2013 SENATE FINANCE AND TAXATION

SB 2104

2013 SENATE STANDING COMMITTEE MINUTES

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

SB 2104
1/16/2013
Job Number 17265

☐ Conference Committee

Committee Clerk Signature Angela K Hmiller

Explanation or reason for introduction of bill/resolution:

A BILL for an Act to create and enact a new section to chapter 57-38 of the North Dakota Century Code, relating to income tax withholding on oil and gas royalty payments to nonresidents; to amend and reenact sections 57-3-31.1 and 57-38-61 of the North Dakota Century Code, relating to composite withholding returns for nonresident members of pass-through entities and the provisions of the income tax chapter applicable to oil and gas royalty payments; and to provide an effective date.

Minutes:

Testimony Attached

Chairman Cook opened the hearing on SB 2104.

Matt Peyerl, Associate Director, Tax Administration, Office of State Tax Commissioner - See attached testimony 1.

Senator Dotzenrod - When these checks go get distributed to the people who are entitled to get royalty payments, the taxes that you want them to deduct, it looks like on line 20 you are referring I think there to 38.30 and 30.3 I think those are income tax, are there any deductions from the royalty checks that represent the production tax or the oil extraction tax?

Matt Peyerl - The royalty recipient receives a net check for their net amount of royalties after the production taxes have been taken out.

Senator Dotzenrod - Is any of that reflected in what we have covered in section 1? The net amount that taxes are computed on is there any reference in here to the deductions that are made to get to that net amount?

Matt Peyerl - I believe subsection 3 might do that, and it talks about the royalty payment as it might be the net amount of payment being made and not of the gross amount that's withheld production taxes.

Senator Triplett - I think I remember sitting in this very chair about 4 years ago and offering to draft this bill if the tax department wanted it and was told at that time that it wasn't necessary. Is it just because there are so many more out of state royalty owners now that you've become interested in it, or why was this not a good idea 4 years ago?

Matt Peyerl - I don't think introducing it today means it wasn't a good idea 4 years ago, I think the level of nonresidents that we are seeing that we are contacting and having too much information and making contact with them and based on their feedback is that they have some of the same thoughts. What took you so long, or we thought it was already taken care of, other states already do it, but I think the volume of activity that we are seeing. This is an issue that probably mirrors production as opposed to preproduction activity and in filing tax returns we are always a little bit behind current activity so I think it's kind of coming together at this point.

Senator Triplett - Are we asking for legal trouble by making the distinction between residents and nonresidents and would it be more straightforward if we just applied this to everyone?

Matt Peyerl - I don't believe there are any legal hurdles as far as the constitutionality of treating residents differently than nonresidents. We already impose different withholding requirements on income tax.

Senator Oehlke - The fiscal note is $4.2 million, that I'm assuming is what you kind of project as uncollected so far, or would be uncollectable.

Matt Peyerl - I believe the fiscal note only brings into play the timing of the collections. I think what it implies is that we will eventually find the nonresidents who haven't reported; it will just take us longer and cost us more to do that. I think what the note says it's just pulling some of those dollars forward.

Senator Oehlke - So the cost savings for going after that money is part of that fiscal note?

Matt Peyerl - I don't believe there was any inclusion of cost savings in that.

Senator Oehlke - You did mention hours and hours of work, how many hours? Any idea?

Matt Peyerl - I don't have a specific on that. The recent last couple years it's grown significantly and that has to do with the timing of the production and royalties and the level of activity. We hope that our first efforts in doing this we get the low hanging food first so that is where we target most of our compliance efforts.

Senator Miller - Is this any different than land rent? How are we doing it with that?

Matt Peyerl - We do not withhold on land rent or surface rents. The bill is constructed very narrowly to apply only to oil and gas interests. I think some states have it for any mineral interests, timber, coal, other types of interests where there is royalties being paid. You could expand it as far as you want to apply to any type of income, it just depends how big of income source is out there that it makes sense to impose a program for withholding on the frontend as opposed to pursuing people on the backend.

Ron Ness, President of ND Petroleum Council - See attached testimony 2, opposed to SB 2104.

Senator Triplett - On your point about preferring the report to be submitted quarterly, do you prefer quarterly to the annual report?

Ron Ness - I'm not sure if that is a summary report. I think the tax department would need to clarify that because I doubt that you are going to have the oil operator hold all of those revenues for one annual report. You are going to submit them either monthly or quarterly, we need some clarification here.

Senator Burckhard - You talked about override owners, can you simplify that? What is that?

Ron Ness - I have asked one of my attorneys for a simple explanation of an override owner and I will get that in better terms but essentially what happens sometimes is Senator Dotzenrod may own an interest in a well and he may sell that interest to Senator Burckhard and Senator Dotzenrod would keep what we call an override. He essentially keeps a part of the deal and in turn may get a 1 tenth of 1% of the deal for being the deal maker.

Todd Kranda, Behalf of Verizon Wireless - See attached testimony 3 opposed to SB 2104.

Chairman Cook - Matt I just have one more question for you. We have a minimum threshold that if royalties are low we are not going to withhold the tax. Some of these Bakken wells they run quite a J curve. It's possible that somebody could be getting a royalty check that qualifies for withholding and then all the sudden it's going to slide below the threshold and it we are set up here so that we would stop withholding?

Matt Peyerl - Yes I believe the withholding requirement would be measured on an annual basis.

Senator Dotzenrod - Section 3 of the bill, it says if your amending a section that is currently in law, which is provisions of the chapter applicable, it lists all the provisions that shall apply and then you've made some changes, do we need that, I guess we always assume that whatever is in the century code applies and that you wouldn't have to list those things that apply implying that there are some things that don't apply. Is there some reason we have to spell out the sections that apply?

Matt Peyerl - Most of those sections have to do with administration, when the return is due, for example the existing references to sections that govern multiple processes so by pulling in the reference we intend to apply those provisions to this new type of withholding activity. The comment regarding quarterly remittance in this very section, then we intend to bring in and apply how we have employees withholding administered and that there is a quarterly remittance of the dollars and that's a very basic filing and that is a filing just to get the dollars because the entity that withheld, they may be sitting on substantial dollars and they probably don't want to sit on them longer than they need to but it would be a quarterly transmittal of the dollars and then the annual filing of all the information of who the recipients are much like they get the 1099 at the end of the year.

Chairman Cook closed the hearing on SB 2104.

2013 SENATE STANDING COMMITTEE MINUTES

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

SB 2104
2/4/2013
Job Number 18225

☐ Conference Committee

Committee Clerk Signature	

Explanation or reason for introduction of bill/resolution:

A BILL for an Act to create and enact a new section to chapter 57-38 of the North Dakota Century Code, relating to income tax withholding on oil and gas royalty payments to nonresidents; to amend and reenact sections 57-3-31.1 and 57-38-61 of the North Dakota Century Code, relating to composite withholding returns for nonresident members of pass-through entities and the provisions of the income tax chapter applicable to oil and gas royalty payments; and to provide an effective date.

Minutes:

Committee Work

Chairman Cook opened discussion on SB 2104.

Donnita Wald, Tax Department, went over the amendment drafted and agreed upon by the Telecom industry.

Chairman Cook closed discussion on SB 2104.

2013 SENATE STANDING COMMITTEE MINUTES

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

SB 2104
2/6/2013
Job Number 18349

☐ Conference Committee

Committee Clerk Signature	Angela R. Hmiller

Explanation or reason for introduction of bill/resolution:

A BILL for an Act to create and enact a new section to chapter 57-38 of the North Dakota Century Code, relating to income tax withholding on oil and gas royalty payments to nonresidents; to amend and reenact sections 57-3-31.1 and 57-38-61 of the North Dakota Century Code, relating to composite withholding returns for nonresident members of pass-through entities and the provisions of the income tax chapter applicable to oil and gas royalty payments; and to provide an effective date.

Minutes: Committee Work

Chairman Cook opened discussion on SB 2104.

Senator Triplett - I would object to removing section 1. One of my primary objections to the larger comprehensive bill that we heard yesterday is that it included this which seems to me to be not related to the larger topic. This is about collecting taxes that are already on the books. It's a compliance process for making sure that taxes already assessed actually get paid. I think to add it in to a mix of tax reduction, the stripper tax fix, and the oil extraction tax reduction, there's no rational reason for it except to sweeten the pot and make it look like there's a larger positive fiscal note in the near term on that bill. I just think they aren't related and my very strong preference would be that we leave this bill the way it is, if it needs a little tweaking for anything we can certainly do that, but in terms of killing that portion of this bill simply because it's in the other one does not seem to me to be the right way of going.

Chairman Cook - I would disagree. I think it has a very appropriate place in the other one. It does place another burden on the oil industry. We have it in 2 bills; it hopefully goes to the governor in one or the other.

Senator Triplett - In Ron's testimony it says, would this regulation apply to override owners, we'd like to see further clarification and then Matt Peyerl said yes that override interests are part of the nonworking interests. So whatever they are, they are included within nonworking interests, so it would apply.

There was brief discussion on override owners.

Chairman Cook - Regardless, the amendments that we have here would remove section 1 from the bill.

Senator Triplett requested the bill be held until Senator Dotzenrod was present.

Chairman Cook closed discussion on SB 2104.

2013 SENATE STANDING COMMITTEE MINUTES

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

SB 2104
2/6/2013
Job Number 18370

☐ Conference Committee

Committee Clerk Signature	Angela K. Johnson

Explanation or reason for introduction of bill/resolution:

A BILL for an Act to create and enact a new section to chapter 57-38 of the North Dakota Century Code, relating to income tax withholding on oil and gas royalty payments to nonresidents; to amend and reenact sections 57-3-31.1 and 57-38-61 of the North Dakota Century Code, relating to composite withholding returns for nonresident members of pass-through entities and the provisions of the income tax chapter applicable to oil and gas royalty payments; and to provide an effective date.

Minutes:

Committee Work

Chairman Cook opened discussion on SB 2104.

Senator Oehlke - I'll move the amendment.

Seconded by **Senator Miller**.

Senator Dotzenrod - What this amendment does, it affects the nonresident withholding?

Chairman Cook - It takes out section 1 of the bill that affected the withholding of royalties from nonresidents, it removes section 3 of the bill, and all that leaves in is section 2 but it has an amendments that fixes the concern Verizon had on a pass-through entity.

Senator Dotzenrod - Did we get indication from the tax department what their position was on these amendments?

Chairman Cook - They are happy with the amendments we have in section 2, they drafted the amendments. I'm sure they will be content as long as section 1 stays in the oil extraction tax bill.

Roll Call Vote (on amendment) 4-2-1

Senator Miller - I'll move a **Do Pass as Amended**.

Seconded by **Senator Burckhard**.

Roll Call Vote 6-0-1

Carried by **Senator Burckhard**.

FISCAL NOTE

Requested by Legislative Council
12/21/2012

Bill/Resolution No.: SB 2104

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			$4,200,000			
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).*

SB 2104 authorizes income tax withholding on oil and gas royalty payments to nonresidents.

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 SB 2104 authorizes individual income tax withholding on oil and gas royalty payments at the rate of 3.99% (the current top marginal rate) for nonresident recipients. This will assist the Tax Department in it's compliance efforts and help to inform some nonresidents of their income tax filing requirement.

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.*

It is estimated that the mandatory withholding provisions in this bill will 'speed up' individual income tax revenue collections and bring an additional $4.2 million in total revenue into the 2013-15 biennium that otherwise would be collected beyond this biennium.

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: 01/14/2013

13.8127.01001
Title.02000

Adopted by the Finance and Taxation Committee

February 6, 2013

2-6-13
1 of 2

PROPOSED AMENDMENTS TO SENATE BILL NO. 2104

Page 1, line 1, remove "to create and enact a new section to chapter 57-38 of the North Dakota"

Page 1, remove line 2

Page 1, line 3, remove "nonresidents;"

Page 1, line 3, replace "sections" with "section"

Page 1, line 3, remove "and 57-38-61"

Page 1, line 5, remove "and the provisions of the income tax chapter applicable to oil and gas"

Page 1, line 6, remove "royalty payments"

Page 1, remove lines 8 through 24

Page 2, remove lines 1 through 31

Page 3, remove lines 1 and 2

Page 3, line 7, remove the overstrike over "~~an individual~~"

Page 3, line 7, after "~~who~~" insert "or passthrough entity that"

Page 3, line 7, remove the overstrike over "~~is~~"

Page 3, line 12, replace "business" with "passthrough"

Page 4, line 22, remove the overstrike over "~~, but not later than the fifteenth day of the third~~"

Page 4, line 23, remove the overstrike over "~~month after the end of its taxable year,~~"

Page 5, line 4, overstrike "or"

Page 5, line 11, after "dollars" insert "; or

(5) The member is a lower-tier passthrough entity that elects to be exempted from the withholding requirement under this subsection. The election must be made on a form and in a manner prescribed by the tax commissioner. The form must include a statement that the member certifies that the member will file any return and pay any tax required by this chapter on its distributive share of income from the source passthrough entity and that the member is subject to this state's jurisdiction for the collection of that tax and any applicable penalty and interest. The tax commissioner may revoke the exemption under this paragraph if the source passthrough entity or member fails to comply with the requirements of this paragraph. If the exemption is revoked, the source passthrough entity shall begin withholding from the member within sixty days of receiving notification of the revocation from the tax commissioner. The tax commissioner

2 of 2

<ins>may prescribe any procedures and guidelines necessary to administer this paragraph</ins>"

Page 5, remove lines 15 through 27

Renumber accordingly

Date: 2-6-13
Roll Call Vote #: 1

2013 SENATE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 2104

Senate Finance & Taxation Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number 13.8127.01001 title .02000

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

☐ Rerefer to Appropriations ☐ Reconsider

Motion Made By Senator Oehlke Seconded By Senator Miller

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

Total (Yes) 4 No 2

Absent 1

Floor Assignment

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

Date: 2-6-13
Roll Call Vote #: 7

2013 SENATE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 2104

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 Miller Seconded By Senator Burckhard

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

SB 2104: Finance and Taxation Committee (Sen. Cook, Chairman) recommends **AMENDMENTS AS FOLLOWS** and when so amended, recommends **DO PASS** (6 YEAS, 0 NAYS, 1 ABSENT AND NOT VOTING). SB 2104 was placed on the Sixth order on the calendar.

Page 1, line 1, remove "to create and enact a new section to chapter 57-38 of the North Dakota"

Page 1, remove line 2

Page 1, line 3, remove "nonresidents;"

Page 1, line 3, replace "sections" with "section"

Page 1, line 3, remove "and 57-38-61"

Page 1, line 5, remove "and the provisions of the income tax chapter applicable to oil and gas"

Page 1, line 6, remove "royalty payments"

Page 1, remove lines 8 through 24

Page 2, remove lines 1 through 31

Page 3, remove lines 1 and 2

Page 3, line 7, remove the overstrike over "~~an individual~~"

Page 3, line 7, after "~~who~~" insert "or passthrough entity that"

Page 3, line 7, remove the overstrike over "~~is~~"

Page 3, line 12, replace "business" with "passthrough"

Page 4, line 22, remove the overstrike over "~~, but not later than the fifteenth day of the third~~"

Page 4, line 23, remove the overstrike over "~~month after the end of its taxable year,~~"

Page 5, line 4, overstrike "or"

Page 5, line 11, after "dollars" insert "; or

(5) The member is a lower-tier passthrough entity that elects to be exempted from the withholding requirement under this subsection. The election must be made on a form and in a manner prescribed by the tax commissioner. The form must include a statement that the member certifies that the member will file any return and pay any tax required by this chapter on its distributive share of income from the source passthrough entity and that the member is subject to this state's jurisdiction for the collection of that tax and any applicable penalty and interest. The tax commissioner may revoke the exemption under this paragraph if the source passthrough entity or member fails to comply with the requirements of this paragraph. If the exemption is revoked, the source passthrough entity shall begin withholding from the member within sixty days of receiving notification of the revocation from the tax commissioner. The tax commissioner may prescribe

any procedures and guidelines necessary to administer this paragraph"

Page 5, remove lines 15 through 27

Renumber accordingly

2013 HOUSE FINANCE AND TAXATION

SB 2104

2013 HOUSE STANDING COMMITTEE MINUTES

House Finance and Taxation Committee
Fort Totten Room, State Capitol

SB 2104
March 11, 2013
Job #19676

☐ Conference Committee

Committee Clerk Signature	Mary Brucker

Explanation or reason for introduction of bill/resolution:

A Bill relating to composite withholding returns for nonresident members of passthrough entities.

Minutes:

Attached testimony #1

Chairman Belter: Opened hearing on SB 2104.

Matt Peyerl, Associate Director, Tax Administration for the Office of State Tax Commissioner: See attached testimony #1 and reviewed changes to the bill.

Chairman Belter: Further testimony in support of 2104? Any opposition to 2104? Any neutral testimony? If not, I will close the hearing on SB 2104. What are the committee's wishes?

Representative Drovdal: Made a motion for a Do Pass.

Representative Schmidt: Seconded.

ROLL CALL VOTE: 12 YES 0 NO 2 ABSENT

Representative Haak will carry this bill.

FISCAL NOTE
Requested by Legislative Council
02/11/2013

Amendment to: SB 2104

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).*

Engrossed SB 2104 authorizes income tax withholding on certain pass-through entities that do not elect out of the provisions.

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

Because of the election to opt out of the provisions, engrossed SB 2104 is expected to have a very small fiscal impact.

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: 02/13/2013

FISCAL NOTE
Requested by Legislative Council
12/21/2012

Bill/Resolution No.: SB 2104

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			$4,200,000			
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).*

SB 2104 authorizes income tax withholding on oil and gas royalty payments to nonresidents.

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 SB 2104 authorizes individual income tax withholding on oil and gas royalty payments at the rate of 3.99% (the current top marginal rate) for nonresident recipients. This will assist the Tax Department in it's compliance efforts and help to inform some nonresidents of their income tax filing requirement.

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.*

It is estimated that the mandatory withholding provisions in this bill will 'speed up' individual income tax revenue collections and bring an additional $4.2 million in total revenue into the 2013-15 biennium that otherwise would be collected beyond this biennium.

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: 01/14/2013

Date: 3-11-13
Roll Call Vote #: 1

2013 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 2104

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 Rep. Drovdal Seconded By Rep. Schmidt

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

Total (Yes) 12 No 0

Absent 2

Floor Assignment Rep. Haak

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

REPORT OF STANDING COMMITTEE

SB 2104, as engrossed: Finance and Taxation Committee (Rep. Belter, Chairman) recommends **DO PASS** (12 YEAS, 0 NAYS, 2 ABSENT AND NOT VOTING). Engrossed SB 2104 was placed on the Fourteenth order on the calendar.

2013 TESTIMONY

SB 2104

/

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

SENATE BILL 2104

January 16, 2013

Chairman Cook, members of the Senate Finance and Taxation Committee, my name is Matt Peyerl, Associate Director, Tax Administration, for the Office of State Tax Commissioner. I am here today on behalf of the Tax Commissioner to testify in support of Senate Bill 2104.

PROPOSED CHANGES

This bill was introduced by the Commissioner to:

- Create a requirement to withhold income tax on certain nonresident recipients of royalty payments; and,
- Redefine which owners are eligible to be part of a passthrough entity composite return and subject to income tax withholding.

SECTION 1 - Withholding on royalty payments to nonresident individuals or entities. Reasons for the proposed change.

This section of the bill will create a requirement for income tax to be withheld from royalty payments to nonresident individuals or business entities. Royalty owners that receive a Form 1099 each year for the royalty payments received from North Dakota sources are required to file a North Dakota income tax return and report that income as sourced to North Dakota, and pay the corresponding tax. In recent years, there has been a significant increase in the amount of nonresidents that are required to file returns for this reason. Currently there is no requirement for the payor to withhold North Dakota income tax on those payments. The bill does not impact the actual tax liability, but rather changes how and when it is collected.

Nonresident individuals are frequently unaware of their requirement to pay tax to North Dakota on that royalty income. Others may be aware, but for other reasons do not file. This change would be an additional measure to ensure nonresidents are paying their tax that is owed, just as residents already are. Collection of the tax owed on royalties for North Dakota residents is not as challenging because 100% of a resident's income is taxable to North Dakota, and there are other more automated processes to ensure it is reported to North Dakota.

The Tax Department allocates significant resources to finding nonresidents and enforcing the collection of tax for those that have not filed. Adding the withholding requirement would simplify the process to make collecting the tax more efficient, which also helps limit the need for additional staff to accommodate the increased levels of activity.

The change would also enhance compliance for nonresidents. An illustration for comparison would be the current system in place that requires employers to withhold income tax from employees on paychecks. Without the withholding up front, compliance and collection would be much more difficult. One principle of efficient tax administration is to collect a tax as close to the source as possible. This change would do that.

Another parallel to the concept of this proposed change is a similar change made in the 2005 Legislative Session, in which SB 2045 added a requirement that passthrough entities withhold income tax on their nonresident individual owners and remit it with the passthrough entity return. This requirement is N.D.C.C. § 57-38-31.1(3), which is also the subject of Section 2 of the bill. This change in Section 1 is consistent with that approach as well.

Not only will this change enhance compliance, it will benefit a significant number of nonresidents the Tax Department ends up contacting at some later date, but by then would have generally incurred penalty and interest, which is significant in some cases. The vast majority of contacts made for this issue do not dispute the tax owed and willingly pay. Having the tax withheld up front would eliminate this issue. Feedback from some nonresident taxpayers indicates the change would be viewed favorably.

Explanation of Section 1 of the bill.

Subsection 1 outlines definitions used in the bill. The requirement to withhold would be placed on the "remitter", which is a term used to define the entity that issues royalty payments and is a term used in other states. The requirement would only apply to "nonworking" interests.

Subsection 2 is the imposition of the requirement to withhold at the highest marginal income tax rate.

Subsection 3 lists types of royalty owners that would be exempted from the withholding, which mostly mirrors entities that would be exempt from income tax.

Subsection 4 allows for an exemption for a small producer to not be required to withhold. Instead of being required to withhold, an annual informational filing would be made. Based on our estimates, most producers would be exempt, but the vast majority of royalty dollars would still be subject to withholding (if paid to nonresidents) because of being attributable to a smaller number of large producers.

Subsection 5(a) provides for a publicly traded partnership that is a royalty recipient and exempt from withholding under subsection 3 to provide information with respect to its owners. Publicly traded partnerships have been previously exempted from other income tax withholding requirements, so this exemption mirrors that.

Subsection 5(b) provides for a publicly traded partnership or other tax exempt entity that is a royalty owner exempt from withholding to provide information to show it is exempt.

Subsection 6 provides for a small royalty recipient exclusion. It allows the Commissioner to exempt a remitter from withholding on payments to a single recipient totaling less than $600 a quarter or $1,000 per year.

SECTION 2 - Redefine which owners are eligible to be part of a passthrough entity composite return and subject to income tax withholding.

Reasons for the proposed change.

Currently, a passthrough entity may choose to file a "composite" return on behalf of its nonresident individual owners. On a composite return, the tax on each nonresident individual's share of income of the passthrough entity is paid to the state. Because the nonresident individual has no other income sourced to North Dakota, the composite return relieves the nonresident individual of the requirement to file a tax return. This option is currently only available to nonresident individuals. This section of the bill expands this eligibility to non-domiciled North Dakota business entities, as well as grantor trusts, sometimes referred to as living or revocable trusts, which currently file informational income tax returns as a "Fiduciary". Based on feedback received from taxpayers and tax preparers, the expansion of this eligibility would be viewed favorably.

By redefining nonresident members that are eligible to be part of a composite return, there is also a corresponding change to which types of entities would be subject to withholding on a passthrough entity return. Currently, passthrough entities are only required to withhold tax on owners that are nonresident individuals. This change would require passthrough entities to withhold tax on owners that are also business entities not domiciled in North Dakota. Similar to the concept outlined in Section 1 of the bill, the change would enhance compliance by having the tax withheld closest to the source and would result in more efficient administration of collection of the tax.

An entity that had tax withheld on its behalf would claim credit for that tax on its own return when it is filed. Both of the changes in Section 2 would also mirror what many other states already have in place.

Explanation of Section 2 of the bill.

Page 3, lines 7 through 9 expand eligibility for a composite return from a nonresident individual to include grantor trusts.

Page 3, lines 12 and 13 modify the term "nonresident" to include business entities that are domiciled outside North Dakota. With this change in definition, this type of entity would now be subject to North Dakota withholding on its share of income the passthrough entity is passing through to it.

Page 3, lines 14 through 23 make a non-substantive change to the definition of passthrough entity, to make it consistent with how it is defined in other sections of the Century Code dealing with taxation.

Changes in the remainder of the section strike the reference to individuals. The bill does not impact the ability of taxpayers who elected to be part of the composite return or that had tax withheld to actually file their own return and obtain a refund if the amount was over-withheld.

SECTION 3 – Administration. This section outlines administrative provisions for Section 1 of the bill. In general, the withholding of royalties for nonresidents would be administered consistent with the current provisions for employers withholding returns, including time and place for filing, refunds, liability, audit, and penalty and interest provisions.

SECTION 4 – Effective date. This section calls for an effective date of the bill starting after December 31, 2013.

CONCLUSION

The Commissioner respectfully requests your favorable consideration of SB 2104.

2

NORTH DAKOTA
PETROLEUM
COUNCIL

120 N. 3rd Street • Suite 200 • P.O. Box 1395 • Bismarck, ND 58502-1395
Phone: 701-223-6380 • Fax: 701-222-0006 • Email: ndpc@ndoil.org

Testimony of Ron Ness
Senate Bill 2104
Senate Finance and Taxation Committee
January 16, 2013

Chairman Cook and members of the Senate Finance and Taxation Committee, my name is Ron Ness, president of the North Dakota Petroleum Council. The North Dakota Petroleum Council represents more than 400 companies in all aspects of the oil and gas industry, including oil and gas production, refining, pipeline, transportation, mineral leasing, consulting, legal work, and oilfield service activities in North Dakota. I appear before you today in opposition of Senate Bill 2104. There are few issues with the bill that we would like to see clarified:

1.) Under section 2, subsection b, there is currently no way to know for sure if a company has a 'commercial domicile' in the state, requiring us to withhold until each company could certify they have a commercial domicile in the state. We believe having a North Dakota address on record would be sufficient.

2.) Would this regulation apply to 'override owners'? We'd like to see further clarification.

3.) We are also concerned about the lack of details regarding reporting requirements. It will take some time to get these regulations programmed into each company's software, and without knowing the forms and regulations to be determined by the Tax Commission that process cannot begin.

4.) We prefer the report be submitted quarterly.

Right now, there are too many questions surrounding this bill. Without the answers to those questions, we ask for a Do Not Pass on SB 2104. I would be happy to answer any questions.

Testimony in Opposition to

SENATE BILL NO. 2104

Senate Finance & Taxation Committee

January 16, 2013

Chairman Cook, Senate Finance & Taxation Committee members, for the record my name is Todd D. Kranda and I am an attorney with the Kelsch Law Firm in Mandan. I appear before you today as a lobbyist on behalf of Verizon Wireless to express a concern about and opposition to SB 2104.

I have received background information from a Verizon Wireless company representative, namely Nancy Riedel, Director for State Tax Policy, who is unable to attend the hearing today but wanted to express a concern about the tax policy changes being proposed namely the modifications in Section 2 at page 3 of SB 2104.

The changes in Section 2 to the definitions of 'Member' and 'Nonresident' are expansive and will require partnerships (and other passthrough entities) to withhold and pay income tax on the share of passthrough income that is distributed to a corporate partner. SB 2104 would create an additional administrative burden for partnerships (and other passthrough entities) who are not currently required to withhold and make payments on behalf of their corporate partners. An exemption from the withholding requirements, similar to what other states have provided, for passthrough entities that receive a certificate from the corporate partner, would alleviate the additional administrative burden.

Accordingly, Verizon Wireless would respectfully request that the following amendment be considered to address the concern expressed:

PROPOSED AMENDMENT

If a passthrough entity receives an exemption certificate from a nonresident member, the passthrough entity shall not withhold income tax on the share of income of the entity distributed to the nonresident member if the exemption certificate is completed by the member in the form and manner prescribed by the department and the exemption certificate certifies that the member will file the returns required under this Act and pay or withhold the tax required under this Act on the share of income received from any passthrough entity in which the member has an ownership or beneficial interest, directly or indirectly through one or more other passthrough entities.

In conclusion I would urge that you either give a **DO NOT PASS** recommendation for SB 2104 or alternatively, amend SB 2104 to add the exemption as described above in order to address the concerns as expressed.

If there are any questions I would be willing to try to answer them.

#/

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

SENATE BILL 2104

March 11, 2013

Chairman Belter, members of the House Finance and Taxation Committee, my name is Matt Peyerl, Associate Director, Tax Administration, for the Office of State Tax Commissioner. I am here today on behalf of the Tax Commissioner to testify in support of Senate Bill 2104.

PROPOSED CHANGES

This bill was introduced by the Tax Commissioner to expand eligibility for which types of owners can choose to be included in a composite return of a passthrough entity, as well as which types of owners of a passthrough entity are subject to income tax withholding.

SECTION 1 – Expand eligibility of types of owners which can be part of a passthrough entity composite return and subject to income tax withholding.

Reasons for the proposed change.

Currently, a passthrough entity may choose to file a "composite" return on behalf of its nonresident individual owners. On a composite return, the tax on each nonresident individual's share of income of the passthrough entity is paid directly to the state by the passthrough entity. Because the nonresident individual owner has no other income sourced to North Dakota, the composite return relieves the nonresident individual of the requirement to file a tax return. This option is currently only available to nonresident individuals. The bill expands this eligibility to non-domiciled North Dakota passthrough entities, as well as grantor trusts, sometimes referred to as living or revocable trusts, which currently file informational income tax returns as a "Fiduciary". Based on feedback received from taxpayers and tax preparers, the expansion of this eligibility would be viewed favorably, as it saves the out-of-state taxpayers from needing to file additional returns to simply report the same income. The bill does not affect the amount of tax of owed by any taxpayer.

In redefining nonresident members that are eligible to be part of a composite return, there is also a corresponding change to which types of entities would be subject to withholding on a

#1 p. 2

passthrough entity return. Currently, passthrough entities are only required to withhold tax on owners that are nonresident individuals. This change would require passthrough entities to withhold tax on owners that are also passthrough entities not domiciled in North Dakota.

The change to withholding would also enhance filing compliance and result in more efficient administration of the collection of tax by having the tax withheld closest to the source of income earned. A passthrough entity that had tax withheld on its behalf would claim credit for that tax on its own return when it is filed. Both of the changes in this bill would also mirror what many other states already have in place.

To address the concerns of some owners that are passthrough entities, a provision was also included to allow the owner to opt out of the requirement to have tax withheld. However, the owner would be required to provide information to the Tax Department to ensure it will file a return to report the income on its own behalf.

Explanation of the bill.

Page 1, lines 9 through 12 expand eligibility for composite return filing to also include a passthrough entity and a grantor trust.

Page 1, lines 14 and 15 modify the term "nonresident" to include a passthrough entity that is domiciled outside North Dakota. With this change in definition, this type of entity would now be subject to North Dakota withholding on its share of income the passthrough entity is passing through to it.

Page 1, lines 16 through 23 and page 2, lines 1 and 2 make a non-substantive change to the definition of passthrough entity, to make it consistent with how it is defined in other sections of the Century Code dealing with taxation.

Page 3, beginning with line 21, the bill adds another exception to the withholding requirement in allowing a passthrough entity to opt out of having North Dakota income tax withheld on its behalf.

SECTION 2 – Effective date. This section calls for an effective date of the bill for tax years starting after December 31, 2013, so it would be effective starting with tax year 2014.

CONCLUSION

The Commissioner respectfully requests your favorable consideration of SB 2104.