NORTH DAKOTA LEGISLATIVE MANAGEMENT

Minutes of the

# POLITICAL SUBDIVISION TAXATION COMMITTEE

Wednesday, July 29, 2015
Roughrider Room, State Capitol
Bismarck, North Dakota

Representative Jason Dockter, Chairman, called the meeting to order at 9:00 a.m.

**Members present:** Representatives Jason Dockter, Larry Bellew, Mark A. Dosch, Craig Headland, Kathy Hogan, Lawrence R. Klemin, Mike Lefor, Gail Mooney, Naomi Muscha, Nathan Toman; Senators Dwight Cook, Jim Dotzenrod, Tim Mathern, Jessica Unruh

**Members absent:** Representatives Ben Koppelman, Alisa Mitskog, Mike Nathe, Robin Weisz; Senators Brad Bekkedahl, Randall A. Burckhard

**Others present:** John Walstad, Legal Division Director, Legislative Council
See Appendix A for additional persons present.

Chairman Dockter welcomed committee members and introduced the topics the committee will be studying over the course of the interim. He said the state previously funded county social services in the 1980s until the state experienced budget shortfalls. He said budget shortfalls resulted in counties taking on some of the funding responsibilities for social services programs. He said the committee will be reviewing a transition plan for state assumption of social services costs currently paid by the counties. He summarized the committee's responsibility to analyze economic development tax incentives as a part of an ongoing six-year review process. He said the committee will analyze tax incentives to determine the effectiveness of each incentive and the state's potential return on investment. He also reviewed the committee's study regarding the application of sales and use taxes to purchases made by contractors on behalf of an exempt entity.

Committee Counsel reviewed the *Supplementary Rules of Operation and Procedure of the North Dakota Legislative Management*.

## SOCIAL SERVICES FINANCING STUDY

### Background

Chairman Dockter called on Ms. Emily Thompson, Committee Counsel, for presentation of a memorandum entitled *Social Services Financing Study - Background Memorandum*. Ms. Thompson reviewed the history of social services funding, key pieces of previously enacted legislation, and the provisions of 2015 Senate Bill No. 2206 providing for the initial phases of transferring costs related to social services programs from the county to the state. She reviewed the committee's task of developing a plan for the remaining phases of the transition and the optional working group referenced in Senate Bill No. 2206. She said the optional working group had been formed and the County Social Services Financing Working Group held its first meeting in June.

In response to a question from Senator Unruh, regarding the identifiable amount of other sources of funding the county may use to supplement its human services budget, Ms. Thompson said these funding sources were identified in a document distributed at the first meeting of the working group. Representative Hogan said examples of other sources of funding also include donations from churches and various grants.

Senator Mathern said this study may provide the committee an opportunity to review other aspects of social services including the accessibility and efficiency of the system. He said it may be beneficial for the committee to receive information from national organizations and private entities during the course of its review.

Representative Klemin said the committee may also want to review the possibility of transitioning staff from the county level to the state level. He said a similar transition was undertaken when the county court system transitioned to a unified state court system. He said the committee should review the appropriateness of this type of transition and how it might be undertaken. He said there is a distinction to be drawn between state payment of county employee's salaries and state supervision over county employee's actions.

Chairman Dockter said the working group will be reviewing a variety of factors involved in the transition and said this committee has broad authority to review a range of topics considering the broad nature of the study directive. He said the subject matter related to this area will likely be complex, but through diligent review and analysis the committee should be able to advance proposed legislation to Legislative Management for review.

## Department of Human Services

Chairman Dockter called on Ms. Maggie D. Anderson, Executive Director, Department of Human Services, for presentation of information (Appendix B) on the organizational structure of the Department of Human Services (DHS), a historical overview of the operation of state and county social services, and an update on the progress of the County Social Services Finance Working Group. Ms. Anderson provided information on the various sections within DHS including the medical services section, the behavioral health section, the administration and support section, and the program and policy section. She said the program and policy section is responsible for drafting administrative rules, administering federal funding, and setting policies for various programs. She said the economic assistance policy group and the medical services areas are highly involved with the counties. She said many economic assistance programs are state supervised and county administered. She said the state provides the policies behind administering economic assistance programs and counties determine the eligibility of individuals applying for services in accordance with those policies. She said a large shift in administering services occurred in 2007 when the state took over the administration of child support services previously administered at the county level. She said the transition resulted in the creation of regional child support offices throughout the state. She said counties have significant responsibilities in the area of child and family services.

Ms. Anderson reviewed the duties of county social services boards and emphasized the concept of a state supervised and county administered human services system. She reviewed the program and service areas the working group is addressing including various economic assistance programs and children and family services. She reviewed home- and community-based services and the funding arrangements associated with those services. She said service payments for elderly and disabled (SPED) is currently funded 95 percent by the state and 5 percent by the county. She said expanded SPED is funded 100 percent by the state. She said, as a result of Senate Bill No. 2206, SPED will be entirely state funded beginning January 1, 2016.

In response to a question from Representative Hogan, Ms. Anderson provided an example of an individual receiving $100 worth of services to illustrate the difference between program and administrative costs. She said until January 1, 2016, if a $100 claim for services is remitted to DHS for payment, the state will pay $95 of the claim amount and then bill the county for the remaining $5 worth of services. She said after January 1, 2016, the state will pay the entire $100 in program costs. She said an example of administrative costs arising at the county level would include the costs associated with employing the staff member who would be making the eligibility determination for the individual receiving $100 worth of services in the prior example. She said the working group is looking to address these administrative costs, which are funded mainly by county property taxes, over the course of this study.

Senator Cook asked if eligibility requirements are uniform across programs. Ms. Anderson said the eligibility requirements are not uniform but there are some similarities between programs. She said eligibility requirements are all means tested but noted that income levels, asset levels, and considerations for defining family structure vary from program to program. She said different priority levels also exist within the funding structure for each program. She said DHS is in the process of building a new eligibility system that will focus on common aspects of each program prior to separating out each program's distinct eligibility requirements. She said DHS does not have the authority to impose uniform eligibility requirements as a large portion of the related policy decisions are dictated from the federal level.

In response to a question from Senator Cook, Ms. Anderson said many individuals apply for services from more than one program. She said these individuals are provided a combined application to establish eligibility for as many services as the individual may be seeking. She said the provision of multiple services can sometimes complicate the data review aspect of how DHS allocates costs.

In response to a question from Representative Headland, Ms. Anderson said she believes county employees have a vested interest in delivering services in a prudent and efficient manner. She said counties bear the responsibility for administrative costs incurred at the county level. She said as a result of 1997 House Bill No. 1041, commonly referred to as the "swap" legislation, counties are responsible for assuming the financial costs of administering certain economic assistance programs and the state is responsible for assuming complete financial responsibility for grant costs. She said a county's eligibility determinations for services do not drive services utilization costs. She said many studies have been conducted to compare administrative and grant costs since passage of the "swap" legislation. She said the topic is difficult to study as new service programs continue to be added and eligibility requirements continue to change.

In response to a question from Representative Dosch, in regard to federally mandated and state created programs, Ms. Anderson said Medicaid and the children's health insurance program are federal programs that include a state option to participate. She said once a state elects to participate, that state is bound by applicable federal rules and financing. She said the temporary assistance for needy families (TANF) and the low income home energy assistance program are both federal programs and SPED and expanded SPED are both state programs. She said all of the grant costs for the supplemental nutrition assistance program (SNAP) are federally funded but the program also entails some unfunded administrative costs. She said the only federal funding received for child care assistance is in the form of block grants. She said the state added some additional funding for child care during the 2013 legislative session.

In response to a question from Representative Hogan, Ms. Anderson said some counties are still providing county funded home- and community-based care in addition to state funded SPED and expanded SPED services. She said some counties are providing these services to individuals who do not meet the more stringent financial requirements for state funded programs. She said some counties provide these services to elderly or disabled individuals in hopes of preventing or postponing more costly institutional placements. She said the working group will be collecting data on county funded home- and community-based services.

In response to a question from Senator Cook, Ms. Anderson said TANF is a federally funded program. She said DHS is responsible for relaying federal program policies and guidelines and ensuring quality control and program integrity at the state level. She said counties are responsible for making individual eligibility determinations in accordance with those guidelines.

In response to a question from Senator Cook regarding SNAP, Ms. Debra McDermott, Chief Financial Officer, Department of Human Services, said the grant money that actually goes out to families under this program is entirely federally funded. She said the administrative costs associated with the program are only partially funded with federal dollars. She said there is a cap, subject to an inflationary factor and a growth factor, on the amount of federal dollars that may be used each year to fund administrative expenses.

In response to a question from Representative Bellew, Ms. McDermott said eligibility workers have always been county employees. She said counties submit a form to DHS each month listing the administrative costs for all programs. She said DHS then applies an allocation formula and submits those expenditures to the federal government for reimbursement. She said prior to the swap, the $50 reimbursed by federal dollars for $100 of expenditures would be passed back to the counties to fund the counties' eligibility workers and cover the administrative costs of programs. She said following the "swap" agreement, counties are responsible for funding their own administrative costs.

In response to a question from Representative Bellew, Ms. McDermott said the counties' computer systems are used to administer the energy assistance program, the child care program, and SNAP. She said what DHS hopes to accomplish in developing a unified eligibility system is to allow a county worker access to just one system. She said a unified system would make the process more efficient and allow an eligibility worker to see all programs an individual may be participating in. She said the first phase of the unified system, which deals with Medicaid, is scheduled to be completed by December 7, 2015. She said the remainder of the program should be completed by mid-2017. She said the underlying assumption that drove the "swap" legislation was that counties have very little control over the eligibility criteria related to economic assistance grant programs as much of that criteria is developed at the federal level. She said counties were in a better position to control the costs of administering those programs. She said at the time the "swap" legislation was enacted, it was believed grant costs would increase by a larger percentage than administrative costs. She said since the passage of the "swap" legislation, many studies have been undertaken to try to compare administrative costs to grant costs. She said as programs continued to be added or changed over the years, it became more difficult to determine whether additional costs were incurred by the state as a result of the "swap" legislation.

In response to a question from Representative Klemin, Ms. McDermott said the most recent review conducted for the 2005-07 biennium showed a savings of $14.3 million to counties as a result of the "swap" legislation. She said the $14.3 million represents grant costs the counties would have incurred had the state not taken over those costs. She said the administrative costs each county incurred were deducted prior to arriving at this $14.3 million amount. She said the administrative costs incurred by the counties and funded by property taxes are the focus of this study.

Ms. Anderson identified the members selected to serve on the County Social Services Finance Working Group. She said the working group discussed the study items provided in Senate Bill No. 2206 and received an update on Section 6 of the bill, pertaining to the human service grant program, at the working group's first meeting on June 18, 2015. She said the grant program provided in Senate Bill No. 2206 was developed as a result of the elimination of the emergency human services levy 1222. She said nine counties have currently applied for the grant and DHS is in the process of reviewing those applications. She said DHS developed rules relating to the grant program and a hearing was held on those rules on July 27, 2015. She said letters have been sent to county auditors and social services directors indicating the percentage budget increases contemplated in Senate Bill No. 2206. She said a request for each county's financial information has also been sent along with the request that counties submit this information to the working group by August 11, 2015. She said the next wave of data the working group intends to collect relates to each county's caseloads. She said the working group will hold its second meeting on September 2, 2015.

In response to a question from Senator Mathern, Ms. Anderson explained the relationship between DHS, the counties, and human service centers. She said human service centers are part of DHS, so DHS has a direct line of authority over these centers. She said DHS does not have a direct line of authority over county directors or county employees. She said she does not believe Senate Bill No. 2206 contemplated the migration of county staff to the state level.

Representative Mooney asked if the working group discussed whether the limitations established in Senate Bill No. 2206 may hinder a county's ability to provide county funded home- and community-based services. Ms. Anderson said this topic did not arise until after the working group's first meeting. She said she hopes the percentages that were recently sent to county auditors and social services directors will be enough to allow these types of services to remain in place.

In response to a question from Representative Hogan, Ms. Anderson said the working group will be requesting data on the number of counties providing county funded home- and community-based services at future meetings.

In response to a question from Senator Cook, Ms. Anderson said an individual would typically seek services in the county in which the individual resides. She said not all services require the individual to go to a county office. She said some services can be applied for online. She said if an individual moves from one county to another, the individual's case will typically transfer. She said eligibility requirements for that individual will only be reassessed if the move results in a change to the individual's employment status, household status, or other relevant data. She said DHS would be able to calculate the number of active cases across all programs. She said in terms of parsing out the number of dollars allocated to clients and the number of dollars allocated to administrative duties, the working group will have more concrete data once it receives the requested financial information from the counties. She said grant dollars and administrative dollars are tracked in different systems.

Ms. McDermott explained the use of a random moment in time study. She said the random moment in time study is a federally approved study and provides statistically valid data for the administrative costs related to each program. She said the study is only statistically valid on a statewide basis and is not broken down county by county. She said a breakdown of economic assistance and grant costs would be relatively easy to generate but a breakdown of foster care and child and family services costs would be a bit more difficult.

Chairman Dockter requested DHS work with the North Dakota Association of Counties to provide the committee a breakdown of some of these costs at the committee's next meeting.

In response to a question from Representative Klemin, Ms. Anderson said the transitioning of staff from the county level to the state level was not explicitly spelled out in Senate Bill No. 2206. She said she understands if the committee or the working group may like to entertain that conversation in the future. She said the working group's current focus is to collect data on counties' costs and caseloads. She said a variety of additional topics may arise as the working group begins to consider alternative funding mechanisms.

Ms. Anderson said there are currently 47 county social service boards, some of which include combined boards. She said the working group is not seeking to propose any required consolidations. She said the language in Section 1 of Senate Bill No. 2206, referencing potential multi-county sharing of staff, relates to additional county budget requests in excess of 2016 limits, that may be required to address situations in which a county is experiencing substantially increased caseloads. She said the bill requires DHS to consider the potential for county sharing of staff when considering any increased budget requests to pay for additional staff. She said when looking at future financing mechanisms, counties may find it advantageous to share or combine staff, but she still views this type of consolidation decision as a local county commission decision.

Representative Klemin said he is interested in reviewing the minutes of the working group's meetings in order to ensure there is no duplication of efforts between the working group and this committee. Representative Dockter said he plans to request an update from the working group after each meeting. He said it is important to ensure all aspects of the study are being reviewed so a comprehensive final product can be delivered.

Representative Hogan said the North Dakota County Social Service Directors Association has in the past kept a detailed list of shared services. She said it would be beneficial for the committee to review this document. In response to a question from Representative Hogan, in regard to monitoring county compliance with federal policies, Ms. Anderson said DHS staff review records related to economic assistance programs to ensure that eligibility determinations are being correctly administered.

In response to a question from Representative Lefor, Ms. McDermott said the State Auditor's office is responsible for auditing the counties as a whole. She said DHS is responsible for paying for the portion of the auditor's fee that relates to ensuring the list of expenditures provided to DHS by the counties for federal reimbursement purposes actually ties to the counties' books and records.

In response to a question from Representative Mooney, Ms. Anderson said human service centers deliver different services than the counties deliver. She said in many cases, eligibility determinations for services may be made at the county level but the actual delivery of services will be provided by a human service center.

### North Dakota Association of Counties

Chairman Dockter called on Mr. Terry Traynor, Assistant Director, North Dakota Association of Counties, for presentation of information (Appendix C) regarding the social services financing study. Mr. Traynor said the study is an important topic for counties and has been discussed over many legislative sessions. He said when the "swap" legislation was implemented it drove the counties to make strong policy decisions. He said as counties became more invested in their staffing costs they began to reach out to look for improvements in the system. He said some counties looked to consolidate, in part due to the "swap" legislation, but noted that consolidation is not always the best option for counties. He said right now, there are some consolidations that would be very unlikely to occur without a legislative mandate. He said consolidations with counties containing a large amount of reservation land are unlikely to occur because so much of the land in these counties goes untaxed. He said under the current funding mechanism, this type of consolidation would result in a property tax shift from one county to another. He said as the committee begins to formulate a state funded social services structure, a whole new dynamic may arise in relation to counties electing to consolidate or share services.

Mr. Traynor reviewed the controls in place relating to state oversight of counties. He said there are state mandated county social service boards responsible for reviewing the delivery of services. He said each board is appointed and overseen by the county commission. He said the county commission has budgetary control over county social services and determines the level of funding available from property taxes. He said in regard to county staff, he would be able to provide the committee with a list of the 800 plus county employees, their job duties, and their classifications within the state system. He said some counties may already be sharing staff across county lines through the use of joint powers agreements or other contracting arrangements.

Mr. Traynor said a main concern for counties during this restructuring is the preservation of access to services. He said if a police officer arrests a parent in a rural community, and that arrest results in the individual's child requiring placement in a safe environment, the services for this child need to be delivered immediately, regardless of whether the arrest occurs in the middle of the night or on a weekend. He said someone must be available to place the child in a safe environment and ensure the party accepting the child is properly reimbursed. He said during the course of this study, the the committee should also give consideration to social service programs that are entirely county funded. He said the committee needs to understand why counties are providing those services and how those services factor into the larger picture.

In response to a question from Chairman Dockter, Mr. Traynor said the North Dakota Association of Counties is willing to provide the committee with any information it may find helpful. He said the working group will be able to provide the committee a better picture of where funds are coming from and how funds are being expended once the working group receives additional financial information from the counties.

In response to a request from Representative Klemin, Chairman Dockter said Committee Counsel will be distributing the working group's meeting minutes to the committee members as they become available.

## ECONOMIC DEVELOPMENT TAX INCENTIVES STUDY

### Background

Chairman Dockter called on Committee Counsel for presentation of a memorandum entitled *Economic Development Tax Incentives Review - Background Memorandum*. Ms. Thompson reviewed the study undertaken by the Taxation Committee during the 2013-14 interim which lead to the development of 2015 Senate Bill No. 2057, codified as North Dakota Century Code Section 54-35-26. She said the committee has until October 1, 2015, to identify the economic development tax incentives the committee will review during the 2015-16 interim as well as a plan to review the remaining incentives over the remaining six-year period. She said the committee should take into account the directive provided in 2015 Senate Bill No. 2340, that the income tax credit for purchases of manufacturing machinery and equipment for automating manufacturing processes must be one of the economic development tax incentives selected for review during the 2015-16 interim.

In response to a question from Representative Klemin, Chairman Dockter said the committee has a six-year period to study all of the incentives listed in Section 54-35-26. He said the committee does not have to divide the number of incentives to be studied each interim in an equal manner. He said the committee must simply ensure that all listed incentives are reviewed prior to the end of the six-year period. He said, for purposes of selecting incentives for study, it may be beneficial for the committee to consider grouping incentives together in a manner that takes into account how certain incentives are related. He said structuring a review in this fashion may prove helpful in allowing for a more uniform and streamlined review of relevant data.

## Department of Commerce

Chairman Dockter called on Mr. Alan Anderson, Commissioner, Department of Commerce, for presentation of information (Appendix D) regarding an overview of economic development tax incentives, services the Department of Commerce may be able to provide the committee regarding the evaluation of tax incentives, and any preferences the department may have for first round study selection. Mr. Anderson said the economic development community has been very supportive of the effort to evaluate incentives. He said tax incentives are one of the primary tools the department and the state use to promote economic diversification and growth. He said this is primarily accomplished through the provisions of sales tax exemptions, income tax credits, and income tax exemptions. He said incentives are also provided at the local level through local ability to reduce or exempt property tax. He said the largest impact on state revenues arises from sales tax exemptions. He said sales tax exemptions are used to promote private sector investment in target industries like manufacturing, information technology, agricultural processing, and the energy industry. He said the department's role in relation to sales tax exemptions it to certify businesses that qualify as primary sector businesses.

Mr. Anderson said income tax credits are also used by the legislature to encourage certain activities and promote economic development. He said the Department of Commerce's role in relation to income tax credits is to certify businesses or funds that may be eligible within a given program. He said incentives relating to renaissance zones are some of the most complex incentives because they encompass both income tax exemptions and credits and property tax exemptions.

Mr. Anderson reviewed the provisions of Section 54-35-26, which requires the Department of Commerce, the Tax Commissioner, and the North Dakota Economic Development Foundation to provide information and analysis to the committee upon request. He said the expanded ability to receive confidential information provided in 2015 House Bill No. 1060 will allow the department to better evaluate incentives. He said the department is currently reviewing tools that may aid the department in evaluating the economic impact of incentives. He said the department was previously utilizing Regional Economic Models, Inc. (REMI) in conducting economic evaluations, but rising costs of that service has led the department to seek other alternatives. He said the department is willing to assist the committee in any way it can and has an interest in providing the most efficient and effective package of incentives to attract businesses to this state. He said one potential point of concern is that the legislature did not provide the department any additional resources to utilize in providing information and analysis to the committee.

He said the Department of Commerce's preferences for incentives to be selected for study during the 2015-16 interim include those incentives nearing expiration, the automation tax credit, and investment income tax credits intended to diversify the economy. He said if the committee wishes to review additional incentives, the department would suggest consideration of the microbusiness income tax credit, the research expense credit, and the wage and salary credit. He said the department has provided a chart listing all of the tax incentives for businesses, in addition to those incentives specified in Section 54-35-26.

Senator Cook said language was added to Senate Bill No. 2057 by the 2013-14 interim Taxation Committee because the committee realized the incentives provided within the bill did not represent a comprehensive listing of incentives. He said during the last interim, the Taxation Committee received testimony from Mr. Jeff Chapman from The Pew Charitable Trusts illustrating the differences between when an incentive is just creating a reduction in taxes and when an incentive is generating additional economic development. He said it would be beneficial for the committee members to review some of the materials provided by The Pew Charitable Trusts during the 2013-14 interim.

Senator Cook said he is also somewhat concerned with the "me too" attitude that tends to arise when the legislature adds incentives. He said there also seems to be an ongoing policy debate regarding whether income tax credits should be allowed to be sold or transferred. He said it would be good for the committee to review a background memorandum regarding the sale and transfer of income credits to see what other states are doing. He said wind credits may be a good area to review in terms of a background memorandum. He said the committee may also want to review the percentage amount of the credits offered by various states. He said the angel fund tax credit may be a good credit to review when comparing the percentage of the credit granted by various states.

Chairman Dockter said Committee Counsel will gather information on this topic for the committee's review.

In response to a question from Senator Mathern, Mr. Anderson said the Department of Commerce has gathered a large amount of information when reviewing incentives in the past. He said the department has one staff member dedicated to this task on a full-time basis and another staff member that has several responsibilities in terms of reviewing incentives. He said the the department is conducting a broad look-back analysis of incentives.

In response to a question from Representative Mooney, Mr. Anderson said the Department of Commerce is not always able to get a full picture of the reasons why a company locates its business in this state. He said this is partially due to confidentiality provisions that bind the Tax Department from releasing information and partially due to companies' unwillingness to release information that might be advantageous to their competitors.

Senator Cook said the committee may need to address existing confidentiality provisions when undertaking a broad review of incentives.

In response to a question from Mr. Walstad, Mr. Anderson said the "NR" notation on his handout indicates specified information is not reportable. Mr. Anderson said it essentially means there are less than five entities or individuals claiming the incentive so certain information cannot be released due to the increased likelihood the public might be able to deduce who the recipients are as a result of the limited number of claimants. He said the fact an incentive may not be utilized by a large number of claimants does not necessarily mean the incentive is not important.

## Tax Department

Chairman Dockter called on Mr. Joe Morrissette, Deputy Tax Commissioner, Tax Department, for testimony on economic development tax incentives including a summary of relevant fiscal data and Tax Department preferences for incentives to be selected for study during the 2015-16 interim. Mr. Morrissette said Mr. Joseph Becker and Mr. Blane Braunberger from the Tax Department will be presenting on income tax incentives and sales tax incentives. Mr. Morrissettee said the Tax Department concurs with the incentives highlighted by the Department of Commerce for first round study selection. He said the Tax Department would provide information as requested to assist the committee in its study of tax incentives.

In response to a question from Senator Mathern, Mr. Morrissette said many of the figures in the materials presented by the Department of Commerce were derived from information provided by the Tax Department. He said the amounts claimed for certain incentives may differ from year to year due to varying levels of usage.

Chairman Dockter called on Mr. Blane Braunberger, Supervisor of Sales and Special Taxes Compliance, Tax Department, for presentation of information (Appendix E) on sales tax incentives. Mr. Braunberger said the sales and special tax division within the Tax Department reviews and approves sales tax exemptions and incentives. He said the information provided in his handout includes the number of applicants for various incentives and the associated dollar amounts that apply to the tangible personal property covered by these incentives. He said an individual may apply for a sales tax exemption prior to making a purchase or may apply for a refund of tax paid after the purchase is made. He said the amounts listed on the handout are only representative of sales tax exemptions applied for prior to purchase. He said it is more difficult for the Tax Department to track the dollar amounts related to refunds requested after a purchase is made. He said the figures on the handout represent the minimum dollar amount the Tax Department is aware of for the last two fiscal years.

In response to a question from Representative Hogan, Mr. Braunberger said the Tax Department does not typically undertake a comparison of the amount of the incentive applied for and the amount of the incentive ultimately utilized. He said individuals and entities that apply for incentives prior to making a purchase typically have a good understanding of the amount of tangible personal property that will be used to complete the project.

In response to a question from Senator Cook, Mr. Braunberger said if the committee were to suggest the elimination of one of the incentives listed on his handout, the corresponding dollar amount listed on the chart would represent the minimum fiscal impact that may occur as a result of eliminating the incentive. Senator Cook said the committee will need to get a clear picture of the fiscal effect of each incentive when conducting its review.

In response to a question from Senator Dotzenrod, Mr. Braunberger said the Tax Department does not conduct an analysis of whether a specific incentive is enticing additional economic development. Mr. Braunberger said he is not aware of any specific methods other states are using to undertake this type of analysis.

In response to a question from Representative Klemin, Mr. Braunberger said the Tax Department may be able to provide data from prior years, where an incentive may have been more widely used, for those incentives that may have too few claimants to be reportable in recent years.

Chairman Dockter said one of the hurdles the committee is anticipating is the availability of data for analysis.

Senator Cook said that some states require a business to sign a waiver allowing for certain disclosures of information prior to a business receiving an incentive. He said this is a practice the committee may wish to review during the course of this study. Chairman Dockter said the committee will work with the Tax Department and Committee Counsel in reviewing the confidentiality aspects of this study.

Mr. Morrissette said legislation passed last session allows the Tax Department to share information that was not previously disclosable with the Department of Commerce for analysis. He said the penalty for improper disclosure of confidential information is up to five years in prison, up to a $10,000 fine, or both.

In response to a question from Representative Hogan, Mr. Braunberger said the Tax Department has a process for reviewing applications for incentives and the Tax Department occasionally issues denials if an applicant does not meet the necessary requirements.

Chairman Dockter called on Mr. Joseph Becker, Auditor III, Tax Department, for presentation of information (Appendix F) relating to income tax incentives. Mr. Becker said his handout contains fiscal data related to income tax incentives available to various entities and individuals. He said the handout contains data collected from tax returns and contains data relating to each incentive's creation date and expiration date. He said information is also provided on the number of returns on which each incentive was claimed and the aggregate dollar amounts associated with those claims. He said any information that is not reportable has been indicated on the handout. He said incentives that represent a deduction from income have been highlighted in yellow and any incentives representing a dollar-for-dollar offset against tax liability appear in white. He said the dollar amounts noted on the handout are not necessarily reflective of the amounts that would appear on a fiscal note due to the carryover features provided by some of the incentives. He said the handout also provides information on specific qualifiers, limitations, and carryforward features related to each incentive.

In response to a question from Chairman Dockter, Mr. Becker said the fact that income tax rates have dropped considerably over the last few years may certainly factor into the amount of credits carried forward each year.

Representative Klemin said it would be beneficial for the committee to review a compilation of all statutes containing confidentiality provisions relating to this study to determine if any changes need to be made.

Chairman Dockter said Committee Council will provide this information at the next meeting for the committee's review.

## PAYMENT OF SALES OR USE TAX BY CONTRACTORS STUDY

### Background

Chairman Dockter called on Committee Counsel for presentation of a memorandum entitled *Application of Sales and Use Tax to Purchases Made by a Contractor on Behalf of an Exempt Entity - Background Memorandum*. Ms. Thompson reviewed the application of sales and use tax and highlighted certain items and entities exempt from tax. She explained contractors' liability for paying use tax on items purchased by a tax exempt entity, without the payment of tax, and later installed by a contractor in the performance of a contract with that exempt entity.

### Tax Department

Chairman Dockter called on Mr. Braunberger for presentation of background information (Appendix G) and various examples pertaining to how sales and use tax applies to contractors contracting with exempt entities. Mr. Braunberger said sales and use tax is paid by the final user or consumer of taxable goods and services. He said tax applies at the location the purchaser takes possession of the property. He said retailers do not pay tax on goods purchased for resale, but the sales tax law requires retailers to collect the tax from the purchaser who will be the final user of the goods. He said contractors are generally not classified as retailers. He said contractors are deemed the final users of materials purchased for use in a construction contract and, as a result, must remit tax on those items. He said contractors are also liable for use tax on property that is owned by another individual or entity, including an individual or entity exempt from sales and use tax, when a contractor uses that property in the performance of a contract. He said a contractor is only liable for the payment of sales or use tax on items for which sales or use tax has not already been remitted. He said Section 57-40.2-03.3 was approved during the 1983 legislative session to prevent exempt entities from avoiding sales tax on construction materials when an entity purchases construction materials itself and then contracts with a separate party for the installation of those materials. He said various exceptions are specified in this section that allows contractors to install materials on which tax has not previously been paid without requiring the contractor to remit use tax. He provided several examples illustrating the operation of this section.

In response to a question from Representative Headland, Mr. Braunberger said if a government entity entered into a construction contract with a contractor, the contractor would be deemed the final user of materials consumed in performance of the contract and would be liable for use tax on those items even though the government entity would have been able to purchase those same items without paying sales or use tax. He said the contractor will likely pass the cost of the tax on to the government entity as an additional contract cost. He said this cost will not be specifically itemized as a sales tax charge on the contract because a contractor is not a retailer.

Representative Klemin said this seems to be a way of getting around providing the exemption to the exempt entity. He said application of sales and use tax appears to be a complicated process and not well understood by even some of the businesses administering the tax.

In response to a question from Representative Klemin, Mr. Braunberger said the Tax Department may become aware of situations in which tax is not being properly applied through tips received from the public and through audits performed by the Tax Department.

Representative Klemin asked how the Tax Department verifies whether tax has already been paid on materials owned by an entity but installed by a contractor. Mr. Braunberger replied that if an exempt entity was the purchaser of the materials, the Tax Department would ask the contractor to secure evidence that the tax had been paid because there is a strong likelihood that the materials were purchased without payment of sales or use tax. He said, on the other hand, if the materials were purchased by a taxable entity, the Tax Department could make the assumption that the tax had been properly remitted.

Senator Cook said various solutions to this issue have been proposed to the Legislative Assembly, but none have been successful. He said the simplest solution would be to eliminate the exemptions and just make everything taxable. He said sooner or later the legislature will have to agree on a solution to the problem or simply put the issue to rest.

In response to a question from Senator Cook, Mr. Braunberger said the Tax Department has not formulated a solution to the problem, but noted the dollar amount listed on the fiscal note each time legislation is considered seems to have an impact on the passage of this type of legislation.

In response to a question from Representative Hogan, Mr. Braunberger said there are a variety of ways other states address this issue. He said some states treat it in a similar manner to North Dakota and some states allow for the exempt entity to pass the exemption on to the contractors installing materials on behalf of the entity.

Mr. Walstad provided an example of a contractor delivering gravel to a government entity to illustrate the fact that if the contractors do not pass the use tax along as part of the contract price, the contractor ends up paying for a use tax expense they may not have been anticipating.

Senator Dotzenrod said the state is expending a large amount of dollars on highway and road projects so he can see where allowing government entities to pass the sales and use tax exemption through to the contractors installing these road materials would result in a large fiscal note.

Mr. Walstad said the committee may want to examine the net fiscal effect of transactions with contractors and the state. He said if the state is essentially paying the 5 percent sales tax by way of an increased contract price, then passing the sales tax exemption through to the contractor purchasing the materials on behalf of the state should logically result in a comparable 5 percent savings on the final contract price. He said the state collects a 5 percent tax from the contractor who then adds that amount into the contract price, which may mean the amount changes hands twice to end up back with the contractor.

Senator Cook asked if repealing the section of law passed in 1983 would resolve the problem. Mr. Braunberger said the Tax Department would need to review the issue further to determine the effect of repealing that section.

Representative Klemin said a possible solution would be to treat contractors as retailers. He said if contractors were treated in the same manner as retailers, then contractors would either collect the tax from the contracting party at the time the materials were purchased, or would refrain from collecting the tax if the materials were purchased on behalf of an exempt entity.

Chairman Dockter said one of the main considerations that appears to impact this type of legislation is the potential fiscal effect and how that fiscal effect is determined.

Senator Mathern said for the next meeting it would be helpful to review a bill draft that essentially repeals the 1983 law and have the Tax Department provide the estimated fiscal impact that may be created as a result.

Chairman Dockter said Committee Counsel would prepare the bill draft and work the Tax Department to determine the potential fiscal effect.

In response to a suggestion from Representative Klemin, Chairman Dockter said governmental entities would also be factored into the language of the bill draft and the resulting fiscal effect.

## COMMITTEE DISCUSSION AND DIRECTIVES

Chairman Dockter said the committee would likely be meeting again in September, but said it would be beneficial for the committee to make some preliminary incentive study selections so Committee Counsel could begin assembling more detailed background information related to those incentives. He suggested the committee consider approving for first round study selection any incentives that will be expiring as well as the automation credit. He said the committee could review the remaining incentives and make additional first round study selections at the committee's next meeting.

**It was moved by Senator Cook, seconded by Representative Lefor, and carried on a voice vote that the committee select the incentives recommended in Mr. Anderson's testimony for first round study selection and select additional incentives for review at the next meeting of the committee.**

In response to question from Senator Dotzenrod, Chairman Dockter said Committee Counsel will contact representatives from The Pew Charitable Trusts and extend an invitation for them to appear at a future committee meeting. Chairman Dockter said Committee Counsel will also provide the committee a copy of the materials provided by The Pew Charitable Trusts during the prior interim.

In response to a question from Senator Cook, Chairman Dockter said Committee Counsel will provide information on the REMI economic analysis tool referenced in Mr. Anderson's testimony as well as other economic analysis tools that assist in the analysis of tax incentives.

In response to a question from Senator Cook, Chairman Dockter said Committee Counsel will compile information received from the Department of Commerce and information received from the Tax Department into one master list of incentives for the committee's further review.

Representative Headland said it was brought to his attention that an income tax reciprocity agreement between this state and the state of Montana is up for renewal. He said he is not aware of any fiscal analysis ever being conducted to estimate the revenue impact of this agreement. He recommended the committee forward a request to the Chairman of the Legislative Management to allow this committee to study the issue during this interim.

**It was moved by Representative Headland, seconded by Senator Cook, and carried on a roll call vote that the Legislative Council staff forward a letter to the Chairman of the Legislative Management requesting the addition to the committee's assignments of a study of the income tax reciprocity agreement between the states of North Dakota and Montana.** Representatives Dockter, Bellew, Dosch, Headland, Hogan, Klemin, Lefor, Mooney, Muscha, and Toman and Senators Cook, Dotzenrod, Mathern, and Unruh voted "aye." No negative votes were cast.

In response to a question from Senator Mathern, Chairman Dockter said Committee Counsel will extend an invitation to the North Dakota Conference of Social Welfare and the North Dakota Economic Security and Prosperity Alliance to attend future committee meetings and potentially receive testimony from these two groups in regard to the committee's study of social services financing.

No further business appearing, Chairman Dockter adjourned the meeting at 2:15 p.m.

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ATTACH:7