Treasury Inflation-Protected Securities reference Consumer Price Index numbers. Said numbers, for each calendar day, are published monthly by the US Treasury. Allow the exclusion, on a net basis, for all said interest income. If the exclusion would be larger than all ND taxable interest income, allow the remainder against ND taxable short-term and/or long-term capital gains.

Testimony—
Senate Finance and Taxation Committee
House Bill 1105

March 18, 2013

Prepared by Joseph Becker, Auditor III/Research Specialist
North Dakota Office of State Tax Commissioner
Phone: 328-3451; e-mail: jjbecker@nd.gov

Chairman Cook, Members of the Committee:

Introduction

For the record, my name is Joseph Becker, and I'm here on behalf of the North Dakota Office of State Tax Commissioner (Tax Department).

House Bill 1105 is an individual income tax bill. It proposes to change the law that allows an individual to exclude 30 percent of qualified dividends from North Dakota taxable income.

Background

North Dakota's qualified dividend exclusion has its roots in federal income tax law. Under federal law, qualified dividends are taxed in a similar manner as long-term capital gains, which are taxed at a rate that is lower than the tax rates on other types of income. For North Dakota purposes, an exclusion from income was adopted in lieu of a lower tax rate on qualified dividends, as defined under federal tax law.

Reason for bill

The federal preferential treatment accorded qualified dividends was added to federal law as part of the Bush-era tax cuts, which were set to expire at the end of 2012. Not knowing how Congress was going to act in this regard, the Tax Department drafted this bill to address a potential administrative problem had Congress allowed the special treatment to expire.

North Dakota law is dependent on federal law for the definition of qualified dividends and, more importantly, the special reporting requirements that identify qualified dividends. Expiration of the federal reporting rules would have presented a problem for both taxpayers and the Tax Department with respect to the ability to identify dividends eligible for the state exclusion.

The immediate concern and necessity for this bill no longer exist in light of the passage of the American Tax Relief Act by Congress earlier this year. The federal legislation removed the expiration date on the special treatment of qualified dividends, making it "permanent" until Congress acts to repeal it. Therefore, as I testified before the House Finance and Taxation Committee, it may be your wish to not move forward with this bill at this time and revisit it later should the issue reappear. Or, you may wish to make the proposed change, which would take effect only if Congress repeals the preferential treatment of qualified dividends at some future date.

Explanation of bill

If passed, this bill would not alter the current 30 percent exclusion for qualified dividends as long as federal tax law taxes qualified dividends at a tax rate that is lower than the tax rates on ordinary income. However, if federal law is changed, and qualified dividends are taxed at the same tax rates that apply to ordinary income, this bill would lower the exclusion rate from 30 percent to 20 percent and apply it to all taxable dividend income.

Fiscal impact

Assuming no change in federal tax law, this bill will no fiscal impact for the 2013-15 biennium (or any future biennium). Should federal law change, the 20 percent exclusion rate is expected to yield approximately the same total exclusion amount for all taxpayers as compared to current law. However, there would be variances among individual taxpayers because the ratio of qualified to nonqualified dividends will differ from taxpayer to taxpayer, and from year to year.

Conclusion

This bill originated with the Tax Department and therefore has the Tax Commissioner's favor. However, the Tax Commissioner would not have any concern if the Committee finds it unnecessary to make this change at this time.

2

USND

Utility Shareholders of North Dakota

House Bill 1105
Senate Finance and Tax
Testimony in Support
March 18, 2013

Chairman Cook, members of the committee, I am Carlee McLeod, President of the Utility Shareholders of North Dakota (USND), and I come before you to testify in support of this bill.

USND represents approximately 3,000 North Dakotans who own stock in one of three investor-owned utilities operating in North Dakota: Otter Tail, Xcel Energy and Montana Dakota Utilities. Each of these companies offers dividend paying stocks, so this bill directly affects my members. The majority of our membership is comprised of retirees who depend on their investment income as a part of their retirement budget. Their income is directly impacted by any changes in the structure by which dividends are taxed.

USND supports efforts to create fairness in taxation, and as such, we support efforts to minimize the tax burden resulting from dividend income tax. Over the past few years, USND has joined with other like entities to fight to keep taxes reasonable on the federal front. This bill, as written, gives North Dakotans some comfort that state dividend taxes will remain stable despite wrangling in D.C. We support this effort.

While we support this bill in its current form, we would also support action by the committee to expand on the exclusions currently allowed in state law. Taxation at the dividend level is often viewed as patently unfair by investors. When an individual investor pays tax on dividend income, that income has already been taxed at the corporate level. When the individual investor is taxed again on that same income, the net amount left in the individual's pocket is often less than 50%. As the state looks to reform certain tax policies in an effort to provide tax relief, we encourage the expansion of these exclusions as part of the overall relief package.

Thank you.