TAXATION COMMITTEE

The Taxation Committee was assigned four studies for the 2019-20 interim:

- Section 1 of Senate Bill No. 2355 (2019) directed a study of the feasibility and desirability of applying an alternative or additional tax on liquid nicotine and electronic smoking devices.
- The Legislative Management directed a study of whether the state's charitable gaming laws on taxation are fair, adequate, and appropriate.
- Section 1 of House Bill No. 1474 (2019) directed a study of options for replacing revenue generated by special assessments with revenue from an alternative local funding source.
- The Legislative Management directed a study of economic development tax incentives pursuant to North Dakota Century Code Section 54-35-26.

The Legislative Management directed the committee to receive six reports:

- An annual report from the Tax Commissioner from compiled reports from counties receiving allocations of oil and gas gross production tax revenues describing funds received, expended, and unexpended (Section 57-51-15(6)).
- An annual report from the Tax Commissioner from compiled reports from school districts receiving allocations of oil and gas gross production tax revenues describing funds received and expended (Section 57-51-15(7)).
- An annual report from the Tax Commissioner on statewide property tax increases (Section 57-20-04).
- An annual report from the Department of Commerce's Division of Community Services on renaissance zone progress (Section 40-63-03(2)).
- An annual report from the Department of Commerce compiling reports from cities that have renaissance zone property included in a tax increment financing district (Section 40-63-03(10)).
- A compilation and summary of state grantor reports filed annually by the Department of Commerce and the reports of state agencies that award business incentives for the previous calendar year (Section 54-60.1-07).

Committee members were Representatives Jason Dockter (Chairman), Matt Eidson, Sebastian Ertelt, Ron Guggisberg, Patrick Hatlestad, Craig Headland, Tom Kading, Ben Koppelman, Alisa Mitskog, and Vicky Steiner and Senators Dwight Cook, Jim Dotzenrod, Jordan Kannianen, Curt Kreun, Dale Patten, and Jessica Unruh-Bell.

Representative Jim Grueneich served as Chairman of the committee until his resignation from the Legislative Assembly in February 2020, and Representative Jake G. Blum served on the committee until his resignation from the Legislative Assembly in October 2019.

TAXATION OF ELECTRONIC SMOKING DEVICES STUDY

Section 1 of Senate Bill No. 2355 (2019) directed a study of the feasibility and desirability of applying an alternative or additional tax on liquid nicotine and electronic smoking devices. The study required consideration of the current method of taxation applied to these products, the methods of taxation applied in other states, and the fiscal impact of applying an alternative or additional method of taxation. As introduced, the bill would have expanded the definition of a tobacco product to include electronic smoking devices and liquid nicotine and changed the tax applied to all cigarette and tobacco products to a value-based method of taxation by imposing a tax of 28 percent on the wholesale cost of those products.

Background

Electronic smoking devices have been available to consumers in the United States for more than a decade. The devices generally consist of a battery, an atomizer, a sensor that detects inhalation, and a cartridge containing a liquid solution (e-liquid) that may or may not contain nicotine. The devices have been marketed as a safer alternative to traditional cigarettes that cause users to inhale smoke and tar.

Federal Regulation

In 2009, Congress passed the federal Family Smoking Prevention and Tobacco Control Act, which gave the United States Food and Drug Administration (FDA) the authority to regulate the manufacturing, distribution, and marketing of tobacco products. This authority was expanded by rule in 2016 under the FDA's authority to "deem" certain products as tobacco products. The final deeming rule, which became effective on August 8, 2016, allows the FDA to regulate electronic nicotine delivery systems, which include e-cigarettes, vapes, e-liquids, e-cigars, e-pipes, and e-hookahs. The rule subjects the products to the same rules applied to other tobacco products, including the prohibition on sales to individuals under the age of 18, sales in vending machines located outside of adult-only areas, and free sample distributions. The rule also subjects all newly regulated tobacco products, including electronic nicotine delivery systems, to FDA marketing authorization requirements unless the products were commercially marketed before February 16, 2007.

The FDA staggered the deadlines by which manufacturers are required to submit premarket review applications based on the type of application submitted. In August 2017, the FDA extended the application deadline for manufacturers submitting applications for review of electronic nicotine delivery system products to August 8, 2022. Following various additional changes to the application deadlines, multiple public health groups filed a lawsuit against the FDA which culminated in an order from the United States District Court in Maryland requiring the FDA to set a deadline of May 11, 2020, for manufacturers to submit premarket tobacco applications for any electronic nicotine delivery systems on the market as of August 8, 2016. Premarket tobacco applications submitted to the FDA must contain information detailing any investigations or reports that illustrate the health risks of the product submitted for review and whether the product poses less of a risk compared to other products; a statement of the components, ingredients, additives, and properties of the product; a description of the methods used in manufacturing, processing, and packaging the product; samples of the product and any necessary components of the product; and samples of proposed warning labels for the product.

On September 11, 2019, President Donald Trump announced the FDA would takes steps to remove flavored e-cigarettes from the market. The announcement targeted the rapid increase in the underage use of e-cigarettes which, according to statistics cited by the FDA, were used by 3.62 million middle and high school students in 2018. The announcement also came after weeks of widely publicized reports of lung injuries and deaths seemingly linked to vaping.

State Regulation

Legislation has been enacted in various states to regulate e-cigarettes, partially as a result of delays in regulating the products at the federal level. According to data published by the Public Health Law Center at Mitchell Hamline School of Law, as of June 15, 2019, 29 states have enacted e-cigarette product packaging laws, 26 states have enacted licensing requirement laws for e-cigarette retailers, and 20 states have enacted laws raising the minimum age at which e-cigarettes legally may be purchased to either age 19 or 21. North Dakota has enacted laws that prohibit the sale or distribution of electronic smoking devices or e-liquid to individuals under the age of 18, require nicotine liquid containers be child-resistant, and prohibit the operation of e-cigarettes in public places, places of employment, and within 20 feet of entrances, exits, windows, air intakes, and ventilation systems.

States and cities also have acted to ban various e-cigarette products following reports of lung injury and death seemingly linked to vaping. In June 2019, San Francisco Mayor London Breed signed an ordinance, effective January 2020, suspending the sale of all e-cigarettes that had yet to undergo a premarket review by the FDA. The ordinance expanded upon the existing ban on flavored e-cigarettes, which had been in place since 2017. On September 4, 2019, Michigan Governor Gretchen Whitmer ordered the Michigan Department of Health and Human Services to issue emergency rules banning the sale of flavored nicotine vaping products in Michigan. On September 15, 2019, New York Governor Andrew Cuomo announced an emergency executive action to ban the sale of flavored e-cigarettes in New York State.

Taxation of Electronic Smoking Devices

Twenty-four states and the District of Columbia have taken administrative action or passed legislation imposing tax on electronic smoking devices or e-liquid. In 2012, Minnesota was the first state to impose a tax. Utah, Virginia, and Wyoming most recently imposed a tax, which became effective on July 1, 2020.

Taxes on electronic smoking devices or e-liquid generally take the form of a specific unit-based tax or a value-based tax. Unit-based taxes are a specific tax based on volume and generally take the form of a cents per milliliter tax on e-liquid. Value-based taxes are imposed at a specified percentage of the cost or price of a product and may be imposed at the wholesale or retail level. Each method of taxation poses its own set of benefits and detriments, which should be weighed by lawmakers when considering a tax.

Consideration also must be given to the point at which the tax will be imposed. Unlike traditional tobacco products, electronic smoking devices do not always flow from a manufacturer to a distributor or retailer. Care must be taken to determine the point at which the tax will be imposed based on the manner in which products reach consumers. The types of products also must be evaluated to determine if a tax will be imposed on all electronic cigarette products, including e-liquid; on e-liquid alone; or only on e-liquid that contains nicotine.

Policy arguments have been raised regarding the rate of tax imposed on electronic smoking devices and e-liquid. Proponents of lower taxes generally argue a higher tax burden may drive consumers back to purchasing traditional cigarettes, which may cause more detrimental health consequences. Proponents of higher taxes generally argue a lower tax burden may make electronic smoking devices more accessible, potentially attracting consumers who previously were not smokers. An alternative method of analysis removes policy arguments from consideration entirely, taking the view taxation should not be applied as a means to influence consumer behaviors. This approach takes into consideration the need for revenue and the amount of tax required to generate the needed revenue.

Testimony and Committee Considerations

The committee received information from a representative of the Tax Department regarding the amount of revenue generated by the tax on cigarette and tobacco products. The committee was informed $26.5 million in cigarette and tobacco tax revenue was generated for the state in fiscal year 2018. Neither a cigarette nor tobacco tax is imposed on vapor products and vapor product wholesalers and retailers are not subject to separate licensing or reporting requirements. Vapor products only are subject to general sales and use tax. The committee reviewed information on the number of states that impose a separate tax on vapor products and the type and amount of tax imposed in each state. Twenty-four states and the District of Columbia impose a tax on vapor products or e-liquid. The tax imposed in these states ranges from 5 cents to 10 cents per milliliter of e-liquid and from 8 to 91 percent of the wholesale or retail price of vapor products. Imposition of tax on a per-milliliter basis was the most prevalent method of taxation among states that impose a tax; however, not all states that impose the tax require the e-liquid to contain nicotine to be taxable.

The committee solicited testimony from representatives of the Tax Department regarding the preferable method of taxation in terms of ease of administration. Representatives of the Tax Department indicated a tax imposed at a single rate per millimeter of e-liquid at the wholesale level rather than the retail level would be the preferable manner of taxation both for taxpayer reporting and Tax Department administration. There are significant differences between the electronic cigarette industry and traditional tobacco industry, which make it more difficult to administer a tax on electronic cigarettes than traditional cigarettes. The electronic cigarette industry does not have a well-developed distribution system of manufacturers, wholesalers, and retailers. Most electronic cigarette products do not go through the traditional distribution channels. In some cases, such as vape shops, the same entity is the manufacturer, wholesaler, and retailer.

The committee was informed administration of the tax would be simpler and less expensive if the tax is applied at the wholesale level rather than the retail level because the department would be dealing with far fewer companies. Wholesalers also would be better equipped to file the returns and pay the tax than retailers. If a tax is applied at the wholesale level, the department recommended the tax be applied to the liquid at a single rate on a volume basis and be applied to all of the components in the liquid. In the case of a vape shop, the tax should be applied either on all the liquid products the shop purchased and mixed together or on the volume of the final salable product. This manner of taxation would help equalize the tax between the different products available for sale. According to testimony, wholesalers are accustomed to remitting tax on a volume basis for cigarette and tobacco products so wholesalers would be familiar with this method of taxation. Purchases over the Internet and purchases in instances in which there is not an established wholesaler will present administrative challenges for the department.

The committee reviewed a bill draft that would have imposed a per-milliliter excise tax on all e-liquid, regardless of whether the e-liquid contains nicotine. The bill draft sought to develop the administrative framework for the tax and contained a placeholder for the tax rate. The bill draft would have mirrored existing licensing and reporting requirements for sellers of cigarettes or other tobacco products and required dealers and distributors that sell e-liquid to be licensed and keep records of purchases and deliveries of e-liquid. The bill draft would have imposed an excise tax on e-liquid purchased by distributors, or on e-liquid purchased by retailers if the tax had not yet been paid by a distributor. A use tax would have been imposed on e-liquid purchased by a consumer if the tax had not yet been paid by either a distributor or a retailer. The bill draft would have imposed an excise tax on e-liquid inventory purchased before the effective date of the bill draft. The bill draft would have become effective January 1, 2022, to allow the Tax Department adequate time to notify distributors and retailers of the new tax and develop reporting forms.

The committee received testimony from representatives of the vapor industry regarding the imposition of tax on e-liquid. The committee was informed 500,000 people die each year from smoking-related deaths and e-cigarettes have been marketed as a safer alternative to traditional smoking. Representatives of the vapor industry testified the industry is not opposed to additional regulations to help curb youth smoking but increased taxation is not an effective means to reduce youth smoking. Representatives of the vapor industry were not opposed to some degree of tax being applied to vapor products but cautioned against applying excessive or punitive taxes that might result in consumers returning to using potentially more harmful traditional cigarettes or purchasing unregulated black-market products. The committee was cautioned about the potential danger of manufacturers producing a highly concentrated e-liquid nicotine products, which could be dangerous if improperly consumed if a tax is applied on a per-milliliter basis.

The committee received testimony from representatives of Tobacco Free North Dakota regarding the imposition of a tax on vapor products. Representatives recommended a 28 percent tax on vapor products, imposed in a similar manner as tax is imposed on other tobacco products. Data published by the Centers for Disease Control and Prevention (CDC) indicates a $1.50 increase is needed before a tax will have a positive impact on consumer health. The representatives felt vapor products should be treated like tobacco products to allow the state to license, regulate, monitor, and tax these products because the majority of vapor products contain nicotine. A 2017 North Dakota Community Readiness Survey indicated over 75 percent of North Dakotans surveyed agreed e-cigarettes should be taxed at the same rate as other tobacco products and 57 percent thought the age to purchase electronic cigarettes should be raised to the age of 21. The age at which tobacco products, including vapor products, can be purchased was raised at the federal level from age 18 to age 21 on January 1, 2020.

The committee received information from representatives of the State Department of Health regarding vaping-related illness cases in the state. Data published by the CDC as of January 21, 2020, indicated a total of 2,711 hospitalizations among all 50 states and 60 deaths among 27 states had been reported as a result of e-cigarette or vaping product use-associated lung injury (EVALI). Twenty EVALI cases were reported in the state from September 2019 to January 2020. Most EVALI cases were in individuals ages 18 to 24. The majority of users reporting lung injuries reported using refillable cartridges and black-market products. Nearly all of the EVALI cases required hospitalization, with hospital stays ranging from 1 to 10 days, and 82 percent of hospitalized patients reporting using products that contained tetrahydrocannabinol (THC). The State Department of Health does not endorse vapor products as tobacco cessation devices because data relating to the safety and efficacy of using vapor products for this purpose is insufficient.

The committee received testimony from a representative of the Department of Public Instruction regarding the use of vapor products by minors. Fifty-two percent of students in the state have reported using an electronic vapor product and the number of students who reported using vapor products daily has tripled since 2017. Testimony indicated the most common ways students are obtaining vapor products is by borrowing the products from others or giving individuals money to acquire the products on the students' behalf. The committee was informed efforts by schools to educate students about the risks of vaping are minimal. The committee received testimony from representatives of the City of Bismarck Police indicating the use of vapor products is widespread among middle school and high school students. Testimony indicated the issuance of citations for underage use of tobacco products has very little impact on deterring the use of vapor products by minors. Law enforcement officers expressed skepticism that an increase in the price of vapor products resulting from the imposition of tax would have a discernable impact on reducing vapor product use by minors. Officers noted prevalent employment opportunities provide minors with a large amount of disposable income. Information provided by school officials indicated schools have seen a decrease in the use of tobacco in the past as a result of increased tobacco education. The committee was informed the rate of vapor product use by high school students increased in two states after a vapor product tax was imposed and decreased in four states and the District of Columbia. The committee agreed on the importance of schools working with law enforcement and health department partners to educate students about the risks of certain behaviors.

Committee members expressed mixed opinions about the dangers of vapor products. Committee members agreed regarding the inappropriateness of vapor product use by minors. However, committee members also acknowledged vapor products have assisted many former adult smokers in quitting smoking. Committee members questioned whether the motivation behind imposing a tax would be to raise revenue or deter behavior. The committee reviewed the categories of taxes that generally are classified as "sin taxes," such as alcohol, tobacco, and gaming taxes, and reviewed studies regarding whether increased taxation is effective in deterring behaviors. The committee was informed sin tax revenue in this state generally is directed for deposit in the general fund, rather than earmarked for use in alleviating the harm caused by the activity being taxed. The testimony indicated revenue generated by sin taxes is volatile and should not be relied on as a stable revenue source for reoccurring budget needs. However, committee members raised concerns regarding the potential future costs to the state associated with any unknown, long-term health impacts relating to vaping. The committee was informed sin taxes are disproportionately burdensome on lower-income populations because an individual pays the same amount of tax on the product or service regardless of the individual's income. Committee members indicated the motivation behind imposing a tax would not be simply to raise revenue. Committee members' primary concerns centered around the use of vapor products by minors. As a result, committee members indicated it would be beneficial to address regulatory concerns regarding the distribution and sale of vapor products before taxation issues are addressed. The committee noted public health and regulatory matters might be better addressed by other committees during the 2021 legislative session, as the Taxation Committee possesses less-specialized knowledge in these areas.

Conclusions

The committee makes no recommendations in regard to its study of the feasibility and desirability of applying an alternative or additional tax on liquid nicotine and electronic smoking devices.

CHARITABLE GAMING TAX STUDY

Section 34 of Senate Bill No. 2015 (2019) directed a study of the state's charitable gaming laws. The Legislative Management directed the Taxation Committee to review whether the state's charitable gaming laws on taxation are fair, adequate, and appropriate. The Judiciary Committee was assigned the remainder of the study directive in the bill, which requires consideration of whether charitable gaming is being expanded properly; whether the addition of new games, such as sports betting and historic horse racing, is appropriate; and whether such expansion should be approved by the voters. The study assigned to the Judiciary Committee also required an evaluation of the appropriate limitations, restrictions, and oversight if new games are added; an evaluation of whether a portion of gaming proceeds should be deposited in the gambling disorder prevention and treatment fund; and a review of whether the laws regarding eligible uses for proceeds, gambling sites and locations, limitations, enforcement, conduct, and play of charitable gaming are fair, adequate, and appropriate.

Background

Charitable gaming first was permitted under the Constitution of North Dakota in 1976. Section 25 of Article XI of the Constitution of North Dakota allows the Legislative Assembly to:

> [A]uthorize bona fide nonprofit veterans', charitable, educational, religious, or fraternal organizations, civic and service clubs, or such other public-spirited organizations as it may recognize, to conduct games of chance when the entire net proceeds of the games are devoted to educational, patriotic, fraternal, religious, or other public-spirited uses.

Legislation enacted by the 1981 Legislative Assembly codified charitable gaming laws in Chapter 53-06.1. Legislation enacted by the 1987 Legislative Assembly codified laws allowing charitable organizations to conduct pari-mutuel horse racing in Chapter 53-06.2. Several changes were made to gaming laws after the 1980s. These changes primarily affected the kinds of organizations that may hold the games, the types of games that may be conducted, the taxation of gaming proceeds, and the administration and enforcement of charitable gaming laws.

Taxation of Charitable Gaming Proceeds

A state tax has been imposed on the proceeds of charitable gaming since 1977. The tax initially was imposed at a rate of 3 percent of adjusted gross proceeds, with revenue allocated to the general fund. The tax was part of the expense limit for the charity. The tax rate was increased to 5 percent in 1979 and was payable from adjusted gross proceeds and not charged against the allowable expenses of the charity.

Before July 1, 2011, the gaming tax structure in Section 53-06.1-12 provided for a sliding scale tax rate that ranged from 5 to 20 percent based upon an organization's adjusted gross proceeds. The intent of the sliding scale tax structure was to discourage large-scale charitable gaming. An additional excise tax of 3 percent also was imposed on the gross proceeds from the sale at retail of pull tabs and bingo cards to final users. No excise tax was imposed on gross proceeds from organizations with pull-tab gross proceeds of $4,000 or less per calendar quarter. The Attorney General was required to deposit 3 percent of the total taxes collected under Section 53-06.1-12 into a gaming and excise tax allocation fund. The money in this fund, pursuant to legislative appropriations, was to be distributed quarterly to cities and counties in proportion to the taxes collected under this section from licensed organizations within each city or county.

The 2011 Legislative Assembly passed a significant change to the gaming tax structure. The change consolidated gaming taxes into four separate tax rates, ranging from 1 to 2.5 percent, based upon an organization's quarterly gross proceeds. The gaming tax structure was simplified further in 2013 by legislation that reduced the four separate tax rates to two tax rates. The legislation imposed a tax of 1 percent of gross proceeds on organizations with gross proceeds not exceeding $1.5 million per quarter and a tax of $15,000 plus 2.25 percent of gross proceeds exceeding $1.5 million on organizations with gross proceeds exceeding $1.5 million per quarter.

Additional background information regarding charitable organizations, administration and enforcement of charitable gaming laws, and federal oversight can be found in the Judiciary Committee Report under Charitable Gaming.

Testimony and Committee Considerations

The committee received information from the Gaming Division of the Attorney General's office regarding charitable gaming activity. The information indicated the Gaming Division regulates gaming conducted by each of the five tribes in the state under the terms of gaming contracts and regulates 325 charitable organizations that conduct charitable gaming at 995 sites in the state. There were 2,582 electronic pull-tab devices operating at 592 sites in the state as of May 30, 2020. The devices are operated by 201 charitable organizations in 210 cities and 48 counties. A record amount of $84.5 million was wagered on electronic pull-tab devices in the state in May 2020. The Gaming Division anticipates $1.8 billion in gaming gross proceeds and $26.8 million in gaming tax during the 2019-21 biennium. The Gaming Division's budget for the 2019-21 biennium was $3.4 million. Of the $3.4 million budget amount, $510,000 is derived from the gaming tax and passed through the Gaming Division for distribution to political subdivisions as gaming enforcement grants. Gaming tax revenue does not directly fund the operations of the Gaming Division.

The Gaming Division requires additional staff to properly regulate gaming due to the explosive growth of electronic pull tabs. The Gaming Division has 1.5 full-time equivalent (FTE) gaming auditor positions dedicated to regulating gaming at tribal casinos and 6 FTE positions to regulate gaming activities at the other 592 sites where electronic pull-tab devices operate. The Gaming Division's FTE staff was reduced by three during the 2017 legislative session, before the use of electronic pull-tab devices was authorized in the state. Representatives of tribal nations expressed concern regarding the unequal monitoring and regulation of gaming at tribal casinos as compared to the level of monitoring and regulation of electronic pull-tab devices at charitable gaming sites. Representatives of the Spirit Lake Tribe noted the tribe has been impacted negatively by electronic pull-tab devices and the state should have had a larger discussion with the tribes before allowing electronic pull-tab devices to operate in the state. Tribal casino revenues decreased by 40 percent compared to prior year revenues since electronic pull-tab devices began operating in August 2018.

Tribal representatives recommended reducing the number of electronic pull-tab devices operating near tribal casinos and subjecting electronic pull-tab devices to the same inspection and testing standards applied to devices located at tribal casinos. Tribal representatives also advocated for subjecting charitable gaming operators to the same strict requirements for reporting and handling cash and reporting winnings. The committee was informed the state does not impose any requirements for the prevention and detection of money laundering at charitable gaming sites, despite the large amount of cash flowing through those sites. The committee was informed tribal casinos are subject to strict federal anti-money laundering requirements which protect against illegal activities. Tribal representatives expressed support for expanding the Gaming Division's budget to allow additional staff to conduct more robust gaming enforcement activities. The committee was informed nearly 500 electronic pull-tab devices operating in the state with pirated software could have been detected if the gaming devices were subject to the same regular inspections carried out on devices at tribal casinos. A representative from the Gaming Division indicated the number of staff in the Gaming Division would need to double for the division to properly monitor and audit charitable gaming activities under existing laws. According to the testimony, it would cost roughly $5 million to double the Gaming Division's budget.

The committee received information regarding the number of states that legalized onsite sports betting or online or mobile sports betting and the rate of tax applied in each state that has legalized sports betting. The rate of tax applied to sports betting ranged from a low of 6.75 percent of gaming revenue to a high of 51 percent. The committee was informed sports betting is not legal in North Dakota outside the boundaries of tribal lands, but could be legalized through a constitutional amendment to authorize sports betting or the passage of legislation authorizing sports betting as a permitted game of chance under the state's gaming laws, in which case the net proceeds would need to be devoted to the charitable organization. The committee was informed the tribes will be expanding gaming operations to include sports book betting as a means to supplement the revenue lost as a result of the prevalence of electronic pull-tab devices. A presentation from a representative of the gaming industry indicated there might be a negative impact on state lottery revenue if sports betting is allowed. The committee was advised to place limits on the number of sports betting locations because regulations would need to be enforced at each site. The committee was informed sports betting does not generate a large amount of revenue, but it can prompt other forms of economic growth by drawing customers to bars and taverns. Testimony from charitable organizations indicated charities do not view sports betting as a viable option due to the space and staffing requirements associated with the game.

The committee also received testimony from representatives of charitable gaming organizations regarding recommended prize payout percentages on electronic pull-tab machines. The committee was informed there is no minimum payout percentage and the state set the maximum payout percentage at 90 percent. Charitable organizations indicated the optimal payout percentage for generating the highest amount of revenue is 92.5 percent. A higher payout percentage keeps players entertained and results in them playing longer. Charitable organizations indicated a preference for allowing industry members to determine payout percentages based on the markets in which the industry member operates.

The committee reviewed the taxing structure applied to charitable gaming. Some states impose tax on gross volume, but the majority of states impose tax on adjusted gross revenue, after paying prizes. Most charitable organizations are generating more revenue since electronic pull-tab devices were authorized and many have moved from the lower tier of tax to the higher tier of tax. The committee received a range of suggestions from representatives of charitable gaming organizations regarding changes to the charitable gaming tax structure, including applying tax on adjusted gross income and returning to a more highly tiered tax structure, similar to the one in place in 1989. The committee was informed the tiered structure would serve to apply a higher tax to charities with higher revenue. Proponents of this change indicated filing returns based on multiple tiers would not carry the burdens experienced in the past because charities can now file returns electronically. A second option entailed applying a tiered tax rate to all games except pull tabs and limiting the rate of tax to a level that would maintain, rather than increase, collections.

The committee also received a recommendation to create a more simplified tax calculated on gross proceeds less cash prizes and merchandize, which would eliminate tax on losses and create a more fair and balanced system. Lastly, the committee was presented with the option of retaining the current tax structure but lowering the rate of tax to the minimum rate required to adequately fund gaming enforcement and addiction services. Charities indicated a preference for returning any excess revenue to charitable organizations, rather than depositing excess revenue in the general fund. Charities were strongly in favor of increasing the funding allocated to the Gaming Division and were not opposed to providing funding for gambling addiction and treatment services, as long as the funding increases are not derived from an increase in tax. The committee was informed gambling prevention and treatment is funded with revenue from tribal casinos and the state lottery, rather than with revenue from charitable gaming.

Committee members recognized additional funds might be needed for gambling prevention and treatment in light of the explosive growth of gaming in the state. Committee members also acknowledged there should be some correlation between the growth in gaming activities and the growth in the number of staff available to regulate gaming activities. The Gaming Division will be seeking increased funding during the 2021 legislative session for additional staff and to add licensing, distribution, and manufacturing components to the online filing and payment software funded by the 2019 Legislative Assembly. Committee members agreed any changes to the charitable gaming laws required due to the recent and substantial increase in charitable gaming activity should be addressed as part of a larger policy discussion by the full Legislative Assembly.

Conclusions

The committee makes no recommendations in regard to its study of whether the state's charitable gaming laws on taxation are fair, adequate, and appropriate.

SPECIAL ASSESSMENT REVENUE REPLACEMENT STUDY

Section 1 of House Bill No. 1474 (2019) directed a study of options for replacing revenue generated by special assessments with revenue from an alternative local funding source. The study required a review of the purposes for which special assessments are imposed, the revenue generated from the imposition of special assessments, local revenue sources that could be used as an alternative to imposing special assessments, and the manner in which fees for an alternative local revenue source would be calculated and imposed as compared to the manner in which special assessments are calculated and imposed. As introduced, the bill would have provided authority for a city or county to levy an infrastructure tax in lieu of special assessments on all residential and commercial utility bills for payment of infrastructure maintenance costs.

Background

Cities were the first political subdivision in North Dakota to receive authority to levy special assessments for improvements. Cities have had authority to levy special assessments since 1897, and as a result the statutory provisions relating to special assessments in cities are the oldest and most detailed. Recreation service districts were the second political subdivision to receive special assessment levy authority in 1975, followed by water resource districts in 1981, counties in 1983, and townships in 2001.

Several chapters of Title 40 govern improvements by special assessment in cities. Recreation service districts and counties glean authority to levy special assessments for improvements by adopting the provisions relating to cities by reference. Special assessment levy authority and related procedures for water resource districts are contained in Chapter 61-16.1. Township special assessment levy authority is governed by an abbreviated statutory procedure in Chapter 58-18.

Purposes for Which Special Assessments Are Imposed

Pursuant to Section 40-22-01, a city may defray the expenses related to a number of improvements by levying special assessments. Improvement costs for which special assessments may be levied include costs for new water supply or sewage systems, or the extension or replacement of existing systems; improvements to a municipal street system; improvements to boulevards or other public places and the maintenance of those improvements; the acquisition of land and easements for flood protection purposes and the construction of necessary works; and the acquisition or leasing of property and easements for parking lots, ramps, and garages and associated construction costs. A city also may establish a special assessment district pursuant to Chapter 40-22.1 for the promotion of business activity and new business development.

The board of county commissioners may initiate a special assessment district and levy special assessments for improvements within a defined area outside the limits of an incorporated city. Pursuant to Section 11-11-55.1, a county is given all the authority and duties pertaining to special assessments which belong to cities in Chapters 40-22 through 40-28.

Townships may defray expenses of improvements through special assessment districts pursuant to Chapter 58-18. The board of township supervisors may create an improvement district upon petition of at least 60 percent of the property owners in a proposed improvement district area. Each improvement district must be of a size and form to include all properties the township board of supervisors believes will be benefited by the improvement project.

A recreation service district may levy special assessments to provide services, including police protection, sewer and water, garbage removal, and public road construction and maintenance. Pursuant to Section 11-28.2-04.1, a recreation service district is deemed to be a "municipality" for purposes of the special assessment provisions in Chapters 40-22 through 40-27.

Chapter 61-16.1 governs the administration of special assessments by water resource districts. Pursuant to Section 61-16.1-15, a water resource board may provide for the cost of construction, alteration, repair, operation, and maintenance of a water resource district project through issuance of improvement warrants or with funds raised by special assessments, a general tax levy, issuance of revenue bonds, or a combination of these methods.

Manner in Which Special Assessments Are Calculated

Section 40-23-01 requires the executive officer of a city to appoint three "reputable residents and freeholders" of the city to the city's special assessment commission. Pursuant to Section 40-23-07, the special assessment commission is required to determine the lots and parcels of property that will benefit from the improvement and the amount in which each lot and parcel will be benefited. The commission is required to assess against each lot and parcel a fair portion of the total cost of the improvement, which may not exceed the amount each property will benefit from the improvement. As an alternative, Chapter 40-23.1 provides the city governing body may assess benefits against property on a per-square-foot basis and considering the distance of the property from the marginal line of the public way or area improved.

Sections 40-23-09 and 40-23.1-07 require the special assessment commission or the city auditor to prepare a complete list of benefits and assessments showing each lot, tract, or parcel benefited by the improvement and the amount assessed against it. Section 40-23-25 requires the special assessment commission to prepare a list of estimated future assessments on property presently located outside the corporate limits of the city, but likely to be annexed, which the commission determines is potentially benefited by the improvement. Sections 40-23-10 and 40-23.1-08 require the special assessment commission or the city auditor to publish the assessment list in the official newspaper of the city once each week for 2 consecutive weeks and include notice of the time and place the commission or the city auditor will meet to hear objections to assessments by any interested party. The special assessment commission or the city auditor may alter assessments at the hearing, as may be just or necessary, pursuant to Sections 40-23-11 and 40-23.1-09. Sections 40-23-07 and 40-23.1-06 provide property of political subdivisions is not exempt from special assessments.

Any person still aggrieved after consideration by the commission or city auditor may file a written notice of appeal stating the grounds for the appeal pursuant to Sections 40-23-14 and 40-23.1-12. At the regular meeting of the city governing body at which the assessment list is to be acted upon, in accordance with Sections 40-23-15 and 40-23.1-13, any person that has appealed may appear and present the reasons why the action of the commission or city auditor should not be approved. The governing body of the city may increase or diminish any assessment as it deems just.

Testimony and Committee Considerations

The committee reviewed Engrossed House Bill No. 1474 (2019), which contains the language of the bill before it was amended into this study. The bill was reviewed as a means to solicit feedback on special assessment revenue replacement options from city representatives. The engrossed bill would have allowed home rule counties and cities to elect to levy an infrastructure tax in lieu of imposing general special assessments and in addition to levying greenfield special assessments. The engrossed bill defined "general special assessments" as assessments for maintaining existing roads and infrastructure and assessments for the construction or repair of arterial roads that benefit the entire community and defined "greenfield special assessments" as assessments for infrastructure costs associated with developing agricultural or other undeveloped property. The committee was informed the language in the engrossed bill was a response to Senate Bill No. 2326 (2017), which prevents a city from seeking voter approval for any funding mechanism that was not present in a city's home rule charter before August 1, 2017.

The committee received comments from several city representatives regarding potential special assessment revenue replacement options and concerns with the concepts provided in Engrossed House Bill No. 1474 (2019). City representatives identified several options for subsidizing or replacing special assessment revenue. Funding options included using revenue from property tax, sales tax, highway user tax, special district fees or surcharges, impact or development fees, federal funds, and grants. It was noted cities also can encourage developers to pay the upfront costs of new developments. Special assessments costs in Fargo are being subsidized with state funds provided by House Bill No. 1066 (2019), commonly referred to as the prairie dog bill. Subsidizing special assessment costs with state funding allowed the city to cap the amount assessed to property owners for sanitary sewer replacement at $40 per front foot and reduce the special assessment costs for paving by 50 percent for single family and small multifamily residences and

25 percent for commercial or mixed-use properties. The city also used state funds to eliminate special assessments for arterial reconstruction costs for single family residences that do not front an arterial roadway. City representatives expressed various concerns with the revenue replacement structure provided in Engrossed House Bill No. 1474. City representatives noted communities might struggle with implementing an infrastructure tax if the tax does not address the payment of existing special assessment debt. City representatives recommended clarification that the county-imposed infrastructure tax would appear on a county-issued utility bill and a city-imposed infrastructure tax would appear on a city-issued utility bill. City representatives voiced opposition to completely eliminating special assessments and viewed a utility tax as a supplemental funding source to reduce all or a portion of special assessment costs relating to infrastructure maintenance.

The committee received information from representatives of the Bismarck-Mandan Chamber of Commerce and the Bismarck-Mandan Development Association regarding the joint task force meetings held by the City of Bismarck's Infrastructure Task Force and Special Assessment Task Force. The joint task force met to review the process for levying special assessments and develop an alternative funding source for infrastructure. The recommendations resulting from the joint task force's review included requiring developers to pay the upfront costs of new greenfield development and imposing a street utility tax to cover the costs of infrastructure maintenance projects. The committee was informed, if approved by the voters, a street utility tax would be added to each residential and commercial utility bill and the revenue from the tax would be placed in a street maintenance fund. Revenue in the street maintenance fund would be used for infrastructure maintenance projects in the city or county levying the tax.

The committee received testimony indicating the frequency in which certain areas would receive improvements funded by the street utility tax would depend on the conditions in each area. A city or county still could levy special assessments for costs associated with things like sewer and surface water management and new infrastructure development. The amount of the street utility tax was estimated at $25 per month for each residential utility bill and $65 per month for each 10,000 square feet of commercial property. The task force arrived at the tax rate by dividing the amount of special assessments to be assessed for street rehabilitation work by the number of residential and commercial units in the city. The fee did not include costs associated with paying off any pre-existing special assessment debt or costs associated with new infrastructure development. There was $120 million in outstanding special assessment debt in Bismarck at the time the task force calculated the street utility tax rate, which amounts to $1.5 million in annual debt payments. The street utility tax is estimated to generate $17 million per year, which is the amount that otherwise would be special assessed for street maintenance projects.

Committee members expressed concerns regarding the disconnect between those receiving the benefit of an improvement and those paying for the improvement. Committee members noted the key concept behind special assessments is a fair distribution of benefits. Special assessments are based on the value of the benefit received by the property as the result of an improvement. A street utility tax would replace a system in which only benefited properties are paying for improvements with one in which all properties would be paying for improvements, even if some properties never benefit from the improvement. Other committee members were less concerned with the lack of direct connection between benefit and burden and viewed citywide infrastructure maintenance as indirectly benefiting all citizens. The tax was likened to the tax paid by all property owners for the support of schools, regardless of whether the property owner has children attending school.

Concerns also were raised regarding an individual being subjected to multiple layers of taxation. An individual potentially could be subject to making payments on exiting special assessment debt previously acquired, plus paying a street utility tax and any new amounts special assessed for new infrastructure costs or sewer or water management costs. Concerns were raised regarding the burden the new tax may place on certain residents, such as seniors living on a fixed income, whose properties may otherwise not have been subject to special assessments. Committee members also expressed concerns regarding the costs and difficulties associated with switching from one assessment method to another and the transparency provided to voters voting on allowing a street utility tax. Committee members questioned the manner in which the street utility tax question would be presented on the ballot and expressed concerns that a ballot question granting blanket authority for a city or county to levy a street utility tax without specifying the rate of the tax could subject property owners to increasing street utility fees in the future. Committee members did not seek to prohibit cities and counties from generating the necessary revenue for maintenance and improvement costs, but wanted to ensure taxpayers were receiving adequate protections. Committee members noted the presentations from various city representatives indicated the costs of providing local development and maintenance will be the same, regardless of the method used to fund the costs.

Conclusions

The committee makes no recommendations in regard to its study of options for replacing revenue generated by special assessments with revenue from an alternative local funding source.

ECONOMIC DEVELOPMENT TAX INCENTIVES STUDY

Section 54-35-26, enacted by Senate Bill No. 2057 (2015), provides for the review of a specified list of economic development tax incentives and requires each incentive be reviewed at least once every 6 years. The Legislative Management selected the Taxation Committee to review tax incentives during the 2019-20 interim.

Background

The practice of legislatively mandating the periodic review of economic development tax incentives began to gain popularity following the 2007-09 recession. As states continued to look at austerity options and ways to grow economies, reviewing tax incentives was viewed as sound public policy to ensure state dollars were being spent in a prudent and effective manner.

In 2012 The Pew Charitable Trusts (Pew) began tracking the progress states were making in evaluating tax incentives and published a report entitled *Evidence Counts: Evaluating State Tax Incentives for Jobs and Growth*. The report identified states leading the way in evaluating the effectiveness of tax incentives, states meeting some of the criteria for effective evaluations, and states not meeting any criteria in terms of the scope or quantity of evaluations. Pew's 2019 report identifies 16 states leading the way in evaluating incentives, 15 states making progress in evaluating incentives, and 19 states trailing behind in evaluating incentives. The report describes the leading states as those with well-designed plans for regular reviews, experience in producing quality evaluations that measure economic impacts, and a process for applying the results of evaluations to inform policy decisions. North Dakota is identified as one of the states leading the way in evaluating incentives.

Tax Incentive Evaluation Law

Section 54-35-26 directs the review of specified economic development tax incentives by an interim committee selected by the Legislative Management. The review entails an assessment of whether each listed incentive is serving the purposes for which it was enacted in a cost-effective and equitable manner. The statute requires each incentive be reviewed at least once every 6 years and provides the following eight items that may be considered when evaluating incentives:

1. The extent of achievement of the goals of the incentive and whether unintended consequences have developed in its application;
2. Whether the design and application of the incentive can be improved;
3. The extent of complementary or duplicative effects of other incentives or governmental programs;
4. Whether the incentive has a positive influence on business behavior or rewards business behavior that is likely to have occurred without the incentive;
5. The effect of the incentive on the state economy, including the extent of primary sector operation of the recipient and any competitive disadvantage imposed or benefit conferred on other state businesses, any benefit or burden created for local government, and the extent of the incentive's benefit that flows to out-of-state concerns;
6. The employment opportunities generated by the incentive and the extent those represent career opportunities;
7. Whether the incentive is the most effective use of state resources to achieve desired goals; and
8. If the committee's analysis of the incentive is constrained by lack of data, whether statutory or administrative changes should be made to improve collection and availability of data.

Interim Committee Review of Incentives

The first interim of incentive evaluations was conducted by the Political Subdivision Taxation Committee during the 2015-16 interim. The committee selected 14 incentives to review from the incentives listed in Section 54-35-26 and an additional four incentives not listed in Section 54-35-26. Legislation resulting from the committee's review led to a uniform definition of "primary sector business," statutory changes to the angel fund credit, and the elimination of the wage and salary income tax credit, the microbusiness income tax credit, and the certified nonprofit development corporation income tax credit. The committee's review also resulted in Senate Bill No. 2044 (2017), which lead to the Bank of North Dakota's acquisition of dynamic revenue analysis software from Regional Economic Models Incorporated (REMI) and the 2017-18 interim committee's ability to request incentive evaluations generated using the software for incentives selected for review during the 2017-18 interim.

The second interim of incentive evaluations was conducted by the Taxation Committee during the 2017-18 interim. The committee selected seven incentives to review from the list in Section 54-35-26. Six of the seven incentives selected for review included incentives selected during the 2015-16 interim, which the Political Subdivision Taxation Committee had insufficient time to analyze. The Taxation Committee selected the new jobs credit from income tax withholding, the internship program credit, the workforce recruitment credit, the research expense credit, new or expanding business exemptions, renaissance zone tax credits and exemptions, and development or renewal area incentives, including tax increment financing incentives. The committee declined to recommend any changes to the incentives selected for review.

The third interim of incentive evaluations, which concluded the first 6-year incentive review cycle, was conducted by the Taxation Committee during the 2019-20 interim. The committee selected the remaining seven incentives in Section 54-35-26 which had not been reviewed during the previous 2 interims. These incentives included fuel tax refunds for certain users; sales tax exemptions for manufacturing and recycling machinery and equipment, materials used to construct a fertilizer or chemical processing facility, materials used to construct or expand a carbon dioxide capture and injection system, and enterprise information technology equipment and software used in a qualified data center; oil and gas gross production and oil extraction tax exemptions; and coal severance and conversion tax exemptions. The following table summarizes the incentives reviewed during each interim in the first 6-year incentive review cycle:

First 6-Year Review Cycle		
2015-16 Interim	**2017-18 Interim**	**2019-20 Interim**
Agricultural commodity processing facility investment tax credit	Renaissance zone credits and exemptions	Fuel tax refunds
Angel fund investment tax credit	Research expense credit	Manufacturing and recycling equipment sales tax exemption
Biodiesel fuel credits	Internship program credit	Fertilizer or chemical processing facility sales tax exemption
Manufacturing automation tax credit	Workforce recruitment credit	Carbon dioxide capture and injection sales tax exemption
Microbusiness income tax credit	New or expanding business exemptions	Qualified data center sales tax exemption
Seed capital investment tax credit	New jobs credit from income tax withholding	Oil and gas gross production and oil extraction tax exemptions
Soybean or canola crushing facility credit	Development or renewal area incentives	Coal severance and conversion tax exemptions
Wage and salary credit		
Certified nonprofit development corporation investment tax credit		
Electrical generating facilities sales tax exemption		
Geothermal, solar, wind, and biomass energy device credit		
Telecommunications infrastructure sales tax exemption		

The committee received background information for each of the selected incentives, which provided an explanation of the incentive, the perceived intent of the Legislative Assembly in creating or altering each incentive, and the data and testimony required to effectively review each incentive. Data regarding the number of claimants and the amounts claimed for each incentive was provided by the Tax Department. The committee also received a presentation on the best practices for evaluating the effectiveness of economic development tax incentives. The committee received information indicating the purpose of incentives is not only to secure a deal, but also should be used to achieve a community's larger economic development goals. The committee was informed companies are seeking well-designed incentive programs that work for both business and the community to drive long-term, mutually beneficial, economic development projects. Well-designed incentives have clear and measurable goals, provide tax breaks after certain benchmarks or commitments have been met, set caps on outlays, and include built-in reporting mechanisms. The committee concluded the first cycle of incentive evaluations has been very worthwhile.

Fuel Tax Refunds for Certain Users

Imposition of Fuel Tax

A 23 cent per gallon tax is imposed on motor vehicle fuels, which includes gasoline and gasohol; and on special fuels, which includes diesel, kerosene, compressed natural gas, liquefied petroleum gas, and other fuels except gasoline, gasohol, or aviation fuels pursuant to Chapters 57-43.1 and 57-43.2. Dyed diesel fuel and special fuel other than diesel fuel which is sold for use in unlicensed machinery used for agricultural, industrial, or railroad purposes is exempt from the 23 cent per gallon special fuels tax and is instead subject to a 4 cent per gallon excise tax, with the exception of propane, which is subject to an excise tax of 2 percent. An 8 cent per gallon tax is imposed on aviation fuels pursuant to Chapter 57-43.3. Tax remitted by certain users and on fuel purchased for specified uses is subject to refund.

Explanation of Fuel Refunds for Specified Users

The operator of an emergency medical services operation who purchases motor vehicle fuel, special fuel, or aviation fuel for use in a licensed emergency medical services operation may claim a refund of tax paid. Tax paid on motor vehicle fuel purchased by the state or a political subdivision for use in construction, reconstruction, and maintenance of a public road or airport also is subject to refund. A Native American may claim a refund of motor vehicle fuel or special fuel tax paid if the fuel was purchased from a retail fuel dealer located on the reservation where the Native American is an enrolled member, and in which a motor fuel agreement is not in place, and the fuel was delivered to the Native American purchaser on that reservation. Refunds also are allowed to fuel resellers who sold fuel on which motor vehicle fuel, special fuel, or aviation fuel tax was paid to an agency of the federal government.

Perceived Goals in Creating or Altering the Refund Provisions for Specified Users

The perceived goal of providing fuel tax refunds for specified users is to reduce the tax burden for those users. The first fuel tax refund provisions provided for specified users were enacted by House Bill No. 360 (1937). The provisions allowed for refunds of the tax paid on motor vehicle fuel purchased by the state or a political subdivision for use in construction, reconstruction, or maintenance of a public road or airport. These refund provisions were followed by the enactment of refund provisions for the tax paid on motor vehicle fuel, special fuel, and aviation fuel for resellers who sold fuel on which tax was paid to an agency of the federal government by Senate Bill No. 2177 (1999). Refund provisions providing a motor vehicle fuel and special fuel tax refund for fuel purchased by a Native American from a retail fuel dealer located on the reservation where the Native American is an enrolled member was enacted by Senate Bill No. 2012 (2005). The final refund provision provided for specified users was enacted by House Bill No. 1138 (2007), which provided refunds for motor vehicle fuel, special fuel, and aviation fuel tax paid on fuel purchased by the operator of an emergency medical services operation. The perceived goal of the Legislative Assembly in enacting the fuel tax refund was to lower the operating costs of emergency medical services operations to keep the operations economically viable, especially in rural areas.

Explanation of Fuel Refunds for Specified Uses

The tax paid on motor vehicle fuel purchased for use in nonlicensed equipment used for agricultural or industrial purposes is subject to refund. The amount of tax refunded on motor fuel purchased for industrial purposes must be reduced by one-half cent per gallon for deposit in the agricultural products utilization fund. Tax paid on special fuel purchased for use in a refrigeration unit that has a separate supply tank on a truck or trailer is subject to refund. The amount of special fuel tax refunded on fuel purchased for use in a refrigeration unit must be reduced by four cents per gallon to account for the payment of special fuel excise tax. Refunds also are allowed on motor vehicle fuel, special fuel, or aviation fuel if the fuel is removed for sale, resale, or use in another state that requires payment of tax on the fuel.

Perceived Goals in Creating or Altering the Refund Provisions for Specified Uses

The perceived goal of providing fuel tax refunds for specified uses is to lower the tax burden applied to those specified uses. Refund provisions for tax paid on motor vehicle fuel purchased for use in nonlicensed equipment for industrial or agricultural purposes have been available since the motor vehicle fuel tax law was first enacted by an initiated measure approved by the voters at a statewide election held on June 30, 1926. The amount withheld from the tax refunded on fuel purchased for industrial purposes was set at one-half of one cent per gallon in 1983. The amount withheld from the tax refunded on fuel purchased for agricultural purposes was amended several times over the years until the deduction was eliminated in 2015.

Refund provisions for tax paid on motor vehicle fuel or special fuel removed for sale, resale, or use in another state were first enacted by House Bill No. 1164 (1975). The refund provisions were amended in 1997 to provide time limits for claiming the refund and require a claimant to include proof the fuel purchased for sale or resale in another state was reported to the taxing agency in the claimant's refund application materials. An aviation fuel tax refund for fuel removed for sale, resale, or use in another state was enacted by Senate Bill No. 2177 (1999). The special fuel tax refund provided for consumers who purchase special fuel for use in a refrigeration unit was enacted by Senate Bill No. 2224 (2009). The perceived goal of the Legislative Assembly in offering the refund was to allow drivers refueling at truck stops at which dyed fuel was not available to fill their refrigeration units with clear fuel and receive a refund on the amount of tax paid in excess of the tax that otherwise would have been paid on the dyed fuel.

Testimony and Committee Considerations

The committee received information from a representative of the Tax Department regarding the amount of fuel tax refunded in fiscal years 2015 to 2019. A total of $293,465 in motor vehicle fuel tax, $115,302 in special fuel tax, and $7,296 in aviation fuel tax was refunded in fiscal year 2019. The highest amount of tax refunded by category of refund was for motor vehicle fuel used for agricultural purposes. The amount of motor vehicle fuel tax refunded for fuel used for agricultural purposes was $148,447 in 2019. The committee reviewed historic fuel tax rate changes and historic fuel prices and effective fuel tax rates. Some committee members questioned whether it would be more beneficial to lower the fuel tax rate for all consumers, rather than provide such an extensive list of refund provisions, once the cost of wages and benefits are calculated for the employees required to process refund requests. Other committee members expressed concern that the fuel tax rate might be too low considering the existing gap between transportation funding revenue and transportation fund needs.

The motor vehicle and special fuel tax rate was last increased to 23 cents from 21 cents in 2005. A one-cent fuel tax rate increase would generate approximately $7.4 million in tax revenue per year. The committee received detailed information from representatives of the Department of Transportation and the Upper Great Plains Transportation Institute regarding fuel tax revenue and distributions and long-term transportation funding needs. The committee acknowledged steps likely would need to be taken by the 2021 Legislative Assembly to address transportation funding needs but did not discuss any recommendations to modify or eliminate the fuel tax refund provisions selected for study to address funding needs. The committee did not receive testimony from interested parties in support of retaining, eliminating, or modifying fuel tax refund provisions. The committee indicated fuel tax refund provisions are operating as intended.

Conclusions

The committee makes no recommendation regarding fuel tax refund provisions.

Manufacturing and Recycling Sales Tax Exemption

Explanation of the Exemption

Section 57-39.2-04.3 provides a sales tax exemption for machinery or equipment used directly in manufacturing or recycling tangible personal property. For purposes of the exemption, manufacturing includes the meaning normally ascribed to the term and the processing of agricultural products but does not include mining or refining activities, oil and gas extraction, or the generation of electricity. Recycling is defined as the collection or recovery of materials that otherwise would be waste and conversion of those materials to a product for sale or a raw material for use in manufacturing. To qualify for the exemption, the machinery or equipment must be used in a new manufacturing plant or recycling facility or used to create a physical or economic expansion of an existing plant or facility. An economic expansion is classified as an increase in production volume, employment, or the types of products that can be manufactured or recycled.

Perceived Goals in Creating and Altering the Exemption

Provisions of the manufacturing and recycling sales tax exemption were first enacted by House Bill No. 1048 (1991). As originally enacted, the exemption applied only to manufacturing machinery and equipment used directly in manufacturing tangible personal property or processing agricultural products. The exemption replaced an existing 3 percent reduced sales tax rate on these items. The perceived goal of the Legislative Assembly in creating the exemption was to attract new manufacturing plants to the state and encourage the expansion of existing manufacturing plants. The exemption was viewed as a driver for job creation and increased income tax collections as a result of manufacturing plant construction and expansion.

The exemption was expanded in 1993 to apply to machinery or equipment used directly in a new recycling facility or in the physical or economic expansion of an existing recycling facility. The definition of machinery also was expanded to include environmental control equipment and devices purchased or constructed at any point from the initial stages of manufacturing through the completion and packaging of an end product. The definition of machinery was further expanded in 1994 to include computer equipment that controls or monitors the function of machinery used in the manufacturing process and devices used through the completion of the product, including packaging and all processes before the completed product is transported from the plant. Machinery or equipment was required be used in the manufacturing process at least 50 percent of the time to qualify for the exemption. The definition of "used directly" also was expanded to include machinery and equipment used to conduct research, and development and design activities related to the manufacturing process of the plant. The definition of manufacturing for purposes of the credit also was temporarily expanded in 1999 to include the refining of crude oil through July 31, 2002. The final change to the exemption was made in 2015 to allow a customer to qualify for an exemption at the time of purchase or apply for a refund of sales tax paid on a mold purchased by a customer and used directly by a manufacturer in the manufacturing process.

Testimony and Committee Considerations

The committee received data from a representative of the Tax Department regarding the number of claimants and the amount exempted in relation to the manufacturing and recycling sales tax exemption. The data indicated an aggregate total of $15,915,697 in sales tax was not collected from 255 taxpayers from fiscal years 2015 to 2019 as a result of the manufacturing sales tax exemption, and $420,371 was not collected from 32 taxpayers as a result of the recycling sales tax exemption during the same period. The committee did not receive testimony from interested parties in support of retaining, eliminating, or modifying the sales tax exemption. The committee did not identify any concerns relating to the exemption or ways in which the exemption could be improved. The committee indicated the exemption is operating as intended.

Conclusions

The committee makes no recommendation regarding the manufacturing and recycling sales tax exemption.

Fertilizer or Chemical Processing Facility Sales Tax Exemption

Explanation of the Exemption

Sections 57-39.2-04.15 and 57-40.2-03.3 provide a sales and use tax exemption for materials used to construct a fertilizer or chemical processing facility. For purposes of the exemption, a fertilizer or chemical processing facility is a processing plant that produces for retail or wholesale a fertilizer, chemical, or chemical derivative from natural gas, natural gas liquids, or crude oil components. The sales tax exemption applies to sales of personal property used to construct a fertilizer or chemical processing facility or any component integral to the facility. A component integral to the facility may be owned directly or indirectly by the facility or an unrelated third party and must be located at the site of the facility and integral to the facility's processing of fertilizers or chemicals. The tangible personal property must be incorporated in the facility or used in the construction process to the point of having no residual economic value to qualify for the exemption. Before July 1, 2023, the owner of a fertilizer or chemical processing plant must receive from the Department of Environmental Quality an air quality permit or notice that the air quality permit is complete and provide the documentation to the Tax Department to qualify for the exemption.

Perceived Goals in Creating and Altering the Exemption

The sales and use tax exemption for materials used to construct a fertilizer or chemical processing facility was enacted by Senate Bill No. 2035 (2015). The perceived goal of the Legislative Assembly in creating the exemption was to encourage economic diversification by incentivizing new industries. Various items were discussed in support of the exemption, including the state's need to compete with other states to attract and develop new industries, the benefits of converting natural gas to fertilizer to reduce flaring and provide a local fertilizer market for farmers, the opportunity to add value to existing energy resources by converting ethane gas into polyethylene, and the creation of new jobs and an expanded tax base. The incentive also was viewed as a tool to lessen the impact of other barriers to doing business in this state, such as the cold climate, limited workforce, and rural infrastructure and transportation issues.

Testimony and Committee Considerations

Testimony received from a representative of the Tax Department indicated no fertilizer or chemical processing facility sales tax exemptions have been claimed since the exemption was enacted in 2015. Testimony indicated the exemption had not been claimed because the exemption was specific to the feed stock of a certain type of plant that was not yet present in the state. The committee did not receive testimony from interested parties in support of retaining, eliminating, or modifying the sales tax exemption. The committee did not identify any concerns relating to the exemption or ways in which the exemption could be improved. The committee did not indicate a desire to eliminate the exemption as a result of the exemption's lack of use.

Conclusions

The committee makes no recommendation regarding the fertilizer or chemical processing facility sales tax exemption.

Carbon Dioxide Capture and Injection Sales Tax Exemption

Explanation of the Exemption

Sections 57-39.2-04.14 and 57-40.2-03.3 provide a sales and use tax exemption for tangible personal property used to construct or expand a system used to compress, gather, collect, store, transport, or inject carbon dioxide for secure geologic storage or use in enhanced recovery of oil or natural gas. To qualify for the exemption, the tangible personal property must be incorporated into a system used to compress, gather, collect, store, transport, or inject carbon dioxide for secure geologic storage or use in enhanced recovery of oil or natural gas. The purchase of replacement equipment does not qualify for the exemption unless the replacement creates an expansion of the system.

Perceived Goals in Creating and Altering the Exemption

The sales and use tax exemption for tangible personal property used to construct or expand a system used to compress, gather, collect, store, transport, or inject carbon dioxide for use in enhanced recovery of oil or natural gas was created by Senate Bill No. 2318 (2015). The perceived goal of the Legislative Assembly in creating the exemption was to provide a green incentive aimed at encouraging investment in costly carbon dioxide capture and injection systems, reducing carbon dioxide emissions, and increasing oil and gas recovery. The exemption also was viewed as a tool to increase jobs and income tax collections as a result of the construction required to complete systems used to compress, gather, collect, store, transport, or inject carbon dioxide. The only changes to the exemption following its enactment were made in 2019, which expanded the exemption to materials used to construct or expand a system used to compress, gather, collect, store, transport, or inject carbon dioxide for secure geologic storage.

Testimony and Committee Considerations

Testimony received from a representative of the Tax Department indicated no carbon dioxide capture or injection sales tax exemptions have been claimed since the exemption was enacted in 2015. Testimony indicated the exemption had not been claimed because most projects associated with the exemption are in the feed study and engineering early project stages. The committee did not receive testimony from interested parties in support of retaining, eliminating, or modifying the sales tax exemption. The committee did not identify any concerns relating to the exemption or ways in which the exemption could be improved. The committee did not indicate a desire to eliminate the incentive as a result of the incentive's lack of use.

Conclusions

The committee makes no recommendation regarding the carbon dioxide capture and injection sales tax exemption.

Qualified Data Center Sales Tax Exemption

Explanation of the Exemption

Section 57-39.2-04.13 provides a sales and use tax exemption for enterprise information technology equipment and computer software purchased for use in a qualified data center. For purposes of the exemption, a qualified data center is a facility that serves as a centralized repository for the storage, management, and dissemination of electronic data and information, located on a single parcel or contiguous parcels, comprised of one or more buildings consisting of a minimum aggregate amount of 16,000 square feet, and which is newly constructed or substantially refurbished after December 31, 2014. The data center must be certified by the Tax Commissioner as a qualified data center and have an uninterrupted power supply, generator backup, or both; a sophisticated fire suppression and prevention system; and enhanced security features. Equipment or software must be incorporated into or physically located within the qualified data center to qualify for the exemption. The exemption includes purchases of upgraded or replacement equipment or software. The exemption is limited to the first four facilities approved by the Tax Commissioner as qualified data centers and expires on January 1, 2021.

Perceived Goals in Creating and Altering the Exemption

The sales and use tax exemption for enterprise information technology equipment and computer software used in a qualified data center was enacted by House Bill No. 1089 (2015). The perceived goal of the Legislative Assembly in creating the exemption was to help diversify the state's economy by creating a more attractive tax environment to attract data centers to this state. Surrounding states that offered a similar tax incentive were successful in attracting data centers, so the exemption was viewed as a means to enhance the state's ability to attract data centers when coupled with the state's cold weather and abundant sources of electricity. The addition of data centers also was thought to lead to the expansion of other information technology businesses and data-intensive industries.

Testimony and Committee Considerations

The committee received data from a representative of the Tax Department regarding the number of claimants and the amount exempted in relation to the qualified data center sales tax exemption. The data indicated an aggregate total of $975,409 in sales tax was not collected from the four qualified data centers from fiscal years 2015 to 2019 as a result of the sales tax exemption. The committee was informed the sales tax exemption for qualified data centers is exhausted because it is limited by statute to the first four claimants. The committee did not receive testimony from interested parties in support of retaining, eliminating, or modifying the sales tax exemption. The committee did not identify any concerns relating to the exemption or express an interest in repealing the exemption or expanding the scope of the exemption to apply to additional qualified data centers.

Conclusions

The committee makes no recommendation regarding the sales tax exemption for qualified data centers.

Oil and Gas Gross Production and Oil Extraction Tax Exemptions

Imposition of Oil and Gas Gross Production Tax

Pursuant to Chapter 57-51, a gross production tax of 5 percent of the gross value at the well is levied upon oil produced in the state. The gross production tax levied upon gas produced in the state is calculated by multiplying taxable production by an annually adjusted flat rate per thousand cubic feet.

Explanation of Gross Production Exemptions

Production exempt from gross production tax includes:

- Gas used on the lease for production purposes and any royalty interest from gas produced from a state, federal, or municipal holding, or from an interest held by an organized Indian tribe.

- Shallow gas produced during the first 24 months of production following the date gas was first sold from a shallow gas well and gas produced from a shallow gas well during testing, but prior to well completion, or during connection to a pipeline.
- Gas burned at the well site to power an electrical generator that consumes at least 75 percent of the gas from the well.
- Gas collected at the well site by a system that intakes at least 75 percent of the gas and natural gas liquids volume from the well for beneficial consumption.

Perceived Goals in Creating and Altering Gross Production Exemptions

The exemption provided in Section 57-51-02 for gas used on the lease for production purposes and any royalty interest from gas produced from a state, federal, or municipal holding, or from an interest held by an organized Indian tribe was enacted by Senate Bill No. 41 (1953). The exemption provided in Section 57-51-02.4, which exempts shallow gas produced from a new or recompleted shallow gas well during the first 24 months of production, was enacted by House Bill No. 1145 (2003). The perceived goal of the Legislative Assembly in creating the exemption was to attract investment in the state's natural resources by encouraging gas well production. The exemption provided in Section 57-51-02.5 for gas burned at the well site to power an electrical generator that consumes at least 75 percent of the gas from the well, was enacted by Senate Bill No. 2413 (2009). The perceived goal of the Legislative Assembly in creating the exemption was to reduce flaring and generate electricity from gas that might otherwise be wasted. The exemption provided in Section 57-51-02.6 for gas collected at the well site by a system that intakes at least 75 percent of the gas and natural gas liquids volume from the well for beneficial consumption was enacted by House Bill No. 1134 (2013). The perceived goal of the Legislative Assembly in creating the exemption was to encourage the use of gas that might otherwise be flared.

Imposition of Oil Extraction Tax

The oil extraction tax is levied on the extraction of oil from the earth pursuant to Chapter 57-51.1. The oil extraction tax rate is 5 percent, subject to a 1 percent increase if the average price of a barrel of crude oil exceeds $90 for 3 consecutive months.

Explanation of Oil Extraction Exemptions

Production exempt from oil extraction tax includes:

- Liquids produced from a collection system employed to avoid flaring, which are exempt for a period of 2 years and 30 days from the time of first production.
- Production that is exempt from the gross production tax imposed by Chapter 57-51.
- Production from stripper well property or an individual stripper well.
- Incremental production from a secondary recovery project for 5 years from the date incremental production begins.
- Incremental production from a tertiary recovery project for 10 years from the date incremental production begins, or 20 years from the date incremental production begins or certified injection begins if the project injects more than 50 percent carbon dioxide produced from coal and is located outside the Bakken or Three Forks Formations.
- Incremental production from a tertiary recovery project from a horizontal well drilled and completed within the Bakken and Three Forks Formations for 5 years from the date incremental production begins, or 10 years from the date incremental production begins or certified injection begins if the project injects more than 50 percent carbon dioxide produced from coal and is located within the Bakken or Three Forks Formations.

The first 75,000 barrels of oil produced during the first 18 months after completion of a well drilled and completed outside the Bakken and Three Forks Formations and 10 miles or more outside an established field that includes either formation are subject to partial exemption in the form of a reduced tax rate of 2 percent on the gross value at the well of oil extracted.

Perceived Goals in Creating and Altering Oil Extraction Exemptions

The limited duration exemption provided in Section 57-51.1-02.1 for liquids produced from a collection system employed to avoid flaring was enacted by House Bill No. 1134 (2013). The perceived goal of the Legislative Assembly in creating the exemption was to encourage the use of gas that might otherwise be flared. The exemption provided in Section 57-51.1-03(1) for oil that is exempt from the gross production tax imposed by Chapter 57-51, and the exemption provided in Section 57-51.1-03(2) for production from stripper well property or an individual stripper well, were enacted by Initiated Measure No. 6, which was approved by the voters at the general election held on November 4, 1980. The exemptions provided in Section 57-51.1-03(3) for incremental oil produced from secondary and tertiary recovery projects were enacted by House Bill No. 1414 (1991). The perceived goal of the Legislative Assembly in creating the exemption was to provide an exemption to encourage the enhanced recovery of oil that might not otherwise be produced. The enhanced oil recovery exemptions were amended several times following their enactment, including in 2009 to provide an exemption for incremental production from a tertiary recovery project that uses carbon dioxide, and in 2019 to provide an exemption for incremental production from a tertiary recovery project that uses carbon dioxide produced from coal.

The partial exemption in the form of a reduced 2 percent tax rate on the gross value at the well of the first 75,000 barrels of oil produced during the first 18 months after completion of a well drilled and completed outside the Bakken and Three Forks Formations, as provided in Section 57-51.1-03(4), was enacted by Senate Bill No. 2397 (2007). The perceived goal of the Legislative Assembly in creating the exemption was to foster a competitive tax environment to encourage industry to continue to develop oil resources in the state. The exemption was amended in 2009 to cap the amount of oil exempted per well at 75,000 barrels of oil produced or the first $4.5 million of gross value at the well, whichever is less.

Testimony and Committee Considerations

The committee received data from a representative of the Tax Department regarding the exemption provided to production from stripper wells and the reduced tax rate applied to production from new non-Bakken wells and the resulting reduction in tax collections. The data indicated 101,800,535 barrels of oil from stripper wells were exempt from oil extraction tax from fiscal years 2015 to 2019, resulting in $258,710,689 in reduced tax collections, and 3,309,174 barrels of oil from new non-Bakken wells were subject to a reduced oil extraction tax rate during the same period, resulting in $5,821,264 in reduced tax collections. The committee did not receive testimony from interested parties in support of retaining, eliminating, or modifying oil and gas gross production or oil extraction tax exemptions. The committee did not identify any concerns relating to the exemptions or ways in which the exemptions could be improved. The committee indicated the exemptions are operating as intended.

Conclusions

The committee makes no recommendation regarding oil and gas gross production or oil extraction tax exemptions.

Coal Severance and Conversion Tax Exemptions

Imposition of Coal Severance Tax

The coal severance tax is imposed on the act of removing coal from the earth pursuant to Chapter 57-61. The tax applied to coal severed for sale or industrial purposes, subject to certain exceptions. The tax is in lieu of both the sales and use taxes on coal and the property tax on minerals in the earth. The tax is applied at a rate of 37.5 cents per ton. An additional 2 cents per ton tax is levied for the lignite research fund.

Explanation of Coal Severance Tax Exemptions

Coal used to heat buildings in the state, by the state or any political subdivision of the state, and in agricultural processing facilities in the state or adjacent states is exempt from coal severance tax. A 50 percent reduction of the 37.5 cent tax is allowed for coal burned in a cogeneration facility designed to use renewable resources to generate 10 percent or more of its energy output. A county may grant a partial or complete exemption from the county's 70 percent portion of the 37.5 cent tax for coal that is shipped out of state.

Perceived Goals in Creating or Altering Coal Severance Tax Exemptions

The exemption provided in Section 57-61-01.1, for coal used to heat buildings in the state and coal used by the state or any political subdivision of the state, was enacted by Senate Bill No. 2239 (1981). The perceived goal of the Legislative Assembly in creating the exemption was to encourage the use of coal by the state and political subdivisions and the use of coal for heating purposes to decrease the state's dependence on other energy sources.

The exemption provided in Section 57-61-01.4, for coal used in agricultural processing facilities in the state or adjacent states, was enacted by House Bill No. 1470 (1985). As originally enacted, the exemption included an exemption for coal used in sugar beet refining plants. The perceived goal of the Legislative Assembly in creating the exemption was to make lignite coal more competitive with coal from Montana and Wyoming for use in agricultural processing facilities and sugar beet refining plants. Proponents of the exemption noted the loss of coal contracts was having a negative impact on employment in coal-producing areas of the state. The exemption was expanded in 2009 to include coal purchased for improvement through beneficiation which is then used in an agricultural commodity processing facility or a facility owned by the state or a political subdivision.

The 50 percent coal severance tax reduction provided in Section 57-61-01.3, for coal burned in a cogeneration facility designed to use renewable resources to generate 10 percent or more of its energy output, was enacted by Senate Bill No. 2449 (1985). The perceived goal of the Legislative Assembly in providing the tax reduction was to grow the export market for North Dakota coal.

Section 57-61-01.7, which allows a county to grant a partial or complete exemption from the county's 70 percent portion of the severance tax for coal that is shipped out of state, was enacted by House Bill No. 1362 (1993). As originally enacted, the exemption allowed a county to grant a partial or complete exemption from the county's 35 percent portion of the severance tax for coal that is shipped out of state. The perceived goal of the Legislative Assembly in creating the exemption was to prevent the potential closure of a local mine by reducing the tax on coal the mine shipped out of state.

Imposition of Coal Conversion Tax

The coal conversion tax is imposed in lieu of property taxes on the operator of each coal conversion facility pursuant to Chapter 57-60. The land on which the facility is located remains subject to property taxes. The privilege tax on coal conversion facilities is applied based on the type of coal conversion facility. Electrical generating plants are subject to two separate levies. One levy is a .65 mill times 60 percent of installed capacity times the number of hours in the taxable period, and the other levy is .25 mill per kilowatt-hour of electricity produced for sale. Installed capacity means the number of kilowatts a power unit can produce as displayed on the nameplate assigned to the turbine of the power unit. Coal gasification plants are subject to a monthly tax of 13.5 cents per thousand cubic feet of synthetic natural gas produced for sale, or 2 percent of gross receipts, whichever is greater. Plants converting coal to products other than gas are taxed at a rate of 2 percent of gross receipts. Coal beneficiation plants are taxed at a rate of 20 cents per ton of beneficiated coal produced for sale, or 1.25 percent of gross receipts, whichever is greater.

Explanation of Coal Conversion Tax Exemptions

Various types of plants and production receive a full or partial exemption from coal conversion tax. Beneficiated coal produced in excess of 80 percent of a plant's design capacity or produced for use within a coal conversion facility is exempt from tax. A new or repowered coal-burning electrical generation plant is exempt from the general fund portion of both levies for 5 years. The county may grant an exemption for up to 5 years from the county's 15 percent share of the levy on installed capacity. All new coal conversion plants other than electrical generating plants are exempt from the general fund's 85 percent share of the tax for 5 years. The county may grant a partial or complete exemption from the county's 15 percent share for up to 5 years. A coal conversion facility that achieves a 20 percent capture of carbon dioxide emissions during a taxable period receives a 20 percent reduction in the general fund share of the tax, and an additional reduction of 1 percent for every additional 2 percentage points of carbon dioxide emissions captured, up to a 50 percent reduction for 80 percent or more capture. The reduction is available for 10 years from the date of the first capture or from the date the facility is eligible to receive the credit. A conversion facility that met the carbon dioxide capture requirements before January 1, 2017, is not eligible for the reduction.

Perceived Goals in Creating or Altering Coal Conversion Tax Exemptions

The exemption provided in Section 57-60-02 for beneficiated coal produced in excess of 80 percent of a plant's design capacity or produced for use within a coal conversion facility was enacted by House Bill No. 1613 (1989). As originally enacted, the exemption only applied to beneficiated coal produced in excess of 80 percent of the plant's design capacity. The perceived goal of the Legislative Assembly in providing the exemption was to incentivize developers to consider beneficiation projects to help maintain existing coal jobs and create future jobs. The exemption was viewed as providing environmental as well as economic benefits. The exemption was expanded in 2015 to include beneficiated coal produced for use within a coal conversion facility.

The 5-year exemption provided in Section 57-60-02 for the general fund's 85 percent share of tax for new coal conversion plants other than electrical generating plants was enacted by House Bill No. 1574 (1985). As originally enacted, the exemption exempted 65 percent of the tax imposed on the plant for 5 years with the county retaining the ability to grant a full or partial exemption on the remainder of the tax for the same time period. The perceived goal of the Legislative Assembly in providing the exemption was to encourage the construction of new coal conversion plants. The exemption was amended in 2001 to reflect changes to the county's portion of the tax, reduced from 35 to 15 percent, for purposes of identifying the amount of tax the county could exempt.

The 5-year exemption provided in Section 57-60-02 for a new or repowered coal-burning electrical generation plant was enacted by House Bill No. 1606 (1991). As originally enacted, the exemption exempted 65 percent of the tax imposed on new electrical generating plants for 5 years with the county retaining the ability to grant a full or partial exemption on the remainder of tax for the same time period. The perceived goal of the Legislative Assembly in providing the exemption was to promote economic development by providing the same tax incentive to electrical generation plants as was provided to coal conversion facilities. It was noted each 400-megawatt plant creates 1,000 direct and indirect jobs and $72 million in business activity. The exemption was amended three times following its enactment. The exemption was amended in 2001 to reflect changes to the county's portion of the tax, reduced from 35 to 15 percent, for purposes of identifying the amount of tax the county could exempt.

The reduction provided in Section 57-60-02.1 for a coal conversion facility that captures carbon dioxide emissions was enacted by Senate Bill No. 2221 (2009). The perceived goal of the Legislative Assembly in providing the tax reduction was to encourage the capture and reduction of carbon dioxide emissions. The tax reduction was amended in 2017 to disqualify coal conversion facilities that met carbon dioxide capture requirements before January 1, 2017, from qualifying for the tax reduction.

Testimony and Committee Considerations

The committee received data from a representative of the Tax Department regarding the number of tons of coal used to heat buildings or used by a political subdivision or an agricultural processing facility which was exempt from coal severance tax. The data indicated 246,926 tons of coal was exempt from coal severance tax in fiscal year 2019, resulting in $97,536 of reduced tax collections. The committee received estimates from the Tax Department regarding the impact of the 5-year coal conversion tax exemption applied to new electrical generating plants or plants that have completed repowering because there are no new or repowered plants in the state. The estimate indicated an annual reduction of $293,004 in coal conversion tax revenue collections might result from the addition of a new or repowered small electrical generating plant, and an annual reduction of $1,445,000 in coal conversion tax revenue collections might result from the addition of a new or repowered large electrical generating plant as a result of the exemption. The committee did not receive testimony from interested parties in support of retaining, eliminating, or modifying coal conversion or coal severance exemptions. The committee did not identify any concerns relating to the exemptions or ways in which the exemptions could be improved. The committee indicated the exemptions are operating as intended.

Conclusions

The committee makes no recommendation regarding coal severance or coal conversion tax exemptions.

REPORTS RECEIVED BY THE COMMITTEE

Oil and Gas Gross Production Tax Allocation Report

The committee was assigned the responsibility to receive an annual compilation and summary from the Tax Department of reports submitted by counties and school districts that received allocations of oil and gas gross production tax revenues.

The report pertaining to allocations received by counties is required to be provided to the Legislative Council within 45 days after the end of each calendar year pursuant to Section 57-51-15(6). The Tax Department sent revenue and expenditure reporting forms to each county that received oil and gas gross production tax distributions. Each county receiving a gross production tax allocation is required to report the county's statement of revenue and expenditures, the county's ending fund balance, the amount of gross production tax revenue deposited in the county general fund, the amount expended from gross production tax allocations, the purposes for which gross production tax revenue was expended, and the amount and purpose of any gross production tax revenue allocations to townships within the county. The reports indicated a total of $201,125,712 was received by the 16 counties receiving oil and gas gross production tax distributions in calendar year 2018, and $185,291,593 was received in calendar year 2019. The reports indicated each responding county placed the revenue allocations in its general fund. Most counties expended funds for law enforcement needs and several counties expended funds for road and county administrative costs.

The report pertaining to allocations received by school districts is required to be provided to the Legislative Council within 30 days after the end of each fiscal year pursuant to Section 57-51-15(7). The Tax Department sent revenue and expenditure reporting forms to each school district that received oil and gas gross production tax distributions. Each school district receiving a gross production tax allocation is required to report the school district's statement of revenue and expenditures and the school district's ending fund balance, which may be provided by reference to the data stored with the Department of Public Instruction, the amount of gross production tax revenue allocated to the school district, the amount expended from gross production tax allocations, and the purposes for which gross production tax revenue was expended. The report indicated a total of $32,438,032 was received by the 60 school districts receiving oil and gas gross production tax distributions in fiscal year 2019 and $31,761,001 was received in fiscal year 2020. Twenty-three school districts did not provide a report for the 2020 fiscal year. Most reporting school districts expended funds to meet general operating expenses.

The committee was informed there is no statutory penalty for schools failing to provide the report. Some schools have difficulty submitting the report before the end of the interim because it falls so close to the end of the fiscal year. Schools also have been preoccupied with matters relating to the Coronavirus (COVID-19), which might have delayed reporting from some schools. The report indicated much of the information reported by schools also is reported to the Department of Public Instruction, and questions were raised whether this was a duplicative reporting requirement. Committee members acknowledged the state imposes several reporting requirements at the local level. Some committee members expressed interest in eliminating the report, while others viewed the report as a valuable tool to help track changes in funding allocations when the oil tax distribution formula is modified by the Legislative Assembly.

Property Tax Increase Report

The committee was assigned the responsibility to receive an annual report from the Tax Department on annual property tax increases pursuant to Section 57-20-04. The report is due by April 1 of each year and must include the annual increase in property taxes levied by each taxing district of the state after adjusting for property that was not taxable in the preceding year and property that is no longer taxable which was taxable in the preceding year. The committee received detailed information regarding the year-to-year change in dollars levied by counties, cities, and school districts in the state. The aggregate increase in property tax levied by class of property from 2017 to 2018 was 3.9 percent for agricultural land, 5.3 percent for residential property, 3.4 percent for locally assessed commercial property, and 5 percent for centrally assessed commercial property. The aggregate increase in property tax levied by class of property from 2018 to 2019 was 4.1 percent for agricultural land, 4.6 percent for residential property, 5.1 percent for locally assessed commercial property, and 8.8 percent for centrally assessed commercial property. The total amount levied in dollars on all classes of property increased by $45,689,326 from 2017 to 2018 and $53,576,089 from 2018 to 2019.

The committee received a demonstration of an online tool created by the Tax Department which enables users to view mill levies imposed by political subdivisions and property tax changes for existing property for each political subdivision of the state. Committee members commended the transparency provided through the creation of the online tool. Committee members also acknowledged the value of receiving the yearly property tax increase report in making the public aware of where property tax increases are occurring and providing a forum for taxing districts to explain the reasons behind any increases.

Renaissance Zone and Tax Increment Financing Report

The committee was assigned the responsibility to receive an annual report from the Department of Commerce's Division of Community Services on renaissance zone progress, pursuant to Section 40-63-03(2), and a report compiling reports from cities that have renaissance zone property included in a tax increment financing district, pursuant to Section 40-63-03(10). According to the report on renaissance zone progress, 1,827 projects have been approved and 1,434 projects have been completed since the inception of the renaissance zone program. A survey of renaissance zone communities conducted in 2018 indicated renaissance zones created 17 new businesses, 10 business expansions, and 168 new jobs. The benefits realized by the 54 projects that reached completion in 2018 amounted to $1,319,639 in income tax exemptions and $1,862,706 in property tax exemptions. A survey of renaissance zone communities conducted in 2019 indicated renaissance zones created 12 new businesses, 16 business expansions, and 110 new jobs. The benefits realized by the 50 projects that reached completion in 2019 amounted to $874,075 in income tax exemptions and $2,845,343 in property tax exemptions.

Information contained in the second report indicated the cities of Hazen, Mandan, and Bismarck have properties located in both a renaissance zone and a tax increment financing district. According to the report, only one property in Mandan is receiving benefits under both the renaissance zone program and tax increment financing program. Testimony indicated the renaissance zone program is functioning as intended and the program continues to be a vital economic tool for smaller communities.

State Grantor Report

The committee was assigned the responsibility to receive from the Department of Commerce an annual compilation and summary of the reports of state agencies that awarded business incentives for the previous calendar year pursuant to Section 54-60.1-07. The business incentive accountability law became effective January 1, 2006. The law applies to businesses that receive incentives totaling $25,000 or more in a given year from state or local grantors. The law requires the recipient business enter a business incentive agreement with the grantor, which must provide a description of the incentive to be granted as well as the job goals the business seeks to achieve within the first 2 years. A recipient business must report progress toward achieving stated goals. The reports indicated 872 business incentive agreements were entered from 2015 to 2019 totaling an incentive value of $129,412,768. The report details the distribution of business incentives by type, public purpose, and type of business. The report also provides the number of agreements entered by year and identifies whether the goal was to create jobs, retain jobs, or neither. The report stated 3,730 jobs were created and retained over the last 5 years compared to a goal of 2,034 jobs. Eleven percent of closed agreements entered from 2014 to 2018 did not meet job creation goals with no repayment of funds.