15.0142.05000

FISCAL NOTE
Requested by Legislative Council
02/16/2015

Amendment to: HB 1167

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.*

	2013-2015 Biennium		2015-2017 Biennium		2017-2019 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues			$(466,659,000)			
Expenditures						
Appropriations						

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

	2013-2015 Biennium	2015-2017 Biennium	2017-2019 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 HB 1167 eliminates the individual income tax continent upon the "big" oil extraction tax trigger not being in effect in the prior tax year.

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.*

Engrossed HB 1167 reduces the individual income tax rates to zero beginning with tax year 2015. Section 3 contains a contingency that reinstates the individual income tax for tax year 2016 and 2017. This is because the "big" oil extraction tax trigger is assumed to be in effect for a portion of the first 9 months of tax years 2015 and 2016. If enacted, engrossed HB 1167 will reduce state general fund revenues by an estimated $466.659 million in the first year of the 2015-17 biennium. The individual income tax is again assumed to be zero for tax years 2018 and beyond (impacting FY 19 and subsequent fiscal years).

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 or a part of the appropriation is 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: 02/17/2015

15.0142.04000

FISCAL NOTE
Requested by Legislative Council
01/08/2015

Bill/Resolution No.: HB 1167

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.*

	2013-2015 Biennium		2015-2017 Biennium		2017-2019 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues			$(973,000,000)			
Expenditures						
Appropriations						

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

	2013-2015 Biennium	2015-2017 Biennium	2017-2019 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 1167 eliminates the individual income tax.

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.*

HB 1167 reduces the individual income tax rates to zero beginning with tax year 2015. If enacted, HB 1167 will reduce state general fund revenues by an estimated $973 million in the 2015-17 biennium.

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 or a part of the appropriation is 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: 01/24/2015

2015 HOUSE FINANCE AND TAXATION

HB 1167

2015 HOUSE STANDING COMMITTEE MINUTES

Finance and Taxation Committee
Fort Totten Room, State Capitol

HB 1167
1/27/2015
Job #22621

☐ Subcommittee
☐ Conference Committee

Committee Clerk Signature Kenneth M. Tostuhn

Explanation or reason for introduction of bill/resolution:

A Bill relating to individual income tax rates.

Minutes:

Attachments 1, 2, 3, 4, 5

Chairman Headland: Opened hearing.

Representative Louser: Introduced bill. See attached testimony #1. Distributed proposed amendments 15.0142.04004. See attachment #2.

Chairman Headland: You referred to states that do not currently have an income tax. How do they fund their state's needs? Do they have broader sales taxes and other types of taxes that we currently don't have in this state?

Representative Louser: Yes. For instance, Alaska, as we're all aware, has oil and energy-related income. Nevada, for instance, has a gaming tax. Others have sales tax. Florida and South Dakota are two that come to mind as sales tax states. In our energy industry, we have a relatively high tax. When you couple that with an income tax, it seems to me that we are a fairly high tax state for a state that has less than a million people.

Representative Steiner: I get a little hung-up on the non-resident portion of it. I was out in Washington, DC for a meeting, and stopped and visited a friend of our family. This person has lived in Arlington, VA for 20 years, and they have a farm in the Red River Valley that they cash-rent out to neighbors, and they have some oil interests in Mountrail County that his aunt bought years ago. And so, he said to me, when are you going to get rid of the income tax, because I'm tired of paying income taxes to ND. I said, who is supposed to pay for those roads? The farmer who lives down the road from you? You don't even live in ND any more. I have some heartburn with the non-resident portion because I think there are expenses to taking that oil to market in Mountrail County. There are expenses for the farm products that run on the roads in the Valley. But I don't want ND farmers and property tax payers here to pick up his burden. What are your thoughts on that?

Representative Louser: I've been asked numerous times. I don't have a perfect answer because we don't have a perfect tax system anywhere in the country. And I don't think this bill is perfect. There are going to be instances where people are receiving income that don't live in this state that wouldn't be taxed. And that is one of the implications of our tax code. I don't have a great answer for that.

Representative Hatlestad: You talked about a trigger going into effect, and the tax rate would go to one percent. Is that retroactive for the entire year?

Representative Louser: The intent is, if the trigger kicks in at any given calendar year, that the following year's income tax rate would be one percent. So the subsequent year, the income tax would be one percent. If the effect of the trigger were to stay on that following year, then the tax rate would stay at one percent. If it came off during the previous calendar year, we would revert back to zero percent for the future. (Refers to Attachment #2) It doesn't say what we would refer to as "trigger." It shows, if there's less revenue based on that number, that's how that's worded.

Chairman Headland: We'll take support for HB 1167.

Wayne Papke, registered volunteer lobbyist for Citizens for Responsible Government: Provided testimony in support. See attachment #3.

Representative Froseth: Nobody likes paying taxes. What do you think would be better: not paying any income taxes or reduced sales tax?

Wayne Papke: The income tax because they choose to buy things, which they in turn pay sales tax on. If they choose to live here, they're going to earn a wage, which they have no choice. They have to pay the income tax. With sales tax, you're making choices on what you buy and when and where. But that is a volunteer tax on the part of individuals. Whereas income tax is a mandatory tax. I believe, therefore, the income tax is a much better economic benefit to them.

Representative Trottier: If you were to rate the worst from all the taxes we have, which one do you think our citizens would say is the most unfriendly, or the one they hate the worst?

Wayne Papke: The property tax is always the one that's the most focal. However, it affects a lot less people than income tax does. And that's one of the interesting ones. I live on a street where I want police protection, fire protection. I want my infrastructure there. Therefore I expect to pay a property tax. And sometimes people don't understand that component of it. That we are paying a direct benefit to my house and my property via property tax. Therefore I expect to pay a reasonable amount of property tax. Now with the property tax levels the way they are, with the state subsidizing them, I think that you've heard a lot less rumblings about that. Income tax, to me, is going to be a much more concentrated group, but you really have to look at it as an economic development tool because, I am looking at some of the most prosperous business people in this state, and they are the ones who are paying the bulk of that income tax. What are they going to do if they don't have to pay that income tax? It is going to get re-invested. These people are savvy businesspeople. They don't just take that and go to Jamaica, or blow that money. They reinvest it in the state. They are the most business-savvy people, so we're really looking at a tax that is going back to the most business-savvy people who again will help build and develop more industry in this state.

Chairman Headland: How would you respond to the point Representative Steiner brought to Representative Louser; in that you're making an argument that you think that the reduction in the income tax allows for those people to go out and spend the money, and therefore will receive sales tax in return. But you can't make that argument for that portion of people who are not here. I do not know what the percentage of the total amount of income is from out-of-state people. Just respond to your thoughts of how the state makes up for that revenue.

Wayne Papke: What a better economic development incentive for more of that money coming into the state. That's the way I turn the tide. We don't always have the private capital in this state to do some of the things we'd like to do. Out-of-state money is welcome, obviously in the oil industry. Without the out-of-state money in the oil industry, we wouldn't have nearly what we have now. So, without the income tax, it would send more inflows of private capital, which in turn benefits ND, and indirectly will pay other taxes such as sales tax.

Chairman Headland: Is there evidence that would suggest in other states that when a state does go to not having an income tax, that people do choose to move to those states?

Wayne Papke: The two that come right to mind would be Texas and South Dakota. I lived in Sioux Falls in l987-88-89, during the financial boom down there, which was directly the result of corporate income tax. On the personal income tax side, it helped them build a labor base where they had none of the professional labor base to start with. They were able to attract people to that state very quickly because that obstacle was gone. If you saw Sioux Falls grow, it grew three times as fast as Bismarck is growing, or even Fargo during that period because it was just an inflow of the CityBanks, the Bank Ones, all of these major financial and credit card institutions. But yet they were able to transplant those people there very quickly, and I have to believe part of it was taking away that roadblock and obstacle. Texas, right now, is going through an incredible boom, and I have to believe, also, that is an attraction for that labor base.

Chairman Headland: You're making a good argument for corporate income tax. However, this bill just refers to the individual income tax. I'm wondering if you think the same argument applies.

Wayne Papke: I think it does. In fact, I am a proponent of eliminating both. All income tax in general. For the same reasons or economic development, which would do very well and broaden our industry base away from more things than just oil and agriculture and energy. That corporate income tax is a very small revenue item for the state relative, and I would believe that it would be a good incentive to package the two. In other words, you'd get the labor base and then you would also get the industry taking away that obstacle.

Representative Schneider: We have a pretty substantial number of people in the state who are working, but don't pay income tax because their wages are minimum wage or lower level wages, often without benefits. Do you envision any benefits for those individuals? They're the ones who we need also, because they take care of mom and dad in the nursing home, and they're cashiers and fast-food workers, and help us out in the retail markets and so forth.

Wayne Papke: Job security and job abundance would be the answer and the benefit to them in that they would have plentiful job availability and wouldn't have to be unemployed compared to the employment they're in. That would secure their employment much better, I feel. With all the state tax credits now, like the charitable gifting one, I make some pretty good money, but I've got my taxes down to virtually zero through the charitable tax credits. If you eliminate income tax, you take that away. So you're not necessarily giving it all away. I'm getting a lot of tax credits myself, personally, that I wouldn't get without the income tax. Therefore, basically, I would be almost a revenue-neutral person myself.

Representative Schneider: Don't those individuals already have job security and what about concerns that they don't have access to health care and some of the other basic needs that would not be available and any kind of support for them if we have this kind of a fiscal note?

Wayne Papke: I still go back to the fact that if we are attracting new industry, new broadening base, they are provided with more opportunity to expand their own job and grow with it. In other words, if they want to upgrade their job, I think they have a much better opportunity if you have much more industry.

Representative Froseth: How does the state handle the needs in those areas in the western part of the state who cause problems? Where is the money going to come from if we get rid of all the taxes for those services and needs out there?

Wayne Papke: The items you mentioned are not necessarily funded by the general fund, which is where income tax goes. Much of those items, I believe, are funded by the oil extraction and production tax. Most of those are one-time spending. Therefore income taxes would not affect that.

Representative Froseth: Don't the income taxes go to the general fund?

Wayne Papke: Yes, but the items you mentioned are one-time spending or oil production and extraction tax expenditures. They don't come out of the income tax.

Representative Haak: You donate to charities to get your tax payment down to zero. Would you continue to donate to charities if that tax credit wasn't there?

Wayne Papke: Yes. I don't donate to charities for tax reasons. I get the benefit of it, but I don't donate to charity for, I'm a supporter of education and I fund scholarships.

Vice Chairman Owens: In North Dakota we deliberately chose to provide certain exemptions in sales tax for those basic elements that people need, food and medicine. I happen to know that's taxed in the other states that you referenced. And it's taxed in a number of other states that still have income tax. According to the last figures I saw, if we taxed food alone, we could get $657-million right into the general fund. So that would be most of this. But really, now we're talking about a regressive tax rather than progressive. So, which way do we want to go here? Are you recommending we do this and get rid of some exemptions to balance it? I do not believe that while I do agree it would help bring in certain people and businesses, it's not going to be the influx that we imagined, and we can look to SD for that. They had an initial boom, and then nothing.

Wayne Papke: SD did have about 100,000 increase in population during that period, and it mostly was in Sioux Falls, Watertown, Brookings area. It was the eastern part of the state. That's a pretty big boom. I'm not at this time proposing any elimination of exemptions. I do know one statistic that was done here several years ago, and that is, if you eliminate all exemptions, you could actually drop our sales tax one full percent in ND and remain revenue neutral. However, I am not at this time, not have any opinion on sales tax exemptions.

Representative Kading: Income tax is deductible on the federal return which would mean North Dakotans wouldn't be able to deduct on the Federal return almost a billion dollars. That means $200-300-million is going into the Federal government for Federal income tax. Is that a concern?

Wayne Papke: We may pay some more into federal taxes as a result. I think the number that you're talking about is very large. Isn't it an itemized deduction, tax people? So therefore, that takes away a lot of it right there. So I don't think those numbers are very close. But the bottom line is, the net effect is, I don't disagree. If you don't have an exemption, you're going to pay more in taxes.

Chairman Headland: Further testimony in support of HB 1167?

Dustin Gawrylow, lobbyist for North Dakota Watchdog Network: Provided testimony in support. See attachment #4. In my view, the best situation would be to zero it out. But if we can't find a way to do that, the next best solution is to find a way to convert to a flat tax. By converting to a flat tax, our individual income tax ranking nationally will improve to mid-teens. We would jump over almost 20 states as far as our business tax climate. For those who think we can't afford to do this right now, I would just reiterate the fact that the only reason we can't afford it is if we continue to spend, to increase spending the way that we have. That should not be a reason not to inject more money into the economy.

Chairman Headland: This chart has always fascinated me to some respect. I've always wondered why North Dakotans complained mostly about their property taxes. But here, we are just about the most friendly state. On the opposite side of it, they rank us really low on individual income tax, and nobody complains about their income tax. What's the reason?

Dustin Gawrylow: I think that it comes from a lack of perspective in how other states treat their taxpayers. On the property tax side, part of the reason that ranking is low is because there are a lot of states that the state itself levies property taxes. ND doesn't do that other than the one mill for the medical school. And so, that does kind of skew the numbers a little bit. I've had them look at that, and they say, "Well, if you took out the state portion on the other states, then ND would actually be in the teens." Overall, I think that leads into this discussion of residence. How many North Dakotans are actually residents of Arizona, pay no income tax, but live here five months of the year and take the benefits from ND? There's both sides of the ledger when you discuss the non-resident benefit, you also have to discuss the used-to-be residents that still benefit because they are no longer residents here and would it be easier for them to return their residency to ND and what would be the positive impact of that? Obviously, for people who are making their residency in Arizona to avoid the income tax, bring their residency back here, there's going to be a positive impact. Whether you can quantify that in fiscal note, no. But at some level, it's going to improve things.

Chairman Headland: There's another conservative organization that puts out a business climate index and that puts us number four overall in business climate. Please respond.

Dustin Gawrylow: The two that I know of are CNBC and Beacon Hill. The reason they rank us much better is because they over-weight things like wages. I've always stated, when you look at the business climate from the state standpoint, we shouldn't even talk about wages, we should talk about the things that the state can control, which are taxes, fees, regulation. The state can't control what wages are. It can control it as far as making it easier to do business here, but when it comes to a lot of those rankings, they over-rely up to 50 percent of the weighting on some of those is based on wages being depressed, and even in those reports that have ND much better on business friendliness, they always rank us very poor on access to venture capital, access to investment. And so that is another feature that this would take care. If you have another billion-dollars every two years in the economy, that's a little more money that can be used for investment. Even if you agree with the rankings that make us look good, and disagree with the rankings that make us look bad, the good ones say that we need more money in the system to invest.

Haak: How many dues-paying members does your organization have?

Dustin Gawrylow: Roughly 500 statewide.

Representative Trottier: If I was to vote according to this ranking, and I went home to my constituents, based it to my constituents at home, I would be recalled before the next session. Do you understand that? I don't believe our people believe nearly any of those rankings. I hear from very few people that say we have to lower our individual income tax. But they need help in property tax.

Dustin Gawrylow: I would say that it comes from the perspective issue. I think the property tax issue has become more of a political than an economic debate. I ran for Mandan School board twice, and when I went door-to-door, and talked about property taxes, the response that I got was, "Oh, yeah. I heard property taxes were high." They didn't know it; they were being told that. So, while I think there are definitely reform aspects on the property tax that need to be done, I think that a lot of the anger on the property tax side has been created for political purposes. We've seen these things ebb and flow back and forth depending on the political mood. I would recommend you take the politics out of it, you take the talking heads out of it, the radio hosts out of it. You should look at the sheer economics of it, and look at what tax does the most good for the most people, and what tax does the least good for the most people. In this case, when you leave money in the system, you allow people to do more economically, and that will result in an improved and more stable, diversified economy. And that should be the goal of tax policy; not to address political winds.

Chairman Headland: Further testimony in support of HB 1167?

(46:09)

Glen Mueller, citizen of Bismarck, North Dakota: The income tax is the one that seems, across the board, seems to be the most level of all the taxes for us to be addressing here. The property tax only affects certain people. Our state, when the coal was really going good, brought in lots of money. When the oil is doing good, we get a lot of money. When, all of a sudden, things aren't going good, we sit there and we aren't being very well with how we're handling our money. I firmly believe that I can better determine how to spend my money than to give it to the government for them to spend it. I just noticed that the parking lot out here gets bigger and bigger all the time. That is not my philosophy of government. My philosophy of government is, I want you to take very penny and make it count so I don't have to pay more.

Chairman Headland: Further support for HB 1167?

Andrea Toman, stay at home mom: I have been doing some casual research on other states, far to the south, where it's warmer, thinking "Gee, some day, it would be really nice." It's real interesting looking at like the Gulf. There's actually two states that have no income tax. There's Texas and Florida, and there's also states like Louisiana that have really low property taxes. They do make up for it with sales taxes. But the thing I wanted to answer somebody's question. If I'm having a tough month, and I'm going to have to cut my expenses in order to make it through the end of the month, I can reduce my expenses. I can spend less money, and that lowers my sales tax burden. But there's nothing I can do to reduce or would want to to, to reduce my income so that I can reduce my income tax burden for that month. So, if it's one or the other, the one that's easiest for me to make a benefit out of, and for me to play my cards right for the month, it's get rid of the income tax because I can work with the sales tax, month-to-month, and make those expenses.

Representative Froseth: Have you ever totaled up the amount of sales tax you pay, compared to the total amount of income tax you pay in a year?

Andrea Toman: Actually I do pay more sales tax than income tax. This is will be the first year that we're going to have to pay in for income tax. I'm kind of excited, "Hey, I'm getting somewhere! Oh, Wait. Now they want more money." So I don't know what the right ratio is. I do, obviously pay more in sales tax than I do in income tax last year. But as we grow as a family, and as we continue to earn more, it's going to have to change. I don't know where the change will be exactly, but I would much rather play my cards right with sales tax, and not have to worry about income tax.

Chairman Headland:

Matt Pereyl, Tax Commissioner's Office: There is one item in the bill that we would probably like to see addressed. That is related to the requirement to still file a return. So if rates are dropped to zero, the requirement to still file a return is in another area of the Code, so that would probably be stricken, depending on the intent of the sponsor and the body. I would assume that we wouldn't want returns filed, and, as well, for pass-through entities, requirements for them. You might have a partnership that's owned by an individual and a corporation, so you'd probably still want that entity to file returns, so with pass-through entities, there's additional considerations to keep in mind.

Chairman Headland: Thank you.

Vice Chairman Owens: How would you manage the income taxes turning on and off?

Matt Pereyl: That was one of the concerns a couple years ago with the two-year suspension. What do you do in the interim, and keep people kind of on the record so they don't just drift off. There would be considerations for employer's withholding if they didn't withhold for a certain part of the year, you'd have a lot more people having to pay in at the end of the year. They haven't really been evaluated yet. I think you're going down that road already. The other thing that I wanted to add is that the Department publishes this Redbook each year, and I think you guys have a copy of it. There is one section that summarizes all of the states for income taxes, and so it's a resource you can use as a starting point. The individual income tax for the 50 states are shown on page 56, and of course there's deductions and credits, and all of that that has to be evaluated along with it, not just the rates.

Jon Godfread, Greater North Dakota Chamber of Commerce: Submitted written testimony but was not at the hearing. See attachment #5.

Chairman Headland: Closed the hearing on HB 1167.

2015 HOUSE STANDING COMMITTEE MINUTES

Finance and Taxation Committee
Fort Totten Room, State Capitol

HB 1167
2/4/2015
23187

☐ Subcommittee
☐ Conference Committee

Committee Clerk Signature	Mary Brucker

Explanation or reason for introduction of bill/resolution:

A Bill relating to individual income tax rates.

Minutes:

Attachment #1

Representative Louser: Distributed amendments 15.0142.04003. See attachment #1. This new amendment says that if the large trigger were in place at any given time during the previous year the tax rate is whatever it is. The income tax would be zero percent unless the large trigger kicks in during the previous year then the tax is whatever it currently is.

Chairman Headland: This amendment would replace this amendment from before?

Representative Louser: Yes.

Representative Steiner: From a practical standpoint that trigger can go at any point and at some point the tax department has to determine the rate so that trigger could be within three days on either side.

Representative Louser: I think the amendment references during any period of the first nine months of the previous year. If the large trigger is in place at any point during the previous year the tax rate is whatever the current tax rate is. If the trigger is removed or never in place then the personal income tax is zero percent. We are preparing for a large shortfall and this says that if it never happens then the income tax is zero.

Representative Froseth: This pretty much places the determination of the tax on one source of our income. Wouldn't it be better to place the impact on the total collections at a certain point?

Representative Louser: Your suggestion would be that if state revenues in general are met at a certain level the income taxes be fixed. I believe this option I'm proposing is the best option.

Chairman Headland: We will stand in recess.

2015 HOUSE STANDING COMMITTEE MINUTES

Finance and Taxation Committee
Fort Totten Room, State Capitol

HB 1167
2/11/2015
23652

☐ Subcommittee
☐ Conference Committee

Committee Clerk Signature	Mary Brucker

Explanation or reason for introduction of bill/resolution:

A bill relating to individual income tax rates.

Minutes:

No attachments.

Chairman Headland: We have an amendment offered by Representative Louser. The intent of the amendment is if the big tax trigger kicks in on the extraction tax the rates go back to what they were prior to them moving to zero. If it happens before they go into effect it would stay.

Representative Froseth: MADE A MOTION TO ADOPT AMENDMENT 15.0142.04003.

Representative Strinden: SECONDED.

VOICE VOTE: MOTION CARRIED TO ADOPT THE AMENDMENT.

Representative Dockter: This would be a logistical nightmare to go back and forth with this trigger.

Representative Klein: MADE A MOTION FOR A DO NOT PASS AS AMENDED.

Representative Strinden: SECONDED.

ROLL CALL VOTE: 12 YES 0 NO 2 ABSENT
MOTION CARRIES FOR DO NOT PASS AS AMENDED

Representative Froseth will carry this bill.

15.0142.04003
Title.05000

Prepared by the Legislative Council staff for Representative Louser
February 3, 2015

2/11/15

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1167

Page 1, line 2, replace "an" with "a contingent"

Page 3, line 30, after the first boldfaced period insert "**CONTINGENT**"

Page 3, line 31, after "2014" insert ", but is ineffective for any taxable year if in any month during the first nine months of the immediately preceding taxable year the exemption under subsection 3 of section 57-51.1-03 was effective for the completion of any new horizontal well. For a taxable year for which section 1 of this Act is ineffective as provided in this section, the provisions of subsection 1 of section 57-38-30.3, without the amendments under section 1 of this Act, are effective"

Renumber accordingly

Date: 2-11-15
Roll Call Vote #: 1

2015 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 1167

House Finance and Taxation Committee

☐ Subcommittee

Amendment LC# or Description: 15.0142.04003

Recommendation: ☒ Adopt Amendment
☐ Do Pass ☐ Do Not Pass ☐ Without Committee Recommendation
☐ As Amended ☐ Rerefer to Appropriations
☐ Place on Consent Calendar

Other Actions: ☐ Reconsider ☐ ____________

Motion Made By Rep. Froseth Seconded By Rep. ~~Ho~~ Strinden

Representatives	Yes	No	Representatives	Yes	No
CHAIRMAN HEADLAND			REP HAAK		
VICE CHAIRMAN OWENS			REP STRINDEN		
REP DOCKTER			REP MITSKOG		
REP TOMAN			REP SCHNEIDER		
REP FROSETH					
REP STEINER					
REP HATLESTAD					
REP KLEIN					
REP KADING					
REP TROTTIER					

Total (Yes) ____________ No ____________

Absent ____________

Floor Assignment ____________

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

Voice vote - Motion carries.

Date: 2-11-15
Roll Call Vote #: 2

2015 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 1167

House Finance and Taxation Committee

☐ Subcommittee

Amendment LC# or Description: 15.0142.04003

Recommendation:
☐ Adopt Amendment
☐ Do Pass ☒ Do Not Pass ☐ Without Committee Recommendation
☒ As Amended ☐ Rerefer to Appropriations
☐ Place on Consent Calendar

Other Actions: ☐ Reconsider ☐ ____________

Motion Made By Rep. Klein Seconded By Rep. Strinden

Representatives	Yes	No	Representatives	Yes	No
CHAIRMAN HEADLAND	✓		REP HAAK	✓	
VICE CHAIRMAN OWENS	AB		REP STRINDEN	✓	
REP DOCKTER	✓		REP MITSKOG	✓	
REP TOMAN	✓		REP SCHNEIDER	✓	
REP FROSETH	✓				
REP STEINER	AB				
REP HATLESTAD	✓				
REP KLEIN	✓				
REP KADING	✓				
REP TROTTIER	✓				

Total (Yes) 12 No 0

Absent 2

Floor Assignment Rep. Froseth

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

REPORT OF STANDING COMMITTEE

HB 1167: Finance and Taxation Committee (Rep. Headland, Chairman) recommends **AMENDMENTS AS FOLLOWS** and when so amended, recommends **DO NOT PASS** (12 YEAS, 0 NAYS, 2 ABSENT AND NOT VOTING). HB 1167 was placed on the Sixth order on the calendar.

Page 1, line 2, replace "an" with "a contingent"

Page 3, line 30, after the first boldfaced period insert "**CONTINGENT**"

Page 3, line 31, after "2014" insert ", but is ineffective for any taxable year if in any month during the first nine months of the immediately preceding taxable year the exemption under subsection 3 of section 57-51.1-03 was effective for the completion of any new horizontal well. For a taxable year for which section 1 of this Act is ineffective as provided in this section, the provisions of subsection 1 of section 57-38-30.3, without the amendments under section 1 of this Act, are effective"

Renumber accordingly

2015 TESTIMONY

HB 1167

HB 1167
1-27-15
#1 p. 1

Mr Chairman and members of the House Finance and Tax Committee,

I have looked forward to meeting with you since 2 years ago when I was before this committee with a proposal to suspend the personal income tax for two years. I'm before you today with a very simple bill: this bill proposes to take the income tax rate to 0% and flatten all brackets to one. It comes with a fiscal note that you'll see and I'm happy to report it's less than $1B. Mr Chairman members of the committee...I considered ending my testimony here, as this really is a simplification to our tax code, but will provide you with further input.

I am of the opinion that a tax on income is a tax on productivity. A consumption tax is a much more fair way to collect revenue than a tax on productivity. Since our unemployment rate is so low in our state, almost everybody can benefit from this policy.

I have always felt the tax code picks winners and losers
Taxes are punitive: governments tax activities they want to change, curb or eliminate: **smoking**
Taxes get reduced to incentivize a behavior that governments want to increase: **housing incentive fund**.

In fact, New York state is advertising all across the nation about tax incentives to move to their state.
Texas Governor Rick Perry is famous for recruiting from other states to his state based on tax policies.
The very nature of taxation on income is illogical...that government can do better with someone's money than they can do with their own.

There are 7 other states with no personal income tax: Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming. New Hampshire collects some tax on dividend and interest income and Tennessee collects similar type taxes on investments.

We have spent the last three sessions reducing personal income taxes while our budgets have grown dramatically. We have failed to eliminate brackets after de-coupling ND state income tax from the federal government. A progressive system that requires different tax rates based on income makes no sense. Those in the high end brackets are already paying more dollars in taxes yet we add an additional layer of burden by increasing the percentage of income paid as well....all for the benefit of receiving similar services (in theory).

This is like taking an effective rate for example from 3% to 2%, only it goes from the current rates to 0%. Yes, less revenue to the government but would also have the effect of restricting unnecessary spending because “we have the money”

For those savvy enough to invest in tax credits, I submit that they are also savvy enough to recognize a 0% liability is better than any credit against a liability greater than 0%.

Committee considering tax credits and deductions (which is right vs which is not right)

I don’t buy the arguments that this will cost the state money….there are no costs associated with less revenue to a government.

I also don’t buy the argument that we are only focusing on income taxes and not property taxes...in fact, I will return to your committee with an out of the box idea on property tax reform later this session.

This is not a short term concept, it’s a long term strategy to allow our state citizens to share in the prosperity of our state without violating the state constitution's gifting clause.

We can be an extremely attractive and competitive state for years to come if we could find a way to take the productivity tax to 0%.

I want to give an example of this would occur: Airplane story

Minneapolis to Minot at night….discussion on the plane with the next passenger

Real estate, business climate, government and tax policy

We traded business cards and greeted each other as we deboarded

18 months later I receive the following email:

Hey Scott – not sure if you remember me but we sat next to each other on the plane (1st class) about a year ago from Minneapolis to Minot. During the one hour flight we had a great discussion about tax policy and some of the changes ND needs. It was fun to see one of the ideas we discussed in motion. I wish you luck with this and other ideas you come up with.

Hope you are doing well and looking forward to the session....

The following was sent to him in the chain of email:

Could make it pretty interesting to locate/headquarter in ND (as a C-Corp)…

#1 p. 5

I can't say how many more businesses might relocate to our business friendly state nor can I say how many businesses may start up or stay in our state. I dont know how many families might consider moving to our state or how many might consider staying rather than leaving based on how we treat their income. I'm certain however, this CAN NOT HURT in any of those circumstances.

Members of the committee: I understand this bill has received quite a bit of attention and am also keenly aware of the financial situation in which we found ourselves leading into this session. I have prepared an amendment for the committee's consideration and it does one thing different: If what we commonly refer to as the "large trigger" were to be in place during any point of the previous calendar year, the income tax rate would be 1% rather than 0%. The rate would then return to 0% if the "trigger" were not in place the previous calendar year and would remain at 0% for future years...subject to legislative action (NOT RECOMMENDED)

This concept treats everybody the same...fairly. It does not play class warfare and it doesn't favor types of income. It actually rewards rather than punishes productivity and I would urge strong consideration in this difficult session for this concept.

15.0142.04001
Title.

Prepared by the Legislative Council staff for
Representative Louser
January 26, 2015

HB 1167
1-27-15
#2 p. 1

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1167

Page 1, line 2, after "date" insert "and a contingent effective date; and to provide a contingent expiration date"

Page 3, after line 29, insert:

"**SECTION 2. AMENDMENT.** Subsection 1 of section 57-38-30.3 of the North Dakota Century Code is amended and reenacted as follows:

1. A tax is hereby imposed for each taxable year upon income earned or received in that taxable year by every resident and nonresident individual, estate, and trust. A taxpayer computing the tax under this section is only eligible for those adjustments or credits that are specifically provided for in this section. Provided, that for purposes of this section, any person required to file a state income tax return under this chapter, but who has not computed a federal taxable income figure, shall compute a federal taxable income figure using a pro forma return in order to determine a federal taxable income figure to be used as a starting point in computing state income tax under this section. The tax for individuals is equal to North Dakota taxable income multiplied by the rates in the applicable rate schedule in subdivisions a through d corresponding to an individual's filing status used for federal income tax purposes. For an estate or trust, the schedule in subdivision e must be used for purposes of this subsection.

   a. Single, other than head of household or surviving spouse.

If North Dakota taxable income is:

Over	Not over	The tax is equal to	Of amount over
$0	~~$36,250~~	~~1.22%~~1%	$0
~~$36,250~~	~~$87,850~~	~~$442.25 + 2.27%~~	~~$36,250~~
~~$87,850~~	~~$183,250~~	~~$1,613.57 + 2.52%~~	~~$87,850~~
~~$183,250~~	~~$398,350~~	~~$4,017.65 + 2.93%~~	~~$183,250~~
~~$398,350~~		~~$10,320.08 + 3.22%~~	~~$398,350~~

   b. Married filing jointly and surviving spouse.

If North Dakota taxable income is:

Over	Not over	The tax is equal to	Of amount over
$0	~~$60,650~~	~~1.22%~~1%	$0
~~$60,650~~	~~$146,400~~	~~$739.93 + 2.27%~~	~~$60,650~~
~~$146,400~~	~~$223,050~~	~~$2,686.46 + 2.52%~~	~~$146,400~~

#2 p.2

~~$223,050~~	~~$398,350~~	~~$4,618.04 + 2.93%~~	~~$223,050~~
~~$398,350~~		~~$9,754.33 + 3.22%~~	~~$398,350~~

c. Married filing separately.

If North Dakota taxable income is:

Over	Not over	The tax is equal to	Of amount over
$0	~~$30,325~~	~~1.22%~~1%	$0
~~$30,325~~	~~$73,200~~	~~$369.97 + 2.27%~~	~~$30,325~~
~~$73,200~~	~~$111,525~~	~~$1,343.23 + 2.52%~~	~~$73,200~~
~~$111,525~~	~~$199,175~~	~~$2,309.02 + 2.93%~~	~~$111,525~~
~~$199,175~~		~~$4,877.17 + 3.22%~~	~~$199,175~~

d. Head of household.

If North Dakota taxable income is:

Over	Not over	The tax is equal to	Of amount over
$0	~~$48,600~~	~~1.22%~~1%	$0
~~$48,600~~	~~$125,450~~	~~$592.92 + 2.27%~~	~~$48,600~~
~~$125,450~~	~~$203,150~~	~~$2,337.42 + 2.52%~~	~~$125,450~~
~~$203,150~~	~~$398,350~~	~~$4,295.46 + 2.93%~~	~~$203,150~~
~~$398,350~~		~~$10,014.82 + 3.22%~~	~~$398,350~~

e. Estates and trusts.

If North Dakota taxable income is:

Over	Not over	The tax is equal to	Of amount over
$0	~~$2,450~~	~~1.22%~~1%	$0
~~$2,450~~	~~$5,700~~	~~$29.89 plus 2.27%~~	~~$2,450~~
~~$5,700~~	~~$8,750~~	~~$103.67 plus 2.52%~~	~~$5,700~~
~~$8,750~~	~~$11,950~~	~~$180.53 plus 2.93%~~	~~$8,750~~
~~$11,950~~		~~$274.29 plus 3.22%~~	~~$11,950~~

f. For an individual who is not a resident of this state for the entire year, or for a nonresident estate or trust, the tax is equal to the tax otherwise computed under this subsection multiplied by a fraction in which:

(1) The numerator is the federal adjusted gross income allocable and apportionable to this state; and

#2p.3

(2) The denominator is the federal adjusted gross income from all sources reduced by the net income from the amounts specified in subdivisions a and b of subsection 2.

In the case of married individuals filing a joint return, if one spouse is a resident of this state for the entire year and the other spouse is a nonresident for part or all of the tax year, the tax on the joint return must be computed under this subdivision.

g. The tax commissioner shall prescribe new rate schedules that apply in lieu of the schedules set forth in subdivisions a through e. The new schedules must be determined by increasing the minimum and maximum dollar amounts for each income bracket for which a tax is imposed by the cost-of-living adjustment for the taxable year as determined by the secretary of the United States treasury for purposes of section 1(f) of the United States Internal Revenue Code of 1954, as amended. For this purpose, the rate applicable to each income bracket may not be changed, and the manner of applying the cost-of-living adjustment must be the same as that used for adjusting the income brackets for federal income tax purposes.

h. The tax commissioner shall prescribe an optional simplified method of computing tax under this section that may be used by an individual taxpayer who is not entitled to claim an adjustment under subsection 2 or credit against income tax liability under subsection 7.

i. The tax commissioner shall prescribe adjusted withholding and estimated tax payments schedules to adjust for the delayed implementation of the taxes under this subsection for the first taxable year beginning after December 31, 2015."

Page 3, line 30, after "**DATE**" insert "**- EXPIRATION DATE**"

Page 3, line 30, replace "This" with "Section 1 of this"

Page 3, line 31, after "2014" insert ", and is ineffective for taxable years for which section 2 of this Act has become effective. Section 2 of this Act is effective for taxable years beginning after December 31, 2015, if the director of the office of management and budget certifies by March 31, 2016, to the governor, tax commissioner, and legislative council that state general fund revenue receipts during calendar year 2015 are more than $258 million dollars less than the amount anticipated for that time period by the revenue forecast at the conclusion of the sixty-fourth legislative assembly"

Renumber accordingly

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1-27-15
3 p. 1

January 27, 2015

Chairman Headland and Members of the House finance and taxation committee;

My name is Wayne Papke, I am a registered volunteer lobbyist for Citizens for Responsible Government. C4RG, as we are commonly known by, is a Statewide organization founded to educate the public on the government process and to communicate to government officials our desire to keep the role of government small so as to provide maximum effectiveness to private sector efforts and the free markets.

My purpose here today is to express our full support of HB 1167. Income tax is the road block to broadening our North Dakota industry base. To attract a young, professional labor force which is needed for diversification of our industry, we need a tax policy that is most attractive to young couples. There is no better way to attract a young professional labor base than to put the money that a young couple would have paid in income tax back in their pocket. This demographic of people spend every dime of their incomes on taxes, housing, food, education and medical. To put that extra $ 500 to $ 1000 back in their pocket by taking our tax rate to zero is worth tremendous value to this age group.

Those who pay the majority of North Dakota's income tax are small business people and those in agriculture. Why not put the one tax back in the hands of the most productive people in North Dakota. These are the people who will reinvest it in their business growth and expansion and they will hire more employees with it.

I've heard the argument that income tax should stay because everyone should have some "skin in the game" and share in expenses. This argument, to me, makes no sense. We all already have skin in the game. We all pay sales taxes, we all pay excise taxes and most of us pay property taxes so this argument seems unfounded.

Of the 4 largest oil producing states in the country, we are the only one with an income tax. Now when you combine this with the fact that we have the highest production and extraction tax of these 4, it appears on the surface that we are on the high end of total taxation.

I urge you to look at this bill as one of the best economic development bills you have ever seen, you attract a young professional labor base which in turn will result in added diversification to our industry base. You put the money directly back in the hands of the most productive citizens and business owners in North Dakota who pay the majority of the income tax now. This investment should result in a revenue neutral or better economic & budget impact.

I ask for your yes vote for the benefits that this bill offers the Great State of North Dakota.

I thank you for your time.

Wayne Papke
Citizens for Responsible Government
1612 River Dr NE
Mandan, ND 58554
Tel. (701)226-2739

HB 1167
1-27-15
#4 p.1

Income Tax Reform and Reductions – Addressing HB 1167, 1223, 1296, 1298 Collectively

Testimony by Dustin Gawrylow (Lobbyist #244) N.D. Watchdog Network

1. We can zero-out the income tax, either immediately or in phases – to say that we can't because we don't know what will happen with oil tax revenues ignores the fact that question was not applied to the rate the legislature increased spending in recent years.
2. If zeroing out immediately is too difficult to do, a phase out plan that gives the next session the ability to re-evaluate the 1st phase of tax cuts, without reversing the reductions would be acceptable. Or, basing the phases on triggers of overall revenue would be acceptable.
3. The middle ground, as far as from both a reform and relief standpoint is HB 1296 which takes us to a Flat Tax with medium-sized exemptions for everyone at the bottom.
    - How much those large exemptions should be debated, but this approach is really the moderate of what has been proposed and introduced this session.

Disclaimer: If spending increases the way it has for the last three biennium's, all bets are off as to whether "we can afford" the kind of tax reform and relief the taxpayers deserve.

2015 Proposed Approaches – Ranked

1. **HB 1167 – Zero-Out Now**
2. **HB 1223 – Phase to Zero**
3. **HB 1296 – Flat Rate – w/medium exemptions**
4. **HB 1298 – reduced rates, bottom faster than top**
5. **SB 2349 – small across the board**
6. **SB 2313/2212 – zero bottom bracket, no change for others**

State Business Tax Climate Index 2014
as of July 1, 2013

State	Overall Index Rank	Ranking on Five Component Taxes: Corp. Tax	Ind. Income Tax	Sales Tax	Unemp. Ins. Tax	Prop. Tax
AL	21	19	22	37	15	10
AK	4	28	1	5	29	25
AZ	22	26	18	49	1	6
AR	35	39	26	42	11	19
CA	48	31	50	41	16	14
CO	19	21	15	44	28	22
CT	42	35	33	32	23	49
DE	13	50	28	2	2	13
FL	5	13	1	18	6	16
GA	32	8	41	12	24	31
HI	30	4	35	16	38	12
ID	18	18	23	23	47	3
IL	31	47	11	33	43	44
IN	10	24	10	11	13	5
IA	40	49	32	24	36	38
KS	20	37	17	31	12	29
KY	27	27	29	10	48	17
LA	33	17	25	50	4	24
ME	29	45	21	9	33	40
MD	41	15	46	8	40	41
MA	25	34	13	17	49	47
MI	14	9	14	7	44	28
MN	47	44	47	35	41	33
MS	17	11	20	28	5	32
MO	16	7	27	26	9	7
MT	7	16	19	3	21	8
NE	34	36	30	29	8	39
NV	3	1	1	40	42	9
NH	8	48	9	1	46	42
NJ	49	41	48	46	32	50
NM	38	40	34	45	17	1
NY	50	25	49	38	45	45
NC	44	29	42	47	7	30
ND	28	22	38	21	19	2
OH	39	23	44	30	10	20
OK	36	12	39	39	3	11
OR	12	32	31	4	34	15
PA	24	46	16	19	39	43
RI	46	43	36	27	50	46
SC	37	10	40	22	30	21
SD	2	1	1	34	37	18
TN	15	14	8	43	27	37
TX	11	38	7	36	14	35
UT	9	5	12	20	18	4
VT	45	42	45	13	22	48
VA	26	6	37	6	35	26
WA	6	30	1	48	20	23
WV	23	20	24	25	26	27
WI	43	33	43	15	25	36
WY	1	1	1	14	31	34
DC	44	35	34	41	26	44

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#4 p.2

More than Half of all Private Sector Workers are Employed by Pass-through Businesses

January 22, 2015
By Kyle Pomerleau, Richard Borean

This week's tax map comes from a report we released this morning and takes a look at the amount of private sector employment that comes from pass-through businesses.

Sole propr etorships, S corporations, limited liability companies (LLCs), and partnerships are also known as pass-through businesses. These entities are called pass-throughs, because the profits of these firms are passed directly through the business to the owners and are taxed on the owners' ind vidual income tax returns.

This is in contrast with traditional C corporations, which pay tax at the entity level through the corporate income tax. Their owners (shareholders) then pay tax on this income again when they receive a d v dend or sell their stock and realize a capital ga n.

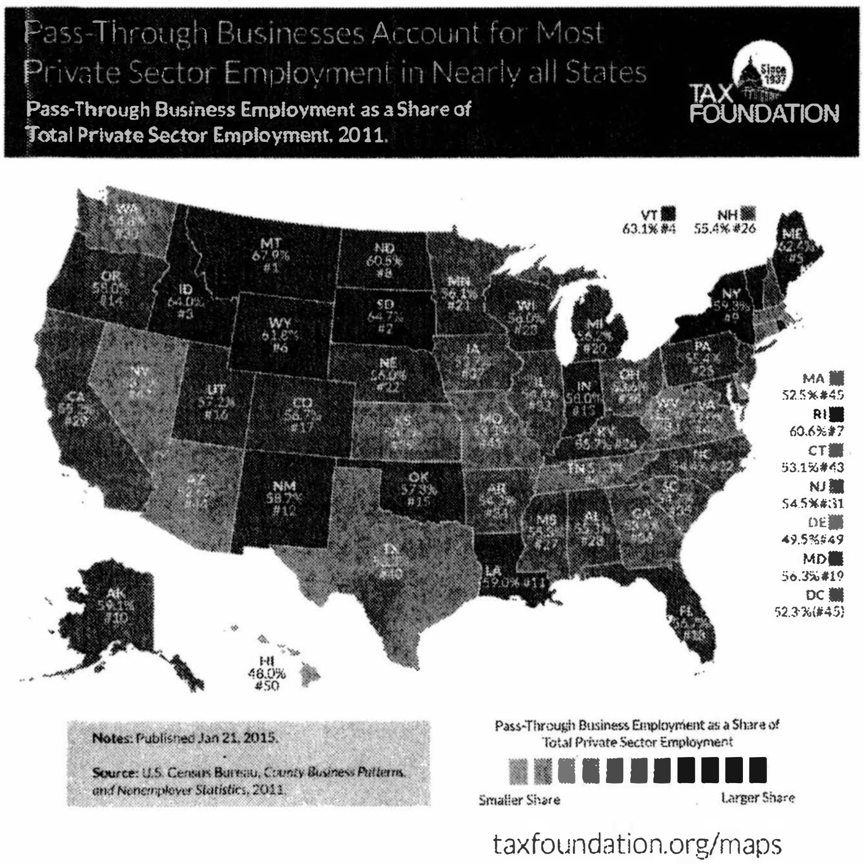
Today, Pass-through businesses pay a sign ficant role in the United States Economy. They account for 95 percent of all businesses and more than 60 percent of all business income.

Even more, pass-through businesses account for 55.2 percent of all private sector employment. This represents 65.7 million workers who are employed at or self-employed as pass-through businesses.

The prevalence of pass-through employment varies among U.S. states. According to 2011 Census Bureau data, pass-through businesses accounted more than 60 percent of business employment in eight states: Idaho (64 percent), Maine (62.4 percent), Montana (67.9 percent), North Dakota (60.5 percent), Rhode Island (60.6 percent), South Dakota (64.7 percent), Vermont (63.1 percent), and Wyoming (61.8 percent).

In contrast, Delaware (49.5 percent) and Hawa (48 percent) had pass-through employment as a share of total private sector employment of less than 50 percent.

Click on map to enlarge. (See our reposting policy here.)



Read more about pass-through businesses here.

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TAX FOUNDATION
Since 1937

SPECIAL REPORT

Jan. 2015
No. 227

An Overview of Pass-through Businesses in the United States

By Kyle Pomerleau
Economist

Key Findings

- Pass-through business income is taxed on the business owners' tax returns through the individual income tax code.
- Pass-through business income faces marginal tax rates that exceed 50 percent in some U.S. states.
- Pass-through businesses face only one layer of tax on their profits compared to the double taxation faced by C corporations.
- The number of pass-through businesses has nearly tripled since 1980, while the number of traditional C corporations has declined.
- Pass-through businesses earn more net business income than C corporations.
- Pass-through businesses employed more than 50 percent of the private sector work force and accounted for 37 percent of total private sector payroll in 2011.
- Although pass-through businesses are smaller than C corporations on average, they are not all small businesses. Many people work for large pass-through companies.
- The majority of pass-through business income is taxed at top individual tax rates.
- Tax reform aimed at improving the competitiveness of U.S. businesses needs to address the individual income tax code due to the economic importance of pass-through businesses.

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Introduction

One of the goals of tax reform is to improve the competitiveness of U.S. businesses and grow the economy. A promising way to do that is by lowering taxes on saving and investment through business tax reform. Much time is devoted to improving the corporate side of the tax code, but corporate-only business tax reform misses a significant portion of business activity.

The United States currently has a large number of pass-through businesses, or businesses that pay their taxes through the individual income tax code rather than through the corporate code. These sole proprietorships, S corporations, and partnerships make up the vast majority of businesses and more than 60 percent of net business income in America. In addition, pass-through businesses account for more than half of the private sector workforce and 37 percent of total private sector payroll. Pass-through businesses are represented in all industries in the United States.

Given that pass-through businesses are a significant part of the U.S. economy, tax reform should address the individual income tax code along with the corporate tax code.

What Are Pass-through Businesses?

Table 1. Major Types of Pass-through Businesses

Legal Form	Description
Sole Proprietorship	An unincorporated business owned by a single individual that reports its income on schedule C of the 1040 tax form.
Partnership	An unincorporated business with multiple owners, either individuals or other businesses.
Limited Liability Company (LLC)	A type of business that has limited liability like a traditional C corporation.
S Corporation	A domestic corporation that can only be owned by U.S. citizens (not other corporations or partnerships) and can only have up to 100 shareholders.

Sole proprietorships, S corporations, limited liability companies (LLCs), and partnerships are also known as pass-through businesses (Table 1). These entities are called pass-throughs, because the profits of these firms are passed directly through the business to the owners and are taxed on the owners' individual income tax returns.

This is in contrast with traditional C corporations, which pay tax at the entity level through the corporate income tax. Their owners (shareholders) then pay tax on this income again when they receive a dividend or sell their stock and realize a capital gain.

Another difference between pass-through businesses and traditional C corporations is that owners of pass-through businesses pay the full tax on their business's income every year as the business earns it. Contrast this with owners or shareholders of C corporations, who can defer the taxation on their share of corporate income as long as the corporation retains its earnings or if the shareholder does not realize a capital gain on his stock.

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#4 p. 5

What Taxes Do Pass-through Businesses Pay?

Since pass-through businesses pass their income and losses directly to their owners, these businesses face the same marginal tax rates as individuals. These rates start at 10 percent on the first $9,075 of taxable income ($18,150 married filed jointly) and rise to 39.6 percent on taxable income over $406,750 ($457,601 married filed jointly) (Table 2).

Table 2. 2014 Federal Income Tax Brackets and Rates, Pass-through Businesses

Rate	Single Filers	Married Joint Filers
10%	$0 to $9,075	$0 to $18,150
15%	$9,076 to $36,900	$18,151 to $73,800
25%	$36,901 to $89,350	$73,801 to $148,850
28%	$89,351 to $186,350	$148,851 to $226,850
33%	$186,351 to $405,100	$226,851 to $405,100
35%	$405,101 to 406,750	$405,101 to 457,600
39.6%	$406,751+	$457,601+

Source: Internal Revenue Service.

In addition, sole proprietorships and partnerships pay the self-employment (SE) tax. SE taxes are levied on self-employment income in order to fund both Social Security and Medicare and are ultimately equivalent to what wage earners pay in payroll taxes.[1] The SE payroll tax is a combined 15.3 percent on the first $117,000, 2.9 percent on the next $83,000, and 3.8 percent on any income above $200,000 ($250,000 for joint filers) (Table 3).

Table 3. Payroll and Self-Employment Taxes for a Single Filer, 2014

Taxable Earnings	Social Security	Medicare	Total
$0-$117,000	12.40%	2.9%	15.3%
$117,000-$200,000	0%	2.9%	2.9%
$200,000 and over	0%	3.8%	3.8%

Source: Social Security Administration.

Owners of sole proprietorships and partnerships are subject to the SE payroll tax on most of their net business income.[2] S corporation owners are subject to SE payroll taxes on the portion of their net income paid out in wages. Specifically, an owner of an S corporation can designate his income as either a profit distribution or wages. The income designated as wages is subject to the SE tax while the non-wage income is not.[3]

S corporation income earned by a passive shareholder—an S corporation owner that does not actively participate in the day-to-day activities of the business but still receives income [4]—is not subject to the SE payroll tax. However, a passive shareholder is liable for the 3.8

1 Half of a worker's payroll taxes are paid by their employer.
2 Rental real estate income is exempt from the self-employment tax.
3 The IRS sets a limit on how much income an owner can designate as a non-wage distribution to prevent abuse.
4 The IRS sets guidelines on what they consider active or passive participation. If shareholders do not satisfy the "material participation" guidelines, the income received from the business is deemed passive and subject to the Net Investment Income Tax. *See Michael Kosnitzky & Michael Grisolia, Net Investment Income Tax Regulations Affecting S Corporations*, http://www.bsflip.com/news/in_the_news/001548/_res/id=sa_File1/.

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percent Net Investment Income Tax that was passed as part of the Affordable Care Act.[5] This tax applies to investment income when a taxpayer's modified AGI exceeds $200,000 ($250,000 for joint filers).

Pass-through business income can also be subject to the Alternative Minimum Tax (AMT), which increases the effective tax rate paid by business owners.[6]

In addition, pass-through businesses pay state and local income taxes, which vary from zero percent in states without personal income taxes to 13.3 percent, the top marginal income tax rate in California.[7]

Combined, the top marginal income tax rates faced by pass-through businesses can exceed 50 percent in some cases. For example, the top marginal tax rate faced by sole proprietors in California tops 51.9 percent (see Table 4). The top marginal income tax rate for active shareholders of S corporations is slightly lower, since they do not pay the payroll tax on non-wage, business income (California's top rate is 48.8 percent).[8] Passive S corporation shareholders in California face an effective marginal rate of 52.6 percent.

Table 4. Top Marginal Tax Rate for a Sole Proprietorship in California

Top Marginal Federal Income Tax	39.60%
Top Marginal State Income Tax	13.30%
Self-employment Tax	3.80%
Deduction for State/Local Income Taxes and Self Employment Taxes (Less Pease)	-4.80%
Total	51.90%

Source: Author's calculations.

The average top marginal income tax rate on sole proprietorships and partnerships in the United States is 47.2 percent, and 44.5 and 48.3 percent, respectively, for active and passive shareholders of S corporations.[9]

5 Regulations require equal distribution among all S corporation shareholders, active or passive. S corporations must distribute enough money to all shareholders, including active shareholders, to cover the 3.8 percent Net Investment Tax, even though active shareholders are not actually required to pay the tax. Although not strictly a tax on S corporations, this limits the amount of money available for reinvestment.

6 More than 2 million income tax returns with pass-through business income were subject to the AMT in 2007. U.S. Department of the Treasury, Office of Tax Analysis, Mathew Knittel et al., OTA Technical Paper 4: *Methodology to Identify Small Businesses and Their Owners (Aug. 2011)*, http://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/OTA-T2011-04-Small-Business-Methodology-Aug-8-2011.pdf.

7 Tax Foundation, *State Personal Income Tax Rates and Brackets 2014 Update*, http://taxfoundation.org/article/state-personal-income-tax-rates-and-brackets-2014-update.

8 Assuming the last dollar earned by an active shareholder is his non-salary income from his business.

9 Averages are both weighted by the amount of pass-through income in each state. Assumes no effect of Pease in states with no individual income tax. Pease may apply in states with no income tax, in some cases adding 1.118 percent to the marginal rate. Many states also apply gross receipts, margin, and franchise taxes to pass-through business income. These numbers do not account for those.

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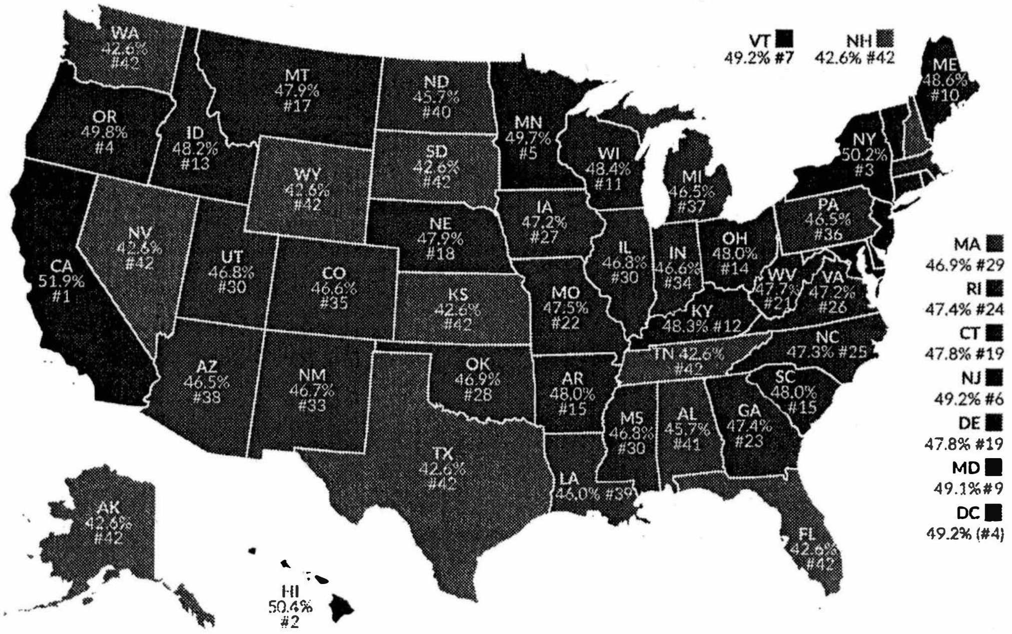
Figure 1. Pass-through Businesses Face Marginal Tax Rates Over 50 percent in Some States

Combined Federal and State Top Marginal Income Tax Rate on Sole Proprietorships and Partnerships, 2014



Notes: Marginal tax rates include federal, state, and local income taxes, payroll taxes, the deduction for state and local income taxes, and the effect of the Pease limitation on itemized deductions. Published January 20, 2015.

Source: State statutes, state tax forms and instructions; Tax Foundation calculations.

Tax Differential with Traditional C Corporations

Due to the different tax treatment of pass-through businesses and C corporations, the two business forms face a tax burden differential (see Table 5). C corporations are first taxed at the entity level at the 39.1 percent combined federal and average state tax rate.[10] Then, when those profits are realized by the owners (shareholders) as either dividends or capital gains, the owners pay taxes on that income again. The double-taxation of corporate income creates a disparity between the total tax burden on the income of pass-through businesses and C corporations.

Pass-through businesses facing the top marginal tax rate (combined with the average state rate) face an average rate of 47.2 percent compared to an average total tax rate of 56.5 percent on C corporate income realized at the shareholder level.

10 Assuming equity-financed investment.

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Table 5. Total Tax Burden on Business Income, C Corporation vs. Pass-through Business

	Traditional C corporation	Pass-through business
Entity-Level Tax	39.1%	0.0%
Individual-Level Tax	28.6%	47.2%
Total Tax Rate	56.5%	47.2%

Note: Assumes C corporation distributes dividends. Pass-through business is a partnership.
Source: Author's calculations.

Although traditional C corporations pay a higher overall tax rate on their income, there are specific advantages to the C corporate form that make it worthwhile for some businesses, specifically the ease of raising money, less restrictive shareholder rules (compared to an S corporation), deferral of domestic taxation on foreign income, and the ability to retain earnings without triggering shareholder taxation.[11]

The Number of Pass-through Businesses Filing Tax Returns Has Greatly Increased Over the Past Thirty Years

The number of pass-through businesses in the United States has increased considerably since the Tax Reform Act of 1986, which substantially lowered individual income tax rates.[12]

Between 1980 and 2011, the number of pass-through business tax returns has increased by 175 percent from roughly 10.9 million returns to about 30 million returns (Figure 2).[13] The number of sole proprietorships increased from 8.9 million in 1980 to 23.4 million in 2011. The number of partnership businesses grew from 1.3 million returns to 3.2 million returns.

S corporations experienced the fastest growth during this period. From 1980 to 2011, the number of S corporations filing tax returns grew from approximately 545,000 returns to over 4.15 million; an increase of 660 percent, more than three times the rate of growth experienced by pass-through businesses overall.

The number of C corporations filing tax returns during this period steadily declined from 2.2 million returns in 1980 to 1.6 million returns in 2011.

11 Nearly 40 percent of corporate equities are held by tax-exempt organizations and individuals (college endowments, pension funds, and tax preferred retirement accounts). The corporate income passed to these taxpayers is exempt from the second layer of tax. *See Congressional Budget Office, Taxing Capital Income: Effective Marginal Tax Rates Under 2014 Law and Selected Policy Options (Dec. 2014)*, http://www.cbo.gov/sites/default/files/cbofiles/attachments/49817-Taxing_Capital_Income_0.pdf.

12 The top marginal individual income tax rates were reduced from 50 percent in 1986 to 28 percent in 1988. This is compared to the corporate income tax rate that was lowered from 46 percent in 1986 to 34 percent in 1988. *See Tax Foundation, U.S. Federal Individual Income Tax Rates History, 1862-2013 (Nominal and Inflation-Adjusted Brackets)*, http://taxfoundation.org/article/us-federal-individual-income-tax-rates-history-1913-2013-nominal-and-inflation-adjusted-brackets; Tax Foundation, *U.S. Federal Individual Income Tax Rates History, 1862-2013 (Nominal and Inflation-Adjusted Brackets)*, http://taxfoundation.org/article/us-federal-individual-income-tax-rates-history-1913-2013-nominal-and-inflation-adjusted-brackets.

13 Internal Revenue Service, *SOI Tax Stats -- Integrated Business Data, 1980–2008*, http://www.irs.gov/uac/SOI-Tax-Stats-Integrated-Business-Data; Internal Revenue Service, *Business Tax Statistics, 2009–2011*, http://www.irs.gov/uac/Tax-Stats-2. IRS data double counts some businesses due to the fact that some private partnerships can be owned by one or more other business entities.

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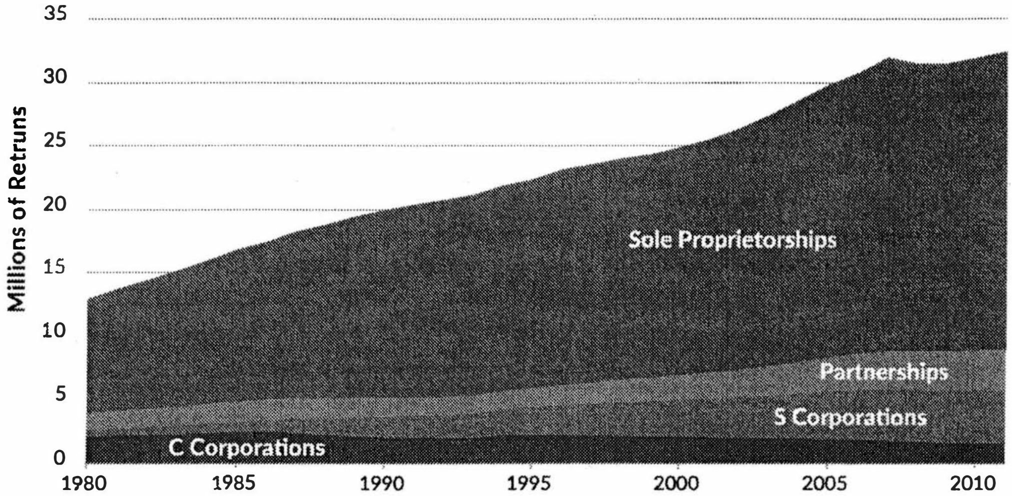
7

Figure 2. The Number of Pass-through Businesses has Nearly Tripled Since 1980

Number of Business Tax Returns by Business Form, 1980–2011

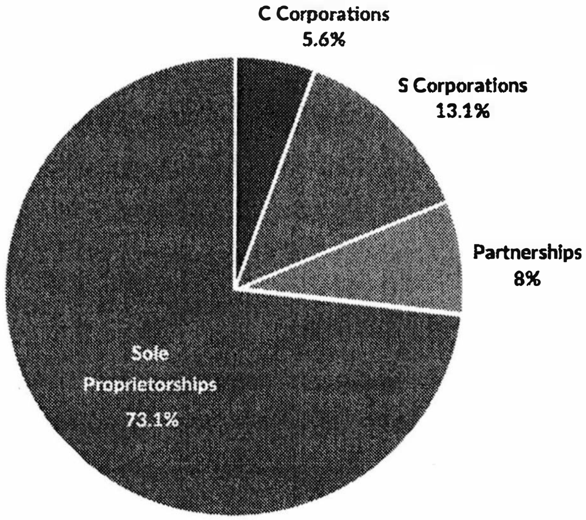


Source: IRS.

Pass-through Businesses Are the Most Common Business Form in the United States

Pass-through businesses are the most common business form in the United States. Of the 27.7 million firms in 2011,[14] about 94 percent of them were pass-through businesses according to the Census Bureau (Figure 3).[15]

Figure 3. Sole Proprietorships Are a Majority of All Businesses



Source: Census Bureau.

14 The number of firms differs from the number of returns. Specifically, an individual firm may own several different businesses that separately file tax returns.

15 Census Bureau, *County Business Patterns*, http://www.census.gov/econ/cbp/; Census Bureau, *Nonemployer Statistics*, http://www.census.gov/econ/nonemployer/. 2011 is the most up-to-date year for all data sources.

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Sole proprietorships comprise the majority of all business forms. According to Census data, 73.1 percent of all businesses were sole proprietorships (20.3 million firms). 13.1 percent of all businesses were S corporations (3.65 million firms), and about 8 percent were partnerships (2.2 million firms).

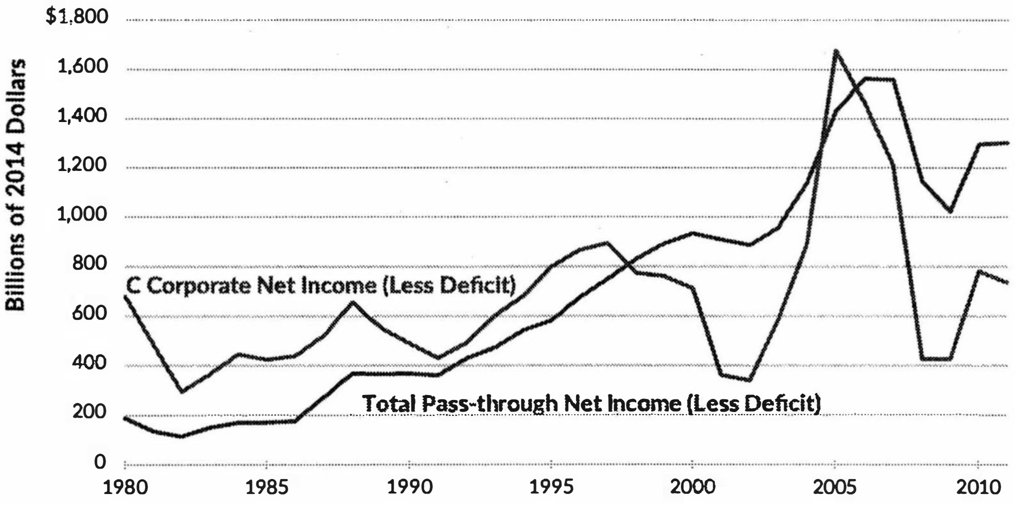
C corporations make up the remaining 5.6 percent of businesses in the United States (1.5 million firms).

Pass-through Businesses Now Earn More Net Income Than Traditional C Corporations

As the number of pass-through businesses increased, they began to generate more net business income as a group than traditional C corporations. The combined net income of sole proprietorships, partnerships, and S corporations in 1980 was $188 billion compared to total C corporate net income of $697 billion (Figure 4).[16] By 1998, net pass-through income had grown by 340 percent to $829 billion, overtaking C corporate income—$773 billion in 1998—for the first time.

Figure 4. Pass-through Businesses Now Earn More Net Income Than Traditional C Corporations

Net Business Income, C Corporations vs. Pass-through Businesses, 1980–2011



Source: IRS.

Pass-through business income has been persistently higher than corporate income since 1998, with the exception of 2005, when corporate net income peaked at $1.6 trillion. The most recent data shows that pass-through businesses earned $1.3 trillion in net income, or 63.9 percent of total business net income in 2011.

16 Internal Revenue Service, *SOI Tax Stats – Integrated Business Data, 1980–2008*, http://www.irs.gov/uac/SOI-Tax-Stats-Integrated-Business-Data; Internal Revenue Service, *Business Tax Statistics, 2009–2011*, http://www.irs.gov/uac/Tax-Stats-2.

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9

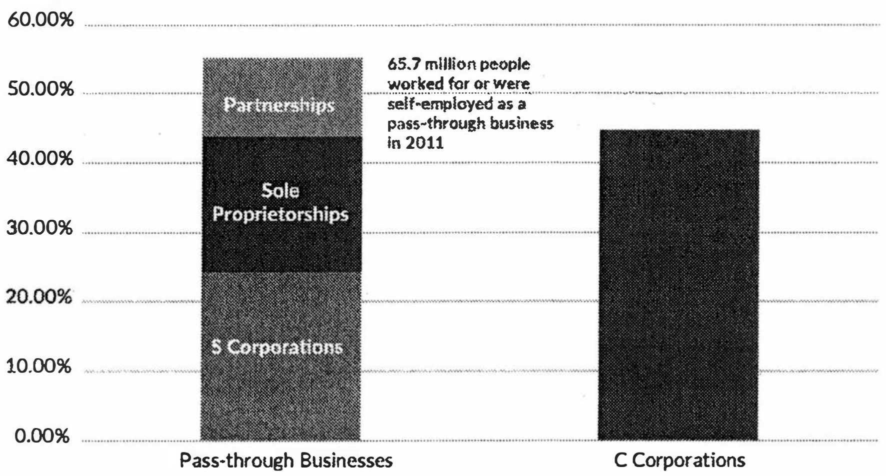
Most of the Private Sector Workforce Works at, or Is Self-Employed as, a Pass-through Business

Not only do pass-through businesses earn more net income than traditional C corporations, they also account for more employment.

According to 2011 Census data, pass-through businesses account for 55.2 percent of all private sector employment.[17] This represents 65.7 million workers. In contrast, traditional C corporations comprise 44.7 percent of the private sector workforce, or 53.2 million workers.

S corporations account for the most employment of all pass-through business types. In 2011, S corporations employed 24.4 percent of the private sector workforce, or 29 million workers. Sole Proprietorships comprised 19.5 percent of the private sector workforce. Partnerships accounted for the lowest amount of employment with only 11.3 percent of the private sector workforce.

Figure 5. Pass-through Businesses Employ More Than Half of the Private Sector Workforce
Share of Private Sector Workforce by Business Type, 2011



Source: Census Bureau.

Pass-Through Businesses Are Generally Smaller Than C Corporations, but Pass-Through Businesses Are Not Always Small Businesses

A major reason why C corporations account for a significant amount of employment but so few firms is that they are significantly larger than pass-through businesses on average. Figure 6, below, compares the distribution of pass-through and corporate employment by the size of firm.

17 Numbers include self-employed individuals in order to get a complete picture of employment by business form. Census Bureau, *County Business Patterns*, http://www.census.gov/econ/cbp/; Census Bureau, *Statistics of U.S. Businesses*, http://www.census.gov/econ/susb/; Census Bureau, *Nonemployer Statistics 2011*, http://www.census.gov/econ/nonemployer/.

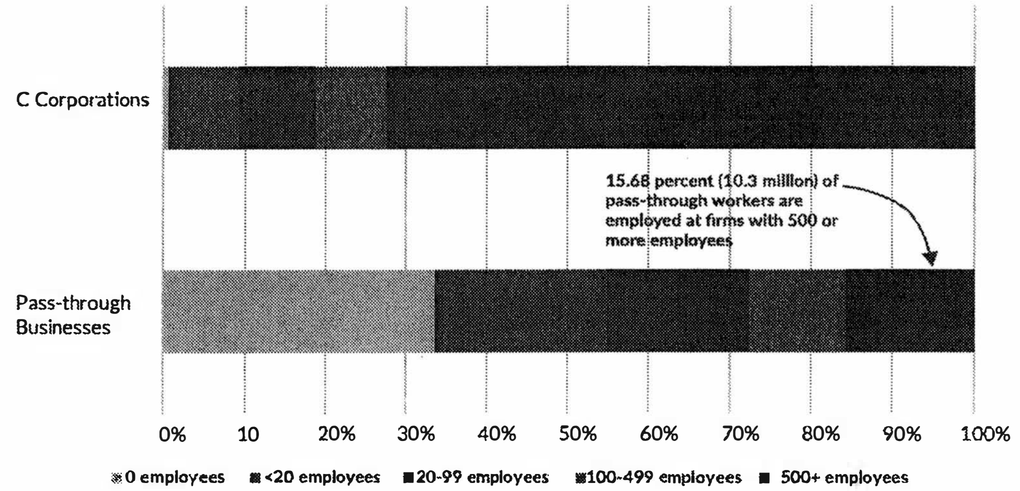
11

Employment at C corporations is heavily concentrated in large firms. In 2011, 72.3 percent (38 million) of C corporate workers were employed at large firms with 500 or more employees with an additional 8.9 percent (4.7 million) working at firms with between 100 and 500 employees.[18] The remaining 18.7 percent (9.9 million) of corporate employment was at firms with fewer than 100 employees.

Pass-through business employment is more heavily distributed among smaller firms. However, it would be a mistake to completely conflate pass-through businesses with small businesses. While most pass-through employment is either self-employment (33.6 percent) or at small firms with between 1 and 100 employees (38.7 percent), a significant number of employees work at large pass-through businesses. According to 2011 Census data, a combined 27.5 percent (18.1 million) of pass-through employment was at firms with more than 100 employees, and 15.9 percent (10.3 million) of pass-through employees work at large firms with 500 or more employees.

Figure 6. Not All Pass-through Businesses Are Small Businesses

Distribution of Pass-through and Corporate Employment by Firm Size, 2011



Source: Census Bureau.

Pass-through Businesses Account for Most of the Private Sector Workforce in 48 States

The prevalence of pass-through employment varies among U.S. states. According to Census Bureau data, pass-through businesses accounted more than 60 percent of business employment in eight states: Idaho (64 percent), Maine (62.4 percent), Montana (67.9 percent), North Dakota (60.5 percent), Rhode Island (60.6 percent), South Dakota (64.7

18 Census Bureau, *County Business Patterns*, http://www.census.gov/econ/cbp/; Census Bureau, *Statistics of U.S. Businesses*, http://www.census.gov/econ/susb/; Census Bureau, *Nonemployer Statistics 2011*, http://www.census.gov/econ/nonemployer/.

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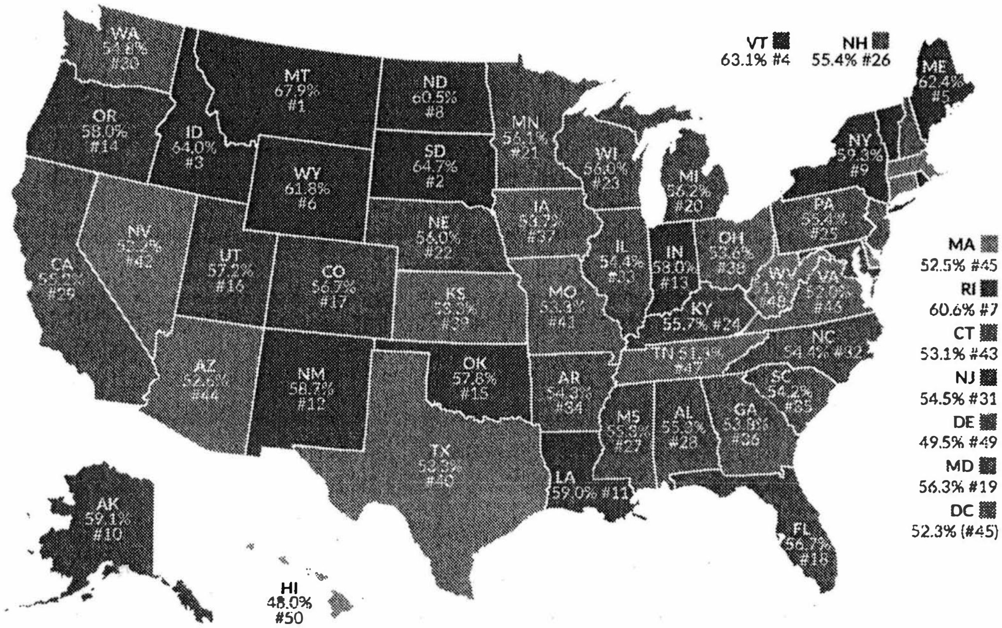
percent), Vermont (63.1 percent), and Wyoming (61.8 percent).[19] In contrast, Delaware (49.5 percent) and Hawaii (48 percent) had pass-through employment as a share of total private sector employment of less than 50 percent.[20]

Figure 7. Pass-through Businesses Account for Most Private Sector Employment in Nearly all States

Pass-through Business Employment as a Share of Total Private Sector Employment, 2011



Notes: Published January 21, 2015.

Source: U.S. Census Bureau, *County Business Patterns*, and *Nonemployer Statistics*, 2011.

Pass-Through Business Employment as a Share of Total Private Sector Employment

Smaller Share — Larger Share

Pass-Through Businesses Accounted for Nearly 40 Percent of Private Sector Payroll

Pass-through businesses also account for a significant amount of private sector payroll. Of the $4.48 trillion of salaries and wages paid in 2011, pass-through businesses accounted for approximately $1.65 trillion, or 37 percent (Figure 8).[21] S corporations accounted for most pass-through business payroll with a total of $1 trillion. Partnerships paid $505 billion and sole proprietorships paid $98 billion.[22]

19 Census Bureau, *County Business Patterns*, http://www.census.gov/econ/cbp/; Census Bureau, *Statistics of U.S. Businesses*, http://www.census.gov/econ/susb/; Census Bureau, *Nonemployer Statistics 2011*, http://www.census.gov/econ/nonemployer/.

20 See Appendix for full employment data table.

21 Census Bureau, *County Business Patterns*, http://www.census.gov/econ/cbp/; Census Bureau, *Statistics of U.S. Businesses*, http://www.census.gov/econ/susb/; Census Bureau, *Nonemployer Statistics 2011*, http://www.census.gov/econ/nonemployer/.

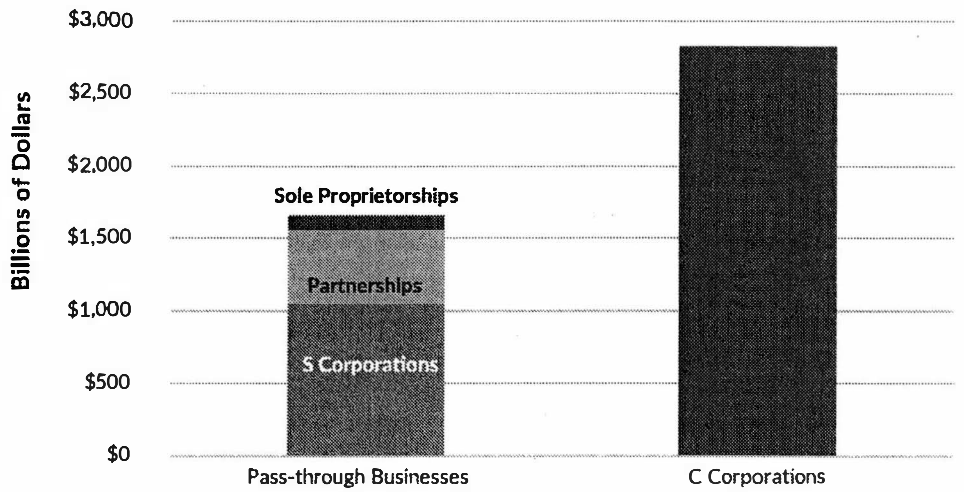
22 These numbers do not account for self-employment income, which is disproportionately earned by pass-through businesses, especially sole proprietorships. Unincorporated self-employed individuals reported approximately $600 billion in gross receipts in 2011. However, gross receipts cannot be directly compared to payroll due to the omission of business expenses. Wages would more accurately be compared to gross receipts minus costs.

#4 p.14

However, given their larger size, C corporations accounted for most of the private sector payroll in the United States. In 2011, 63 percent of private sector payroll was paid by C corporations, or $2.8 trillion.[23]

Figure 8. Pass-through Businesses Paid $1.6 Trillion in Wages and Salaries in 2011

Total Payroll by Business Form, 2011



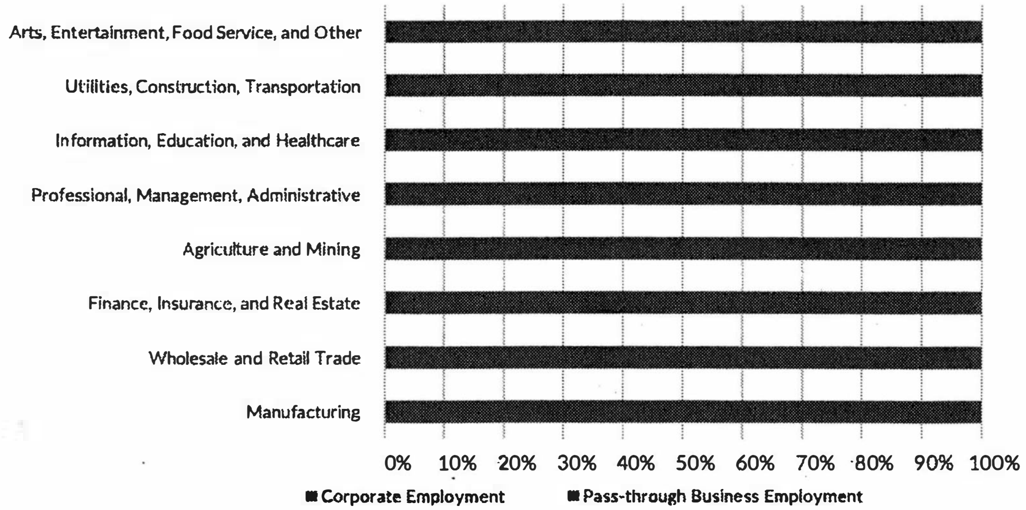
Source: Census Bureau.

Pass-through Businesses Employ the Majority of Workers in Service Sector Industries

Pass-through businesses employ workers in every industry. However, service sector industries have larger shares of pass-through employment than corporate employment. In contrast, manufacturing and trade industries are dominated by C corporate employment.

Figure 9. Pass-through Business Employment Dominates Service Industries

Share of Corporate and Pass-through Employment by Industry, 2011



Source: Census Bureau.

23 See Appendix for full data table with payroll by state and business form for 2011.

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Figure 9 shows the share of corporate versus pass-through employment by industry. According to Census data, pass-through business employment accounts for most employment in most industries. Pass-through employment accounts for 60 percent or more employment in the Arts, Entertainment, and Food Service (72.1 percent); Utilities, Construction, and Transportation (60.8 percent); and Information, Education, and Healthcare (60.3 percent) industries.[24]

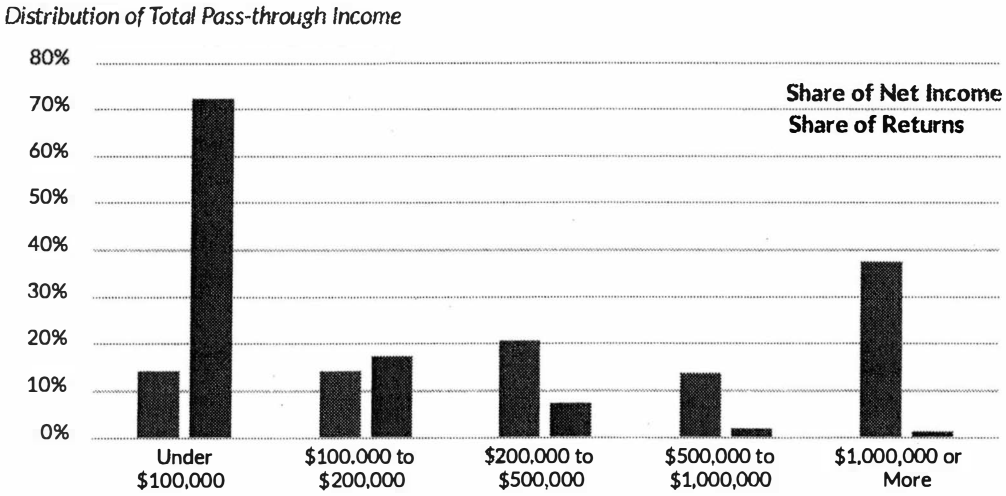
C corporations accounted for a majority of employment in only three major industries: manufacturing (63.7 percent); wholesale and retail trade (58 percent); and Finance, Insurance, and Real Estate (50.6 percent).

Although C corporations accounted for more employment in these industries, there are consistently more pass-through businesses (firms) in all industries. For example, most employment in manufacturing is at C corporations, but the vast majority of manufacturing firms are pass-through businesses.[25] (See Appendix for complete industry numbers.)

High Income Individuals Report Most Pass-through Business Income

Since pass-through business income is taxed at the individual level, the distribution of pass-through income across individuals is important in understanding the effect of individual marginal tax rates.

Figure 10. High Income Taxpayers Report Most Pass-through Business Income



Source: IRS.

24 Census Bureau, *County Business Patterns*, http://www.census.gov/econ/cbp/; Census Bureau, *Statistics of U.S. Businesses*, http://www.census.gov/econ/susb/; Census Bureau, *Nonemployer Statistics 2011*, http://www.census.gov/econ/nonemployer/.

25 Robert Carroll & Gerald Prante, *The Flow-Through Business Sector and Tax Reform: The economic footprint of the flow-through sector and the potential impact of tax reform (Apr. 2011)*, http://www.s-corp.org/wp-content/uploads/2011/04/Flow-Through-Report-Final-2011-04-08.pdf.

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If most pass-through business income were earned by low to moderate income individuals, pass-through business income would face relatively low marginal rates. Conversely, if most business income is earned by high-income individuals, pass-through business income would be taxed at potentially high marginal rates.

According to IRS data, 72 percent of returns with business income reported between $1 and $100,000 in business income.[26] However, these returns only accounted for 14 percent of total business income.[27]

The largest concentration of pass-through business income was reported on the 1.3 percent of returns that earned $1 million in net business income or more. This group of taxpayers earned 37 percent of total pass-through business income.

Combined with the 1.8 percent of tax returns with business income between $500,000 and $1 million, 51 percent of business income was earned by the few taxpayers (3.1 percent of returns) with net business income of $500,000 or more.

This means that 51 percent of pass-through business income in 2012 was potentially subject to the federal top marginal tax rate on individual income of 39.6 percent.

Conclusion

In the last thirty years, the number of pass-through businesses has greatly increased while the number of C corporations has declined. As a result, pass-through businesses now account for 94 percent of all businesses, earn more than 64 percent of total business net income, and employ more than half of the private sector workforce in the United States. In addition, they pay more than $1.6 trillion in wages and salaries and operate in every U.S. industry.

One of the main goals of fundamental tax reform is to make U.S. businesses more competitive and to increase economic growth. This requires a reduction in taxes on businesses and investment. Most attention is given to traditional C corporations because they face high tax burdens by international standards and account for a large amount of economic activity. As a result, less attention has been given to pass-through businesses. Since pass-through businesses now account for more than half of the business income and employment in the United States, any business tax reform needs to address the individual income tax code as well as the corporate income tax code.

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26 Internal Revenue Service, *SOI Tax Stats – Individual Statistical Tables by Size of Adjusted Gross Income, Table 1.4*, http://www.irs.gov/uac/SOI-Tax-Stats---Individual-Statistical-Tables-by-Size-of-Adjusted-Gross-Income. Business income includes: business and professional income (Schedule C, 1040 Line 12), Rents, Royalties, S Corporation and Partnerships income (Schedule E), and Farm Income (Schedule F).

27 It is important to note that individuals can report business income from incidental business activity. For example, an individual can earn rental income from a vacation home.

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Appendix

Appendix Table 1. Combined Top Marginal Tax Rate on Pass-through Businesses by State, 2014

State	Top Marginal Income Tax Rate (Sole Proprietorships/ Partnerships)	Top Marginal Income Tax Rate (S Corporations)	
		Active Shareholders	Passive Shareholders
Alabama	45.65%	42.67%	46.47%
Alaska	42.58%	39.60%	43.40%
Arizona	46.51%	43.53%	47.33%
Arkansas	48.00%	45.02%	48.82%
California	51.86%	48.88%	52.68%
Colorado	46.56%	43.58%	47.38%
Connecticut	47.81%	44.83%	48.63%
Delaware	47.81%	44.83%	48.63%
Florida	42.58%	39.60%	43.40%
Georgia	47.39%	44.41%	48.21%
Hawaii	50.41%	47.43%	51.23%
Idaho	48.24%	45.26%	49.06%
Illinois	46.79%	43.81%	47.61%
Indiana	46.61%	43.63%	47.43%
Iowa	47.22%	44.25%	48.05%
Kansas	42.58%	39.60%	43.40%
Kentucky	48.30%	45.32%	49.12%
Louisiana	45.96%	42.98%	46.78%
Maine	48.57%	45.59%	49.39%
Maryland	49.05%	46.07%	49.87%
Massachusetts	46.91%	43.93%	47.73%
Michigan	46.52%	43.54%	47.34%
Minnesota	49.72%	46.74%	50.54%
Mississippi	46.79%	43.81%	47.61%
Missouri	47.51%	44.53%	48.33%
Montana	47.93%	44.96%	48.76%
Nebraska	47.90%	44.92%	48.72%
Nevada	42.58%	39.60%	43.40%
New Hampshire	42.58%	39.60%	43.40%
New Jersey	49.18%	46.21%	50.01%
New Mexico	46.73%	43.75%	47.55%
New York	50.24%	47.26%	51.06%
North Carolina	47.27%	44.29%	48.09%
North Dakota	45.71%	42.73%	46.53%
Ohio	48.01%	45.03%	48.83%
Oklahoma	46.94%	43.96%	47.76%
Oregon	49.81%	46.83%	50.63%
Pennsylvania	46.53%	43.55%	47.35%
Rhode Island	47.38%	44.41%	48.21%
South Carolina	48.00%	45.02%	48.82%
South Dakota	42.58%	39.60%	43.40%
Tennessee	42.58%	44.41%	48.21%
Texas	42.58%	39.60%	43.40%
Utah	46.79%	43.81%	47.61%
Vermont	49.17%	46.19%	49.99%
Virginia	47.24%	44.26%	48.06%
Washington	42.58%	39.60%	43.40%
West Virginia	47.69%	44.71%	48.51%
Wisconsin	48.39%	45.41%	49.21%
Wyoming	42.58%	39.60%	43.40%
District of Columbia	49.17%	46.19%	49.99%
U.S. Average	47.25%	44.51%	48.31%

Note: Many states also apply gross receipts, margin, and franchise taxes to pass-through business income. These numbers do not account for those.

Source: Author's calculations.

.17

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Appendix Table 2. Employment by Business Form and State, 2011

	C Corporations		Pass-through Total		Sole Proprietorship		Partnership		S Corporations	
State	Share	Employment	Share	Employment	Share	Employment	Share	Employment	Share	Employment
Alabama	44.66%	759,390	55.34%	941,143	19.86%	337,810	10.38%	176,477	25.10%	426,856
Alaska	40.87%	109,453	59.13%	158,359	22.64%	60,631	11.60%	31,054	24.90%	66,674
Arizona	47.42%	1,082,867	52.58%	1,200,610	17.43%	397,950	12.50%	285,528	22.65%	517,132
Arkansas	45.68%	470,789	54.32%	559,763	19.41%	200,025	10.43%	107,464	24.48%	252,274
California	44.79%	6,281,899	55.21%	7,743,121	22.55%	3,162,609	9.67%	1,356,736	22.99%	3,223,776
Colorado	43.28%	940,781	56.72%	1,233,139	18.54%	402,999	13.04%	283,389	25.15%	546,751
Connecticut	46.90%	670,857	53.10%	759,461	20.03%	286,557	14.79%	211,596	18.27%	261,308
Delaware	50.50%	183,955	49.50%	180,326	13.57%	49,425	13.63%	49,656	22.30%	81,245
District of Columbia	47.72%	167,067	52.28%	183,012	15.44%	54,037	21.26%	74,435	15.58%	54,540
Florida	43.30%	3,347,252	56.70%	4,382,664	19.28%	1,490,678	9.57%	739,885	27.84%	2,152,101
Georgia	46.21%	1,728,269	53.79%	2,011,755	20.61%	770,791	9.64%	360,372	23.55%	880,592
Hawaii	51.96%	262,206	48.04%	242,420	20.58%	103,853	10.32%	52,053	17.14%	86,514
Idaho	35.98%	192,506	64.02%	342,513	21.29%	113,916	15.06%	80,578	27.67%	148,019
Illinois	45.65%	2,381,740	54.35%	2,836,017	17.50%	912,902	9.85%	513,968	27.01%	1,409,147
Indiana	41.98%	1,036,757	58.02%	1,433,031	16.49%	407,276	11.75%	290,192	29.78%	735,563
Iowa	46.27%	570,868	53.73%	662,857	17.63%	217,458	8.79%	108,486	27.31%	336,913
Kansas	46.70%	526,274	53.30%	600,592	18.27%	205,836	10.72%	120,835	24.31%	273,921
Kentucky	44.34%	677,683	55.66%	850,549	19.90%	304,105	11.74%	179,351	24.02%	367,093
Louisiana	41.03%	712,283	58.97%	1,023,924	20.02%	347,506	15.05%	261,321	23.91%	415,097
Maine	37.64%	182,221	62.36%	301,958	24.41%	118,201	8.29%	40,159	29.66%	143,598
Maryland	43.75%	952,896	56.25%	1,225,339	20.13%	438,505	10.55%	229,728	25.58%	557,106
Massachusetts	47.52%	1,322,241	52.48%	1,460,544	18.21%	506,686	9.62%	267,801	24.65%	686,057
Michigan	43.80%	1,553,073	56.20%	1,992,942	19.41%	688,336	11.44%	405,675	25.35%	898,931
Minnesota	43.94%	1,012,541	56.06%	1,291,745	17.43%	401,737	8.43%	194,226	30.20%	695,782
Mississippi	44.65%	425,946	55.35%	528,010	22.49%	214,554	11.23%	107,121	21.63%	206,335
Missouri	46.72%	1,076,499	53.28%	1,227,605	18.39%	423,710	10.66%	245,567	24.23%	558,328
Montana	32.10%	113,952	67.90%	241,049	23.97%	85,091	11.13%	39,516	32.80%	116,442
Nebraska	44.02%	350,531	55.98%	445,817	16.58%	132,034	8.72%	69,434	30.68%	244,349
Nevada	46.82%	530,211	53.18%	602,201	17.00%	192,474	15.32%	173,438	20.87%	236,289
New Hampshire	44.65%	250,754	55.35%	310,874	20.67%	116,064	9.60%	53,901	25.09%	140,909
New Jersey	45.46%	1,617,960	54.54%	1,941,400	17.12%	609,281	13.66%	486,253	23.76%	845,866
New Mexico	41.31%	262,688	58.69%	373,147	20.85%	132,589	12.97%	82,499	24.86%	158,059
New York	40.69%	2,985,817	59.31%	4,351,881	21.13%	1,550,289	12.49%	916,635	25.69%	1,884,957
North Carolina	45.56%	1,576,409	54.44%	1,883,894	19.20%	664,216	9.47%	327,524	25.78%	892,154
North Dakota	39.54%	111,283	60.46%	170,176	18.77%	52,831	10.37%	29,201	31.32%	88,144
Ohio	46.43%	2,071,166	53.57%	2,389,484	17.68%	788,483	11.40%	508,487	24.49%	1,092,514
Oklahoma	42.23%	573,296	57.77%	784,340	20.33%	276,021	13.08%	177,594	24.36%	330,725
Oregon	42.03%	577,733	57.97%	796,751	19.97%	274,531	11.04%	151,715	26.96%	370,505
Pennsylvania	44.64%	2,150,826	55.36%	2,667,428	18.03%	868,870	10.54%	507,738	26.79%	1,290,820
Rhode Island	39.39%	152,988	60.61%	235,359	19.30%	74,945	8.40%	32,629	32.90%	127,785
South Carolina	45.77%	751,398	54.23%	890,332	19.01%	312,102	10.95%	179,753	24.27%	398,477
South Dakota	35.27%	111,142	64.73%	203,998	20.85%	65,698	11.28%	35,561	32.60%	102,739
Tennessee	48.72%	1,193,808	51.28%	1,256,432	22.21%	544,306	14.90%	364,991	14.17%	347,135
Texas	46.72%	4,715,695	53.28%	5,378,460	21.02%	2,121,668	14.54%	1,468,145	17.72%	1,788,647
Utah	42.84%	472,883	57.16%	630,968	15.39%	169,915	14.84%	163,839	26.93%	297,214
Vermont	36.88%	96,160	63.12%	164,610	26.69%	69,589	9.45%	24,653	26.98%	70,368
Virginia	48.01%	1,521,565	51.99%	1,647,972	16.81%	532,800	10.01%	317,146	25.18%	798,026
Washington	45.23%	1,087,939	54.77%	1,317,293	18.45%	443,831	10.73%	258,114	25.58%	615,348
West Virginia	48.80%	270,479	51.20%	283,815	19.43%	107,701	11.77%	65,268	20.00%	110,846
Wisconsin	44.03%	1,002,392	55.97%	1,274,178	16.53%	376,296	9.90%	225,355	29.54%	672,527
Wyoming	38.17%	86,542	61.83%	140,161	20.13%	45,631	13.22%	29,965	28.48%	64,565

Source: Author's calculations based on U.S. Census data.

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Appendix Table 3. Payroll by Business Form and State, 2011

State	C Corporate Payroll		Pass-Through Payroll		Sole Proprietorship Payroll		Partnership Payroll		S Corporation Payroll	
	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount
Alabama	60.5%	$32,007,619	39.5%	$20,921,116	2.3%	$1,242,116	9.35%	$4,948,624	27.8%	$14,730,376
Alaska	58.9%	$6,837,634	41.1%	$4,777,962	3.9%	$450,529	10.87%	$1,263,055	26.4%	$3,064,378
Arizona	66.4%	$50,723,125	33.6%	$25,705,549	1.5%	$1,138,622	10.18%	$7,778,764	22.0%	$16,788,163
Arkansas	65.0%	$19,880,118	35.0%	$10,727,277	1.8%	$548,160	9.68%	$2,962,057	23.6%	$7,217,060
California	66.3%	$391,528,884	33.7%	$199,022,094	2.5%	$14,631,666	9.64%	$56,916,574	21.6%	$127,473,854
Colorado	62.2%	$51,740,233	37.8%	$31,422,572	1.5%	$1,285,006	11.89%	$9,889,960	24.3%	$20,247,606
Connecticut	65.0%	$45,463,512	35.0%	$24,480,045	2.6%	$1,806,889	15.18%	$10,618,564	17.2%	$12,054,592
Delaware	63.1%	$9,733,653	36.9%	$5,699,143	1.4%	$221,388	17.36%	$2,679,297	18.1%	$2,798,458
District of Columbia	56.5%	$12,464,549	43.5%	$9,595,380	2.9%	$630,936	27.74%	$6,119,752	12.9%	$2,844,692
Florida	59.9%	$142,247,165	40.1%	$95,084,198	1.3%	$3,105,904	10.41%	$24,716,547	28.3%	$67,261,747
Georgia	66.1%	$83,965,206	33.9%	$43,133,496	1.6%	$1,976,450	9.93%	$12,619,545	22.5%	$28,537,501
Hawaii	68.3%	$10,349,394	31.7%	$4,807,095	3.6%	$549,641	10.35%	$1,568,729	17.7%	$2,688,725
Idaho	52.5%	$7,778,024	47.5%	$7,026,080	2.2%	$320,483	15.97%	$2,364,049	29.3%	$4,341,548
Illinois	62.0%	$132,851,641	38.0%	$81,256,813	2.1%	$4,574,599	11.38%	$24,375,339	24.4%	$52,306,875
Indiana	57.4%	$47,204,435	42.6%	$35,090,766	2.1%	$1,724,555	11.25%	$9,255,257	29.3%	$24,110,954
Iowa	63.3%	$24,808,579	36.7%	$14,408,835	2.2%	$844,610	6.90%	$2,704,843	27.7%	$10,859,382
Kansas	65.0%	$24,718,807	35.0%	$13,321,261	2.2%	$828,865	8.77%	$3,336,798	24.1%	$9,155,598
Kentucky	61.7%	$28,913,905	38.3%	$17,918,397	3.8%	$1,788,935	10.67%	$4,994,966	23.8%	$11,134,496
Louisiana	55.6%	$32,183,055	44.4%	$25,695,038	2.3%	$1,350,352	16.15%	$9,344,547	25.9%	$15,000,139
Maine	56.3%	$7,762,347	43.7%	$6,035,022	3.2%	$438,128	7.41%	$1,021,861	33.2%	$4,575,033
Maryland	59.9%	$51,226,319	40.1%	$34,226,875	2.2%	$1,913,324	9.98%	$8,531,057	27.8%	$23,782,494
Massachusetts	66.7%	$89,890,293	33.3%	$44,910,224	1.7%	$2,327,184	9.78%	$13,178,838	21.8%	$29,404,202
Michigan	62.3%	$78,744,124	37.7%	$47,663,679	1.9%	$2,449,317	10.78%	$13,623,258	25.0%	$31,591,104
Minnesota	63.8%	$59,108,837	36.2%	$33,589,449	1.9%	$1,764,278	7.62%	$7,059,076	26.7%	$24,766,095
Mississippi	62.9%	$15,818,019	37.1%	$9,310,039	2.8%	$698,193	10.93%	$2,747,398	23.3%	$5,864,448
Missouri	64.7%	$50,397,113	35.3%	$27,542,251	1.9%	$1,486,279	9.51%	$7,411,191	23.9%	$18,644,781
Montana	51.2%	$4,632,791	48.8%	$4,423,065	2.9%	$259,706	9.29%	$841,740	36.7%	$3,321,619
Nebraska	58.8%	$15,008,653	41.2%	$10,536,723	1.7%	$443,661	6.90%	$1,763,625	32.6%	$8,329,437
Nevada	59.2%	$21,750,823	40.8%	$14,967,337	4.1%	$1,497,066	14.65%	$5,377,575	22.0%	$8,092,696
New Hampshire	61.6%	$12,618,559	38.4%	$7,856,197	3.0%	$620,889	7.10%	$1,453,691	28.2%	$5,781,617
New Jersey	64.5%	$106,136,669	35.5%	$58,534,325	2.0%	$3,235,618	10.88%	$17,912,850	22.7%	$37,385,857
New Mexico	56.4%	$10,599,304	43.6%	$8,204,404	2.7%	$512,359	15.03%	$2,825,448	25.9%	$4,866,597
New York	59.9%	$218,057,598	40.1%	$146,082,409	2.1%	$7,636,085	16.49%	$60,063,617	21.5%	$78,382,707
North Carolina	65.0%	$73,648,168	35.0%	$39,575,743	1.9%	$2,183,591	8.59%	$9,723,911	24.4%	$27,668,241
North Dakota	57.0%	$5,435,830	43.0%	$4,099,686	2.3%	$217,953	7.94%	$757,496	32.8%	$3,124,237
Ohio	63.7%	$99,012,006	36.3%	$56,340,183	2.1%	$3,266,377	10.12%	$15,722,600	24.0%	$37,351,206
Oklahoma	60.8%	$26,676,707	39.2%	$17,185,828	2.4%	$1,032,740	12.38%	$5,428,372	24.5%	$10,724,716
Oregon	63.0%	$29,763,256	37.0%	$17,498,294	2.3%	$1,072,023	8.37%	$3,955,555	26.4%	$12,470,716
Pennsylvania	61.1%	$111,739,161	38.9%	$71,289,612	2.6%	$4,823,178	9.53%	$17,438,586	26.8%	$49,027,848
Rhode Island	54.1%	$7,406,493	45.9%	$6,294,069	4.6%	$625,134	7.34%	$1,005,234	34.0%	$4,663,701
South Carolina	62.2%	$29,860,505	37.8%	$18,155,968	2.3%	$1,107,622	10.60%	$5,091,516	24.9%	$11,956,830
South Dakota	49.6%	$4,249,432	50.4%	$4,325,195	2.8%	$243,397	10.20%	$874,870	37.4%	$3,206,928
Tennessee	66.6%	$53,449,846	33.4%	$26,780,728	3.1%	$2,481,896	13.86%	$11,118,643	16.4%	$13,180,189
Texas	65.5%	$249,208,105	34.5%	$131,034,636	2.3%	$8,837,959	15.18%	$57,711,580	17.0%	$64,485,097
Utah	60.7%	$21,540,940	39.3%	$13,958,186	1.2%	$419,387	11.21%	$3,979,060	26.9%	$9,559,739
Vermont	56.6%	$4,248,011	43.4%	$3,255,347	3.5%	$265,584	7.24%	$543,079	32.6%	$2,446,684
Virginia	63.5%	$82,006,387	36.5%	$47,083,789	1.9%	$2,401,574	9.68%	$12,501,885	24.9%	$32,180,330
Washington	65.7%	$67,815,134	34.3%	$35,472,191	2.5%	$2,573,819	8.62%	$8,906,822	23.2%	$23,991,550
West Virginia	66.9%	$11,431,956	33.1%	$5,666,790	3.4%	$581,332	10.32%	$1,763,804	19.4%	$3,321,654
Wisconsin	60.4%	$48,179,529	39.6%	$31,615,544	2.3%	$1,854,671	7.78%	$6,204,305	29.5%	$23,556,568
Wyoming	56.1%	$4,545,034	43.9%	$3,559,474	2.3%	$188,161	10.63%	$861,799	31.0%	$2,509,514

Note: Does not include non-employer firms; dollar amounts in thousands.
Source: Author's calculations based on U.S. Census data.

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Appendix Table 4. Pass-through Businesses, Employment, and Payroll by Industry

NAICS Classification	NAICS Code	Total Private Sector			C Corporations			Pass-through Businesses		
		Firms	Employment	Payroll	Firms	Employment	Payroll	Firms	Employment	Payroll
Agriculture, forestry, fishing and hunting	11	258188	386229	$5,186,733	6767	50678	$1,957,557	251421	335551	$3,229,176
Mining, quarrying, and oil and gas extraction	21	131247	758959	$55,142,854	8863	433115	$39,779,751	122384	325844	$15,363,103
Utilities	22	20703	580534	$52,791,916	2159	537163	$50,520,384	18544	43371	$2,271,532
Construction	23	3032846	7570862	$264,873,890	180636	1862122	$101,836,009	2852210	5708740	$163,037,881
Manufacturing	31-33	585945	11237036	$571,217,485	95521	7160805	$406,976,997	490424	4076231	$164,240,488
Wholesale trade	42	712192	5955180	$353,649,072	129530	3223821	$230,411,033	582662	2731359	$123,238,039
Retail trade	44-45	2498799	16365278	$366,560,872	191122	9735727	$233,317,378	2307677	6629551	$133,243,494
Transportation and warehousing	48-49	1202842	5115544	$174,926,243	62017	2794022	$125,680,588	1140825	2321522	$49,245,655
Information	51	383354	3340315	$229,570,366	29305	2323834	$188,692,027	354049	1016481	$40,878,339
Finance and insurance	52	940019	6214086	$472,183,897	63534	4461143	$376,795,088	876485	1752943	$95,388,809
Real estate and rental and leasing	53	2604917	4209817	$82,333,393	132816	823592	$36,584,148	2472101	3386225	$45,749,245
Professional, scientific, and technical services	54	3924278	10847469	$551,274,359	200958	3681456	$302,677,017	3723320	7166013	$248,597,342
Management of companies and enterprises	55	25009	2605175	$278,703,195	12321	2131746	$240,527,725	12688	473429	$38,175,470
Administrative and support and waste management and remediation services	56	2301092	11257122	$321,620,087	79696	4547393	$176,609,396	2221396	6709729	$145,010,691
Educational services	61	630490	1405289	$25,206,522	13364	400570	$14,262,759	617126	1004719	$10,943,763
Health care and social assistance	62	2534133	10742519	$367,325,270	125854	3421261	$175,269,506	2408279	7321258	$192,055,764
Arts, entertainment, and recreation	71	1277971	2545644	$47,681,968	31199	541619	$16,208,131	1246772	2004025	$31,473,837
Accommodation and food services	72	824512	11744451	$190,190,752	100135	4130380	$77,708,593	724377	7614071	$112,482,159
Other services (except public administration)	81	3905021	6121087	$73,832,944	124134	1000942	$31,498,530	3780887	5120145	$42,334,414
Industries not classified	99	15970	3716	$262,048	2123	2544	$54,870	13847	1172	$207,178

Note: Dollars in thousands of dollars.
Source: Author's calculations based on U.S. Census data.

HB 1167
1-27-15
#5

GNDC
Greater North Dakota Chamber

Testimony of Jon Godfread
Greater North Dakota Chamber of Commerce
HB 1167
January 27, 2015

Mr. Chairman and members of the committee, my name is Jon Godfread; I am the Vice President of Government Affairs for the Greater North Dakota Chamber. GNDC is working on behalf of our more than 1,100 members, to build the strongest business environment in North Dakota. GNDC also represents the National Association of Manufacturers and works closely with the U.S. Chamber of Commerce. As a group we stand in Support income tax relief.

The Greater North Dakota Chamber has been among the principle advocates for tax reductions in past sessions and that role will continue in this session. In seeking those reductions our goal is that any reductions given will be measured, fairly distributed among all classes of taxpayers and above all else sustainable for the long term. Our overarching goal is drive North Dakota to a position where it is considered the best state to do business. As you know, taxes play an important role in those rankings, we have made some good strides over the last three biennia and we feel we can take another step this biennium.

As is the usual practice, we are anticipating that the tax relief package will be passed through both houses as one bill. This bill, in its current form, does not include any relief for corporate income tax. That is something we would like addressed as corporate income tax is also a priority to us and greatly benefits the state.

We understand that there are many unknowns this session and tax relief will be one of the biggest issues debated. That being said, we will be advocating for the largest amount of tax relief possible, should that be dropping the income tax rates to 0% as laid out in this bill or the higher rates outlined in other pieces of legislation. We believe it's likely somewhere in the middle.

Thank you and I would be happy to answer any questions.

Champions for Business

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HB 1167
2-4-15
#1

15.0142.04003
Title.

Prepared by the Legislative Council staff for Representative Louser
February 3, 2015

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1167

Page 1, line 2, replace "an" with "a contingent"

Page 3, line 30, after the boldfaced period insert "**CONTINGENT**"

Page 3, line 31, after "2014" insert ", but is ineffective for any taxable year if in any month during the first nine months of the immediately preceding taxable year the exemption under subsection 3 of section 57-51.1-03 was effective for the completion of any new horizontal well. For a taxable year for which section 1 of this Act is ineffective as provided in this section, the provisions of subsection 1 of section 57-38-30.3, without the amendments under section 1 of this Act, are effective"

Renumber accordingly