NORTH DAKOTA LEGISLATIVE MANAGEMENT

Minutes of the

POLITICAL SUBDIVISION TAXATION COMMITTEE

Tuesday, April 26, 2016
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, Craig Headland, Kathy Hogan, Lawrence R. Klemin, Ben Koppelman, William E. Kretschmar, Mike Lefor, Gail Mooney, Mike Nathe, Nathan Toman, Robin Weisz; Senators Brad Bekkedahl, Randall A. Burckhard, Dwight Cook, Jim Dotzenrod, Tim Mathern, Jessica Unruh

Members absent: Representatives Larry Bellew, Mark A. Dosch, Alisa Mitskog, Naomi Muscha

Others present: Representative Wesley R. Belter, Fargo, member of the Legislative Management
Representative Al Carlson, Fargo, member of the Legislative Management
Representative Jim Schmidt, Huff, member of the Legislative Management
Senator Rich Wardner, Dickinson, member of the Legislative Management
See Appendix A for additional persons present.

It was moved by Senator Mathern, seconded by Senator Burckhard, and carried on a voice vote that the minutes of the March 1-2, 2016, meeting be approved as distributed.

CONTRACTOR SALES AND USE TAX STUDY

Chairman Dockter called on Mr. Myles Vosberg, Director, Tax Administration Division, Tax Department, for a presentation (Appendix B) of the anticipated fiscal impact on local sales tax revenue of a bill draft to eliminate the payment of sales and use taxes on items purchased by or for an exempt entity and installed by a contractor. Mr. Vosberg said the information he is providing is similar to information provided on a previous occasion, except this information also includes data pertaining to the impact on local sales and use taxes. He reviewed the assumptions the Tax Department applied to arrive at the estimates contained in his handout and explained the difficulties in estimating local sales and use tax when dealing with construction contracts. He said the total estimated loss in local sales and use tax revenue would be $2.9 million.

In response to a question from Senator Bekkedahl, Mr. Vosberg said sales and use tax is levied at the local level in 137 cities and 7 counties. Mr. Vosberg said it is possible for multiple taxes to apply in areas in which a city or county sales tax is levied in addition to the state sales tax.

In response to a question from Senator Mathern, Mr. Vosberg said an example of a federal contract would be a contract with an Air Force base.

Committee Discussion and Directives

Chairman Dockter asked the committee what its wishes were in regard to the study.

Representative Weisz said the true cost of eliminating the application of sales and use tax on items purchased or installed by a contractor on behalf of an exempt entity would only be $5.78 million using the estimates provided by the Tax Department. He said $5.78 million would be the amount remaining after sales tax paid using state agency appropriations or property tax revenue is deducted from the total estimated loss in sales tax revenue. He said sales and use tax applied to items purchased or installed by contractors on behalf of an exempt entity should be eliminated as the same items could be purchased or installed without payment of sales or use tax if purchased or installed by the exempt entity.

Chairman Dockter said it appears the committee members have received enough information on this topic to make an informed decision on the bill drafts before the committee or to bring forth their own bill drafts during the legislative session.

In response to a question from Representative Weisz, Representative Klemin said the state would not be able to charge the federal government sales or use tax.

Representative Koppelman said he does not know that it is safe to assume all contractors would lower their bids by 5 percent if sales and use tax were eliminated on items purchased or installed by contractors on behalf of exempt entities. He said contractors often apply a markup to everything related to a contract so an exempt entity might not see a reduction equivalent to the 5 percent sales or use tax savings realized by the contractor.

Representative Weisz agreed with Representative Koppelman and said he could not guarantee that the entire savings resulting from the elimination of sales and use tax would be passed on in the contract but, on the other hand, he could confidently state that if contractors were told sales and use tax rates were increasing by 5 percent exempt entities would certainly see bid amounts in contracts rise by 5 percent. Representative Weisz said, following that logic, it is fair to assume that if the price on all the materials tied to a contract decrease by 5 percent the amount quoted in the contract for materials would also decrease by 5 percent.

Senator Bekkedahl said he understood the benefit that would be realized by exempt entities if sales and use tax was no longer applied to items purchased or installed by a contractor on behalf of the exempt entity. He said the committee should also keep in mind that not all sales and use tax charges are paid by municipalities using property tax revenue. He said some municipalities use other revenue sources and as a result, the elimination of sales and use tax might not lead to a reduction in taxpayer's property tax bill in all cases. He said eliminating a portion of a municipality's sales and use tax revenue base could also lead to a reduction in the amount of revenue a municipality would have to dedicate towards other community uses.

Chairman Dockter said the committee will not be scheduling any additional testimony on this topic, but will set aside time at the next committee meeting to take final action on the bill drafts the committee has previously reviewed.

ECONOMIC DEVELOPMENT TAX INCENTIVE STUDY

Chairman Dockter called on the Legislative Council staff for a presentation of an updated copy of the *Economic Development Tax Incentive Study - Evaluation Chart*, the *Economic Development Tax Incentive Study - Angel Fund Investment Tax Credit* memorandum, the *Economic Development Tax Incentive Study - Agricultural Commodity Processing Facility Investment Tax Credit* memorandum, the *Economic Development Tax Incentive Study - Seed Capital Investment Tax Credit* memorandum, and the *Economic Development Tax Incentive Study - Electrical Generating Facilities Sales Tax Exemption* memorandum. The Legislative Council staff said the evaluation chart and updated background memorandums have been provided to assist the committee in tracking its progress in evaluating the economic development tax incentives selected for review this interim. She said additional checkmarks have been placed on the evaluation chart based on information received by the committee at the previous meeting. She said checkmarks have been placed on the chart to indicate the incentives on which the committee has received adequate information to undertake an analysis of each of the eight items the committee is considering in its review. She said the checkmarks do not indicate a yes or no response to the eight considerations listed on the chart, with the exception of consideration number 8. She said for item number 8, a checkmark has been placed under each incentive for which the committee had limited data to review due to few or no claimants or for which the committee has identified other barriers to data collection. She said she welcomed the committee's input on the modification or addition of any checkmarks placed on the chart as a determination of whether the committee has received enough information to address each of the eight considerations is quite subjective. She said additional information detailing the data and testimony the committee has received in regard to each of the 18 selected incentives can be found in the last section of each incentive's corresponding background memorandum. She said the background memorandums pertaining to the angel fund investment tax credit, agricultural commodity processing facility investment tax credit, seed capital investment tax credit, and electrical generating facilities sales tax exemption have all been updated to include links to information the committee has received throughout the interim.

Chairman Dockter requested the Legislative Council staff provide a brief summary of the committee's progress in its study of economic development incentives. The Legislative Council staff said, to date, the committee has sought testimony from interested parties for the angel fund investment tax credit, the biodiesel fuel credits, the certified nonprofit development corporation investment credit, the electrical generating facilities sales tax exemption, the microbusiness income tax credit, the seed capital investment tax credit, the soybean or canola crushing facility credit, and the wage and salary credit. She said testimony was not received on several of these incentives as some incentives have seen little to no use over the past several years. She said the committee has yet to solicit testimony from interested parties for the agricultural commodity processing facility investment tax credit; the geothermal, solar, wind, and biomass energy device credit; the internship program credit; the manufacturing automation tax credit; the new jobs credit from income tax withholding; the new or expanding business income tax exemption; renaissance zone income tax credits and exemptions; the research expense tax credit; the telecommunications infrastructure sales tax exemption; and the workforce recruitment credit. She said the testimony provided by interested parties in regard to each of these remaining incentives will be a key component in the committee's analysis of several of the considerations listed on the chart.

The Legislative Council staff said the committee has also received data and testimony from the Tax Department and the Department of Commerce regarding the number of claimants and amount claimed for each incentive, which has been summarized and linked in each of the corresponding background memorandums. She said the Department of Commerce has also provided a return on investment analysis for the agricultural commodity processing facility investment tax credit and the seed capital investment tax credit. She said this analysis will assist the committee in addressing consideration number 7, which pertains to whether the incentive is the most effective use of state resources to achieve desired goals.

Chairman Dockter said the committee will be receiving testimony from interested parties in regard to the remaining 10 incentives at its next meeting.

Department of Commerce

Chairman Dockter called on Mr. Justin Dever, Co-Deputy Commissioner, Department of Commerce, for an update (Appendix C) on the department's progress in compiling an estimated return on investment analysis for the incentives selected for review by the committee. Mr. Dever provided a summary of the information the department has already provided to the committee and the information the department anticipates providing to the committee in the future. He also requested direction from the committee in regard to the analysis the committee is seeking for the geothermal, solar, wind, and biomass energy device credit as this credit has expired for new projects. He said information pertaining to the large wind projects associated with this credit could not be disclosed due to the small number of claimants.

Senator Mathern asked if the department had any specific recommendations pertaining to any of the incentives being reviewed and especially those incentives used by a small number of claimants. In response, Mr. Dever said he was not sure it was the department's role to provide any specific recommendations. He said recommendations have been provided by the EmPower ND Commission, of which the Director of the Department of Commerce is a member, in regard to eliminating the sunset clause associated with the wind energy sales tax exemption. He said all electric generating facilities other than wind-powered facilities are allowed a permanent sales tax exemption.

In response to a question from Senator Mathern in regard to whether the department was limited in its assessment of the value of credits or just in its ability to comment on that assessment, Mr. Dever said the department is able to analyze credits having few claimants but is not able to comment on its assessment due to the confidentiality restrictions tied to credits having a small number of claimants.

In response to a question from Senator Cook, Chairman Dockter said the committee will continue to gather information on the remaining incentives selected for review in order to complete its assessment of the effectiveness of tax incentives and to prepare any necessary bill drafts for the elimination or modification of incentives based on that review. Chairman Dockter said the committee will conduct as thorough of an analysis as time allows in evaluating all 18 incentives.

Senator Mathern asked if one approach the committee could take would be to keep all current incentives in place and rank each according to its value. He said the Legislative Assembly could then fund incentives in order of importance based on amount of funds available in any given biennium. He said some incentives might have value regardless of the economic climate, whereas others might not. In response, Mr. Dever said a current practice most closely resembling this type of approach is the placement of caps on the amount that may be awarded for certain incentives. Mr. Dever said caps have been placed on the seed capital investment tax credit and caps are also applied to the angel fund credit program in Minnesota, which the committee will be reviewing later today.

Senator Cook said individual bill drafts should be prepared to repeal the certified nonprofit corporation credit, the microbusiness credit, the wage and salary credit, and the soybean and canola crushing facility credit as these credits have seen little to no use.

Chairman Dockter requested the Legislative Council staff prepare separate bill drafts to repeal each of the four incentives referenced by Senator Cook.

In response to a question from Representative Headland, Mr. Paul Lucy, Director, Economic Development and Finance Division, Department of Commerce, said the soybean and canola crushing facility credit is currently being used by one project and he anticipates additional projects will be looking to use the credit in the future.

In response to a question from Senator Cook, Mr. Lucy said whether a project could qualify for the agricultural commodity processing facility investment tax credit, in addition to the soybean and canola crushing facility credit, would depend on the business's structure and how the business wishes to use the investments it is receiving.

Senator Cook said the committee should receive information regarding the degree to which the agricultural commodity processing facility investment tax credit can be used in place of the soybean and canola crushing facility credit.

Chairman Dockter requested Mr. Lucy provide this information to the committee at the committee's next meeting.

Chairman Dockter called on Mr. Lucy for comments (Appendix D) on bill draft [17.0077.01000] pertaining to a standard definition of primary sector business. Mr. Lucy said his handout provides proposed amendments to the bill draft. He said the first amendment the department recommends is incorporating into the standard definition the requirement that a primary sector business must be certified by the Department of Commerce. He said if this language is added, any references to certification within the various individual definitions should be removed. He said this would remedy any current inconsistencies between those primary sector businesses that are required to be certified by the department and those that are not. He also suggested removing any language that appeared to be redundant with language placed in the standard definition and removing the definition of new wealth in Section 9 of the bill draft. He said evaluating whether a primary sector business creates new wealth is not a one size fits all determination. He said this determination is better left as an administrative determination rather than explicitly defined in the North Dakota Century Code. He said the constant evolution of how industries operate and how markets are developed and created requires a case-by-case determination of whether a business is creating new wealth.

In response to a question from Representative Nathe, Mr. Lucy said the primary sector companies referenced within the language of the angel fund investment tax credit are not further defined in that section. Mr. Lucy said if a standard definition of primary sector business was placed in Title 1, the department would use the standard definition to evaluate primary sector businesses for purposes of the angel fund investment tax credit.

In repose to a question from Representative Klemin, Mr. Lucy said the definition of new wealth only appears in one section of Century Code.

Representative Koppelman said it might be beneficial to incorporate the definition of new wealth into the definition of a primary sector business rather than allow the department to make an administrative determination of activities that result in the creation of new wealth.

Mr. Lucy said the definition of new wealth can be a moving target and a definition that might fit well for one company might not fit well for another company. He said trying to define the creation of new wealth uniformly for all companies would be extremely difficult. He said there is an evolution of businesses, markets, and customer bases and how funds transfer between businesses and customer bases into different markets that makes it complicated to craft a definition that would apply in all cases.

Representative Koppelman said credits are generally targeted towards a particular purpose so it may be necessary to define terms related to the credit to fit within a specifically tailored box. He said the box may then be narrowed or expanded during a legislative session to exclude problematic items or accommodate additional items. He said as policymakers, he is not sure it would be wise for legislators to allow for elastic boxes that can be administratively stretched to fit certain situations based on the opinion of individuals within a department.

Mr. Lucy said he could understand this concern but noted there is a 2-year period between legislative sessions and a company might not want to wait that long for the opportunity to expand a currently defined box to fit that company's situation. He said a team of people are tasked with reviewing applications at the department and if a gray area arises the department contacts additional sources to verify information and receive additional input.

In response to a question from Senator Cook, Mr. Lucy said an example of a business that does not technically create new wealth, but might still be worthy of a tax credit, would be an in-state company manufacturing a component of a larger final product manufactured by a separate company that ultimately sells the product to consumers outside of this state. Mr. Lucy said an objective analysis of this scenario shows the first company is not generating any revenue from out-of-state sales as all of its sales are to the in-state manufacturer. He said this is a scenario the department would apply a subjective analysis to and would certify the first company as a primary sector business. He said even thought the first company is not making out-of-state sales, it is serving as a link in the value stream connected to the second company, which is creating new wealth as a result of that company's sales to out-of-state consumers.

Representative Hogan said Mr. Lucy provided a good example and it is possible that the definition of new wealth might need to be adjusted, but said also agreed with Representative Koppelman that legislators need to craft laws to fit within defined boxes. Representative Hogan said this necessity is highlighted by the committee's current struggle to evaluate each of the incentives it is tasked with reviewing. She said if legislators do not have definitions to reference as a starting point in their evaluation, she does not know how legislators can realistically be expected to measure outcomes related to the operation of incentives.

Chairman Dockter agreed and said Representative Hogan makes a very good point in her analysis.

Senator Dotzenrod also agreed and said it would be beneficial to provide a definition of new wealth.

Representative Klemin said the definition of new wealth could be built into the definition of primary sector business to prevent an administratively determined definition of new wealth from changing day-to-day based on decisions made by the department.

Mr. Lucy said the only place new wealth is currently defined is in the seed capital investment tax credit. He said the department would be willing to work with the committee to craft a proposed definition of new wealth.

Representative Koppelman and Senator Mathern said they supported incorporating the amendments provided by the department and the addition of a definition for new wealth.

Chairman Dockter requested the Legislative Council staff prepare a revised version of the bill draft to include the requested edits.

Tax Department

Chairman Dockter called on Mr. Ryan Rauschenberger, Tax Commissioner, Tax Department, for a brief introduction regarding the Tax Department's work on comparing the Minnesota angel fund credit program to the North Dakota angel fund credit program, and then called on Mr. Joseph Becker, Auditor III, Research and Education Section, Tax Department, for presentation (Appendix E) of a detailed comparison of the credit program available in each state. Mr. Becker explained the differences between the programs in each state and said the angel fund program offered in Minnesota is significantly broader than the program offered in North Dakota.

In response to a question from Senator Mathern, Mr. Becker said it is possible a taxpayer could receive a credit for investing in an angel fund even if the taxpayer's dollars never actually leave the angel fund for further investment in a business.

In response to a question from Representative Headland, Mr. Becker said the angel fund tax credit in Minnesota is equal to 25 percent of a taxpayer's investment and the credit in this state is equal to 45 percent of a taxpayer's investment. Mr. Becker said the credit percentage offered in this state is higher than the credit percentage offered in most other states.

In response to a question from Representative Nathe, Mr. Becker said the Tax Department is not aware of how much of a taxpayer's investment remains in the fund and how much is further invested in a business. Mr. Becker said the department receives information regarding the names of the businesses in which each angel fund invests, but does not receive information as to the amount invested in each business or the amount that might be retained in each angel fund.

Representative Headland said once an angel fund is certified it seems as if the state is essentially blind to how an angel fund is investing money placed in the fund and whether the angel fund is following the intent of the law.

Chairman Dockter said the only people who would have the information the committee is looking for are the angel fund managers.

In response to a question from Senator Cook, Mr. Becker said a yearly fee of $50 is charged to certify investors and a yearly fee of $1,000 is charged to certify funds under Minnesota's angel fund program.

In response to a question from Senator Bekkedahl, Mr. Becker said recertification in Minnesota occurs on a yearly basis, rather than the 3-year period that applies in this state.

In response to a question from Chairman Dockter, Mr. Becker said an angel fund would need to be registered in this state to receive certification under North Dakota's angel fund program.

In response to a question from Representative Nathe, Mr. Lucy said the list of businesses an angel fund has invested in, which is provided to the Tax Department, would not specify whether any of those businesses are engaged in real estate deals.

In response to a question from Representative Klemin, Mr. Becker said the $5 million cap on credits pertains to each individual angel fund so the cumulative amount of credits that may be earned by all investors in a single angel fund is limited to $5 million.

In response to a question from Representative Docker, Mr. Becker said an angel fund can continue to receive investments after the cap is reached, but those investments will not qualify for a tax credit for purposes of the program.

In response to a question from Representative Nathe, Mr. Becker said there is nothing in statute to prohibit the members of an angel fund from forming a new angel fund once the first fund reaches the $5 million cap.

In response to a question from Senator Bekkedahl, Mr. Becker said a taxpayer is subject to a lifetime limit of $500,000 in credits regardless of the number of angel funds a taxpayer chooses to invest in.

In response to a question from Representative Klemin, Mr. Becker said an angel fund investor under the Minnesota program is limited to individuals, whereas any taxpayer is entitled to invest under the angel fund program in this state. Mr. Becker said he was not aware of any angel funds having owners other than individuals but there is nothing in statute that would prohibit that type of arrangement.

In response to a question from Representative Lefor, Mr. Becker said the program in Minnesota is capped at $15 million in credits per year. Mr. Becker said credits in Minnesota are awarded on a first-come, first-serve basis and an individual investor is limited to claiming no more than $125,000 in credits per year.

Representative Headland said it is interesting to hear how Minnesota's credit is working considering Minnesota restricts the credit to in-state investments and the percentage of the credit that is offered is one-half of what is offered in this state. He said the email the committee recently received from an angel fund representative seems to indicate the credit would not be effective if angel funds were restricted to making only in-state investments. He said it is important for the committee to review information regarding Minnesota's credit to see how a credit with similar restrictions is working in that state.

In response to a question from Chairman Dockter, Mr. Becker said he is not aware of whether an investor has ever held an investment in an angel fund for fewer than the 3 years required under statute.

In response to a question from Senator Cook, Mr. Becker said if the department was aware an investor had withdrawn an investment prior to the end of the 3-year period required under statute, the department could require the taxpayer to file an amended return to have the credit amount paid back to the state.

Representative Klemin said, in the case of Minnesota's program requiring a recipient business to pay back the credit, a business may not have any funds to pay a credit back with if the business is not doing well to begin with.

In response to a question from Representative Koppelman, Mr. Becker said a qualified business cannot be involved in an unqualified activity, like investing in real estate. Mr. Becker said, in regard to whether an investor can receive a credit if the money the investor placed in the fund is never actually invested in a business, there is no requirement that the fund actually place an investor's money in a qualified business as a condition to the investor receiving the credit.

Representative Klemin said whether a business is allowed to use angel fund dollars to invest in the real property a business is situated on may be a gray area in the statute.

Mr. Becker said the cost to administer the program in Minnesota was $370,000 in 2015, but the program brought in $420,000 in fees to cover those costs. He said three full-time employees are employed to administer the program in Minnesota and additional staff are hired in December of each year to handle year-end reports.

In response to a question from Representative Klemin, Mr. Becker said the names of qualified businesses, investors, and funds associated with Minnesota's program are all publicly disclosed on a website. Mr. Becker said this information is disclosed for purposes of transparency and to allow interested parties a convenient way to contact one another.

In response to a question from Senator Cook, Mr. Becker said information related to Minnesota's angel fund program is not confidential because Minnesota's angel fund statute specifies that the information is subject to disclosure.

Chairman Dockter said the confidentiality provisions associated with credits are one aspect of the committee's study this interim.

In response to a question from Senator Cook, Mr. Becker said the total amount of credits issued under Minnesota's program from 2010 through 2015 was a little over $75 million and the total amount of qualifying investments that generated those credits was a little over $203 million. Mr. Becker said Minnesota's credit will expire at the end of 2016 unless the program is extended.

In response to a question from Senator Bekkedahl, Mr. Becker said the total available amount of credits in Minnesota was either exhausted, or nearly exhausted, each year the program has been in effect.

In response to a question from Senator Cook, Mr. Becker said use of the seed capital credit has declined since the angel fund credit became available. Mr. Becker said credit limits for the seed capital credit were reached in 2004 and 2005. He said use of the seed capital credit has dropped off significantly since that time.

Representative Koppelman said it is possible that the angel fund credit might not be building new wealth in this state due to the lack of certain requirements within the language of statute. He said the credit might simply be serving to provide tax breaks.

Representative Nathe said, looking at the testimony provided by Mr. Bruce Gjovig, Chief Executive Officer, University of North Dakota Center for Innovation Foundation, Mr. Gjovig states that the angel fund credit is all about creating an equity industry in this state, not an economic development incentive. Representative Nathe said it appears some individuals are terribly misinterpreting the intent of this credit. He said additional testimony received from Mr. James Burgum, Co-founder and Managing Partner, Arthur Ventures, states that the only metric that matters when gauging the success of the credit is the number of dollars aggregated in angel funds. Representative Nathe said Mr. Burgum's testimony indicated that economic development metrics, such as the number of jobs created and other indirect economic indicators, do not matter and all angel funds are concerned with is building an equity structure in this state. He said he has a hard time believing the Legislative Assembly's intent in allowing the credit in 2007 was simply to build an equity structure. He said in his mind, the intent of the angel fund credit is being completely misinterpreted. He said some of the statements that have been made regarding the perceived intent of the credit raise a lot of red flags in his mind. He said the committee needs to continue to look at this credit.

Senator Mathern asked whether the development of angel funds might be a result of the failure of the banking industry to provide funds to startups. In response, Mr. Lucy said there are certainly additional restrictions imposed on the banking industry that were not in place 20 to 30 years ago. He said it might be harder for a young entrepreneur to raise capital today. He said he believes the angel fund program was put in place to encourage investment of private capital into economic or business development opportunities. He said the program could generate positive economic impacts for this state if it is administered with the appropriate rules and regulations.

Representative Headland said he agreed with Mr. Lucy's last statement. He said he also agreed with Representative Nathe that there are some real questions regarding the motives of some angel fund investors. He said he questioned whether angel funds were being developed with the intent of producing new wealth and economic returns in this state, or if the motivation behind creating angel funds centered more around the availability of a 45 percent tax credit. He said it is concerning the committee is in the dark regarding the amounts angel funds are investing in businesses. He said the statements made in Mr. Gjovig's testimony that indicated the angel fund program has failed in any state in which funds have been restricted to investing only in-state businesses, seems contrary to the fact after hearing of the success of Minnesota's angel fund program. He said it appears Minnesota has used the available amount of credits almost to the maximum each year since it became available despite the fact that Minnesota's program restricts investments to only in-state businesses.

Representative Nathe said the committee needs to remember that this credit is being offered on the "backs of North Dakota taxpayers." He said taxpayers expect some kind of benefit to the state in return for subsidizing this credit. He said North Dakota taxpayers are not paying for individuals to invest in Minnesota businesses to help Minnesota's economy. He said without available information to show otherwise, the assumption is that these investments are going to out-of-state businesses with no measurable benefits coming back to this state.

Representative Klemin said he found several aspects of Minnesota's credit appealing and wondered if it would be appropriate to incorporate some of Minnesota's program features into North Dakota's credit.

Chairman Dockter said the Tax Department was tasked with preparing a draft to illustrate how the language from Minnesota's credit program would translate into North Dakota law.

In response to a question from Representative Koppelman, Mr. Rauschenberger said the department could provide information relating to the name and principal place of business of entities that received investments from angel funds.

Chairman Dockter called on Ms. Donnita Wald, General Counsel, Tax Department, for presentation of a bill draft (Appendix F) illustrating the placement of Minnesota's angel fund credit provisions into a newly created chapter of Century Code. Ms. Wald reviewed the bill draft and said any highlighted sections of the draft represented items within Minnesota's angel fund program that differ from North Dakota's program or have been offset as policy considerations the committee would need to address. She said the department essentially picked up Minnesota's statute, with a few changes, and put it on this piece of paper.

Representative Carlson said he is aware of a situation in which a taxpayer pays a large amount of federal tax but no state tax as a result of the angel fund tax credit. He said the taxpayer was not aware of the purpose angel funds serve or whether the business that would ultimately receive the investment would be successful. He said the taxpayer was motivated to make an investment solely as a result of the available credit. He said he does not know that this scenario reflects the original intent behind enacting the credit. He said the intent of creating a platform for individuals to invest venture capital in risky new businesses in this state was a valid reason for the credit when it was enacted. He said he has been trying to "clip the wings" on this credit since 2007 because it is too wide open. He said it appears that a business does not even need to make an investment for an angel fund investor to receive a tax credit. He said this certainly was not the intent of the law when put forward by the Legislative Assembly. He said it is shameful that legislators have no idea of the amounts being invested in businesses or how those businesses are using the investment dollars. He said the Legislative Assembly should not allow a tax break unless it is afforded some measure of transparency regarding how investment dollars are being used. He said the Legislative Assembly spent a considerable amount of time ensuring that value-added processing plants, ethanol plants, and diesel plants were built with an eye towards improving this state's economy and the same criteria should apply to any tax credit as large as the 45 percent angel fund credit. He said the committee needs to produce an end product that leads to the credit aligning more realistically with the expectations that were in place when the credit was originally enacted. He said it is not necessary to know every detail related to angel fund investors or angel fund investments, but taxpayers should be aware of whether the credit is creating additional jobs or new wealth in this state. He said that is just a matter of good government. He said the committee needs to formulate a bill draft to address these concerns.

Chairman Dockter said Representative Carlson's concerns are at the heart of why Senate Bill No. 2057 passed during the 2015 legislative session. He said this state has never really analyzed economic development incentives to see how incentives are impacting taxpayers and what the state might be receiving in return.

Senator Mathern asked why Minnesota's provision relating to qualifying businesses paying at least 175 percent of the federal poverty level had been overstruck. Ms. Wald said several provisions contained in the draft were overstruck based on direction the department received when preparing the draft.

Senator Cook said the department was instructed to prepare the draft as a starting point for the committee's consideration. He said all of the provisions contained within the draft are open for the committee's debate and discussion. He said he hopes today's discussion will result in the committee providing direction to the Legislative Council staff to prepare a bill draft to address some of the issues related to the credit. He said provisions regarding audit and disclosure requirements were the main focus when Minnesota's law was reviewed.

Senator Mathern said he is concerned about removing the provisions related to paying at least 175 percent of the federal poverty level. He said it seems logical to include that type of provision in the draft to prevent people working for industries being subsidized by the state from receiving wages that are low enough to allow the individual to qualify for assistance.

Senator Cook said he was not looking at the language from a social welfare perspective when reviewing the draft, but Senator Mathern's concerns are a perfect example of the type of questions that should be discussed by the committee.

Representative Mooney said she would also like the committee to further examine provisions relating to 175 percent of the federal poverty level. She said if the state is going to be providing incentives from the top down the state should also consider providing incentives from the bottom up. She said the resulting policy might end up being better for everyone involved.

In response to a question from Senator Dotzenrod, Ms. Wald said a qualifying investor in this draft would be limited to a natural person.

Chairman Dockter requested the Legislative Council staff prepare a bill draft to incorporate some of the concepts from Minnesota's language into North Dakota's angel fund credit provisions.

In response to a question from Senator Dotzenrod, Ms. Wald said the provisions relating to fees have been overstruck in the draft as no other credit programs are currently self-funded in this manner.

Senator Cook said he is not opposed to including fee language, but said if fees are applied to this credit the committee might want to consider whether a similar fee structure should be applied to all credit programs. He said considerations relating to fees and payment of wages at 175 percent of the federal poverty level are separate from the concerns the committee has in relation to the accountability and transparency of angel funds.

In response to a question from Senator Dotzenrod, Ms. Wald said any certifications relating to the credit would be made by the Department of Commerce. Ms. Wald said the Tax Department would simply administer and audit the credit.

Representative Weisz said the draft includes several additional qualifiers beyond what is included in the definition of a primary sector business. He said he is not sure the definition of a business that can receive angel fund investments should be as restrictive as what is seen in the draft.

In response to a question from Representative Klemin, Ms. Wald said the list of activities a qualified business can engage in could be replaced with a reference to the definition of a primary sector business.

Chairman Dockter said if there are no objections from the committee members, the definition of primary sector business will be used in place of the list of qualifiers presently outlined in the draft.

Representative Hogan said if the committee chooses not to insert language referencing 175 percent of the federal poverty level into all credits, the angel fund credit could be used as somewhat of a pilot project to see how that language would operate within one credit's provisions.

Senator Mathern said he would like to know if any other programs currently reference similar poverty level guidelines.

Chairman Dockter requested the Legislative Council staff review language in Century Code for any similar provisions.

Representative Klemin said he had concerns with the language on page 13 of the draft allowing the Director of the Division of Economic Development and Finance to adopt rules relating to the credit. He said the Division of Economic Development and Finance is specifically excluded from the list of agencies subject to the Administrative Agencies Practice Act so the division would not be subject to the rulemaking procedures specified under that act. He said if a similar provision is included in a bill draft prepared by the Legislative Council staff, either the entity tasked with making the rule should be changed, or the Administrative Agencies Practice Act should be amended to remove the exclusion that applies to the Division of Economic Development and Finance.

Representative Carlson said the draft provided by the Tax Department seemed to be making things more complicated than they needed to be. He said the committee should simply choose the main concepts it likes from Minnesota's law and incorporate them into North Dakota's statute.

Representative Klemin said the committee should consider preparing two drafts, one streamlining the language provided by the Tax Department and the other simply incorporating the main concepts the committee likes from Minnesota's language into North Dakota's angel fund statute.

Chairman Dockter requested the Legislative Council staff prepare the two referenced bill drafts for the committee's review.

In response to a question from Representative Headland, Mr. Lucy said when the Department of Commerce reviews angel fund certification applications the department makes sure the angel fund has identified at least six investors and commitments totaling at least $500,000. Mr. Lucy said the department would not certify a fund that did not meet both requirements.

In response to a question from Senator Unruh, Mr. Lucy said angel funds will not necessarily disclose information relating to all investors in the angel fund's application materials. Mr. Lucy said some funds will just provide the names of at least six investors to verify that the fund has met the certification requirements. He said the department is not able to disclose the names of individual investors to the public.

Senator Unruh said she would be interested in information regarding the investors and the companies each fund has invested in as well as information identifying whether those companies are located in state or out of state. Mr. Lucy said a portion of this information has been submitted for the years certain reporting requirements were in place.

Comments by Interested Persons

Chairman Dockter invited comments from interested persons in attendance regarding the angel fund investment tax credit.

Mr. Greg Syrup, Chair, 701 Angel Fund, Grand Forks, presented testimony (Appendix G) in support of the angel fund investment tax credit. Mr. Syrup said he would like to clarify some of the comments Representative Nathe made regarding Mr. Gjovig's testimony. He clarified that the credit was created to focus on building angel funds as a capital industry and said the credit was not directly tied to economic development. He said prior to 2006, organized angel capital networks did not exist in this state. He suggested the committee form a working group with interested angel fund investors to discuss any necessary changes to the credit.

Senator Cook asked if Mr. Syrup would be opposed to some of the changes the committee was seeking, other than the changes restricting an angel fund's ability to make out-of-state investments. In response, Mr. Syrup said he understood the committee's concerns regarding transparency and would be more than willing to cooperate with the committee to find a solution to some of the gray areas that might exist. He said in regard to limiting a taxpayer from receiving a credit until funds are actually received by a business, he said he would need to see how language to that effect might operate before he could provide an opinion. He said the impact created by adding that type of provision would depend on how a particular fund was set up. He said this topic might be best discussed with additional angel fund managers.

In response to a question from Representative Nathe, Mr. Syrup said he could not speak for other angel fund managers, but he would be willing to disclose information relating to the investments made by the 701 Angel Fund. Mr. Syrup said the committee made some good points regarding issues with transparency and understands the committee's desire to have access to enough information to ensure angel funds are following the rules. He said he does not think any funds have sought out to take advantage of any loopholes and that has certainly not been his experience.

In response to a question from Representative Klemin regarding syndicated deals, Mr. Syrup said there has been interest from organizations his fund works with in Minnesota regarding investment opportunities that might be available in North Dakota even though most Minnesota investors would not be eligible to claim the credit.

In response to a question from Senator Mathern, Mr. Syrup said he did not have a specific preference in mind regarding the definition of a business that can receive investments from angel funds.

In response to a question from Representative Headland regarding the purpose for which the 701 Angel Fund was originally created, Mr. Syrup said he saw a need for angel fund capital. Mr. Syrup said, looking at the data related to North Dakota, this state ranks among the highest in regard to entrepreneurial and startup activity, but among the lowest in regard to access to capital. He said there was a need to ensure capital was available to startups looking to come to this state. He said there was also an interest in keeping young talent in this state and growing industries in this state.

In response to a question from Senator Burckhard, Mr. Syrup said, in most cases, banks are less willing to get involved in startups due to the risky nature of some of those ventures. Mr. Syrup said once financial institutions see that these ventures have been able to secure capital commitments from angel funds, financial institutions tend to open the door to additional capital financing opportunities.

In response to a question from Representative Nathe, Mr. Syrup said he is not specifically familiar with the names of any funds that might have misused the angel fund credit program. Mr. Syrup said he is aware that there were some prior issues regarding investing in real estate, but to his knowledge the issue has been remedied through legislation. He said he has rarely heard of angel funds misusing the program and is frustrated that any misuse has given other angel fund investors a bad reputation. Representative Nathe said it is unfortunate that some investors get a black eye due to the actions of others.

In response to a question from Representative Mooney, Mr. Syrup said he is not familiar enough with Minnesota's provisions relating to paying wages at 175 percent of the poverty level to specifically comment on it, but said he would be willing to discuss the topic further.

In response to a question from Representative Headland, Mr. Syrup said the 701 Angel Fund is also certified in Minnesota. Mr. Syrup said it is not the fund's goal to invest outside of this state, but the fund does seek investment opportunities throughout the capital industry and some of those opportunities might be outside of this state.

Ms. Emily O'Brien, President and Chairman, Dakota Venture Group, presented testimony (Appendix H) in support of the angel fund investment tax credit. She said Dakota Venture Group would also be interested in working towards a compromise regarding the angel fund credit and suggested the committee form a working group with interested angel fund investors. She also invited any interested parties to sit in on meetings of the Dakota Venture Group.

In response to a question from Chairman Dockter, Ms. O'Brien said the Dakota Venture Group is also certified in Minnesota through syndication efforts through Go For Angels.

Mr. Thomas Rolfstad, Venture Partner, Linn Grove Ventures, Fargo, testified in favor of the angel fund investment tax credit. He said he was previously involved in promoting economic development in Williston. He said there was a large amount of outside investment in Williston over the last several years. He said Williston would have never been able to fund the amount of growth that occurred in the city without out-of-state investment. He said legislators deserve credit for getting the angel fund capital industry started in this state. He said any past concerns regarding angel funds investing in real estate have been addressed through prior legislation so those types of investments no longer appear to be an issue. He said he is concerned that it might be hard to start new angel funds if the Legislative Assembly places too many stipulations on funds. He said he supports any changes to ensure the legislation is effective, but has reservations about borrowing too much from Minnesota's credit provisions or having the credit get too bogged down in bureaucracy. He explained the origin of the term "angel fund" and said the state needs to take a long-term view of these types of funds. He said it is unfortunate that Minnesota placed a sunset on its credit program. He said North Dakota needs angel funds to grow if is is going to grow as a state. He said in today's climate, young business majors are taught to come up with an idea and then go out and find someone to fund that idea. He said he does not know that the committee needs to be too concerned with adding language related to the federal poverty level as most businesses receiving angel fund investments employ highly qualified individuals and pay those individuals wages commensurate with their qualifications. He said the individual who started Linn Grove Ventures started the fund with proceeds from the sale of his very successful medical testing facility in Fargo. He said his fund currently has 40 to 50 investors that have been involved in Linn Grove Ventures One and Two. He said individuals who invest in angel funds get involved and they network so he thinks funds need to retain some latitude in terms of investing out of state. He said his fund has attracted entrepreneurs from Canada and Montana. He said one of his partners travels the world and sits down with various agricultural funds to share knowledge. He said in some cases, those funds have invested in opportunities in North Dakota. He said this state has some of the top minds in agriculture, and raising capital to promote further developments in that field is important. He said the key issue in crafting any amendments to the angel fund credit center around a determination of whether the purpose of the credit is to incentivize development in North Dakota or just incentivize investment. He said all the investors he has dealt with are very aware of the businesses the fund is investing in and he finds it hard to understand how investors in other angel funds would not be aware of the types of businesses receiving investments from the fund.

In response to a question from Chairman Dockter, Mr. Rolfstad said Linn Grove Ventures is not certified in Minnesota, but might seek certification in Montana if Montana enacts an angel fund credit. Mr. Rolfstad said Montana has quite a few individuals in the technology field so he could see entrepreneurs in Montana having a need for angel funds.

Representative Headland said it appears that a fund reaches its potential when it has used all of the tax credit available to the fund. He said once this occurs, it seems that the same group of investors simply form a new fund in order to continue to use the credit. He asked Mr. Rolfstad to clarify his comments advising against tying the receipt of the credit to the receipt of investment dollars by a business so as to not hinder the growth of a fund. In response, Mr. Rolfstad said the point he was seeking to make was that it would be difficult for a new angel fund to have enough money in place to invest in three businesses early on. He said this might not be a problem for larger funds, but it might place a burden on smaller funds. He said Linn Grove Ventures One is no longer taking any additional investments. He said this is not due to the fact that Linn Grove Ventures One has reached its cap for receiving credits. He said investors will continue to invest in a fund even if the credit limit has been reached if investors find a program they like.

Representative Hogan said between 2012 and 2014 North Dakota taxpayers contributed $21 million to provide for the angel fund tax credit. She asked if Mr. Rolfstad thought taxpayers received a good return on their investment considering the committee has not been able to quantify what that return on investment has been. In response, Mr. Rolfstad said he might not be the best individual to respond to that question, but said his fund could show profits. He said his fund would be as transparent with the committee regarding its investments as it could be without violating any confidentiality provisions.

In response to a question from Senator Cook regarding why an individual would seek to use the angel fund credit rather than the seed capital credit, Mr. Rolfstad said investors in his fund have actually used both credits together on several occasions. Mr. Rolfstad said the seed capital credit will be used at the early stages of investing in a business and the angel fund credit will be used for investments in a business once it is further along.

In response to a question from Representative Nathe, Mr. Rolfstad said he thinks his fund would be open to sharing information with the committee. Mr. Rolfstad said his fund is audited on a regular basis and he thinks his fund is doing things right. He said angel funds are partners with legislators and he wants to see the angel fund credit crafted in a manner that incentivizes investments and does the right thing for North Dakota as well.

Representative Nathe said he would be interested in surveying angel funds to see which funds would be willing to share additional information with the committee.

Chairman Dockter requested the Legislative Council staff contact angel fund managers and request additional information regarding angel fund investments.

Senator Dotzenrod said the public interest needs to be kept in mind when analyzing the angel fund credit. He said legislators serve the public and any funds the Legislative Assembly expends are public money. He asked if Mr. Rolfstad could provide an example of a company that was formed, or a project that was started, that would not have gone forward unless the angel fund credit was in place. In response, Mr. Rolfstad said one example would be farm quality assurance which involves items that can be electronically measured on a farm. He said a team of programmers have developed software that can download data by satellite and coordinate the data to allow a farmer to see everything that is occurring on the farm. He said this type of tool is particularly helpful on larger farms. He said the sensor devices are being manufactured in Fargo and the state already has a market to sell the product.

Committee Discussion and Directives

Chairman Dockter called on the Legislative Council staff to provide a summary of what the committee will be addressing in regard to the angel fund credit at its next meeting. The Legislative Council staff said she will be contacting angel funds with additional survey questions regarding angel fund investments and will be preparing two bill drafts relating to the angel fund investment credit.

SOCIAL SERVICES FINANCING STUDY

Chairman Dockter called on the Legislative Council staff for a presentation regarding other states' experiences with restructuring human service systems. The Legislative Council staff said she provided a list of survey questions to the surrounding states of Illinois, Indiana, Iowa, Michigan, Minnesota, Montana, Nebraska, South Dakota, Wisconsin, and Wyoming. She said the four survey questions comprised of the following:

1. Has your state undergone any significant restructuring in the area of social services in the past 10 years?
2. If so, please briefly describe the restructuring that was undertaken.
3. Did the restructuring result in any cost savings (*provide amount if possible*) or other benefits?
4. Were any negative outcomes realized as a result of the restructuring?

The Legislative Council staff said, to date, she only received responses from South Dakota and Wyoming. She said South Dakota replied that its state social service agency administers several social service programs including Medicaid, temporary assistance for needy families (TANF), supplemental nutrition assistance program (SNAP), energy assistance, weatherization, and child care. She said South Dakota's state agency also houses the unit on aging, provides all behavioral health services, and operates the child welfare agency which administers the state's child support program. She said South Dakota has used a state-level model since the early 1970s. She said South Dakota highlighted several benefits to using a state-level approach, as compared to a county-level approach, including the ease of using a centralized billing, payment, and accounting system; consistent administration of program benefits across the state; the ability to efficiently manage federal and other reporting requirements; and the ability to leverage both its administrative and direct support workforces to provide services statewide for programs that do not require face-to-face contact.

The Legislative Council staff said Wyoming also provided a response to the survey. She said Wyoming's social service system is state funded. She said the state has 26 counties but uses a centralized fiscal, computer, tracking, and reporting system. She said Wyoming consolidated its child protection department and juvenile justice department roughly 3 to 4 years ago and the consolidation is working well. She said Wyoming noted two programs that might be of interest to this state. She said Wyoming recommended looking into Casey Family Programs and the Statewide Automated Child Welfare Information System (SACWIS), which is an automated case management tool. She said Wyoming noted there is a large federal push for states to use SACWIS so federal funding is available to purchase this system.

In response to a question from Senator Bekkedahl, the Legislative Council staff said she was not aware of the exact number of states having social service systems that were entirely state funded. The Legislative Council staff said the material she presented at the prior meeting from the National Conference of State Legislatures contained information regarding supplemental funds used for social services in various states, but did not break out on a state-by-state basis which states had programs that were entirely state funded.

In response to a question from Representative Weisz, the Legislative Council staff said the social service system in Wyoming is a state-funded system, but Wyoming did conduct a study in the past to determine the amount of state dollars that were being expended per case from county to county.

Representative Hogan said the American Public Human Services Association is an umbrella association for all public human service entities and might be a good source for the committee to reference if it is seeking any additional structure or funding data pertaining to other states.

Department of Human Services

Chairman Dockter called on Ms. Debra McDermott, Chief Financial Officer, Department of Human Services, for a presentation (Appendix I) regarding yearly changes to social service caseloads. Ms. McDermott said the information she provided is a 4-year comparison of caseloads assembled to measure the work effort put forth by a county for purposes of the funding formula. She said an updated copy of her prior handout relating to the last 4 years of economic assistance caseloads has also been provided. She said the only changes to the economic assistance data are changes relating to child care assistance paid cases and the medical eligible chart. She said the department discovered an error in how data was being pulled from the department's computer system for child care assistance paid cases so this portion of the chart has been updated. She said the caseload information reflected in the handouts is counted on a monthly basis so one individual using one program for 1 year would be counted as twelve cases for purposes of the handouts and the funding formula.

In response to a question from Senator Bekkedahl, Ms. McDermott said essential child facilities are not reflected on the chart because the chart only measures work effort at the county level.

In response to a question from Senator Cook, Ms. McDermott said subsidized adoption cases are cases in which an individual receives a subsidy payment for adopting a child in a foster care program.

Representative Hogan said county work effort related to psychiatric residential services would likely be counted under the work effort associated with foster care because a foster care child receiving these services would be case managed by the county.

County Social Services Finance Working Group

Chairman Dockter called on Mr. Joe Morrissette, Member, County Social Services Finance Working Group and Deputy Tax Commissioner, Tax Department, for a presentation (Appendix J) of information illustrating how the 12 percent state-paid property tax credit would compare to a mill levy reduction resulting from a state assumption of social service costs. Mr. Morrissette said the second column on the chart illustrates the amount each county will receive for the 12 percent state-paid property tax credit for the 2015 tax year. He said the fourth and fifth column of the chart illustrate the amount each county levied for social services and the percentage of a county's total tax levy the social service levy represents. He said the seventh column on the chart represents the amount each county would receive if the amount levied in all counties for social services, approximately $51.9 million, were equally distributed as a percentage of the total taxes levied in each county. He said an equal distribution of the $51.9 million would amount to roughly 5.4 percent of the taxes levied in each county. He said some counties might come out ahead depending on the percentage of a county's total tax levy that represents a levy for social services.

In response to a question from Chairman Dockter, Mr. Morrissette said the last column on the chart represents a comparison of the total amount levied in each county for social services and the amount each county would receive using an equal distribution of $51.9 million levied in 2015 for social services in all counties. Mr. Morrissette said any amount in parenthesis indicates an instance in which the amount derived from a county's social service tax levy would be less than the amount a county would receive if the total $51.9 million were evenly distributed between all of the counties. He said adding any shortfalls to the $51.9 million would result in a total of approximately $57.2 million.

In response to a question from Representative Weisz, Mr. Morrissette said the total amount of taxes levied in 2015 does not take into account any levy authority that was eliminated as a result of 2015 Senate Bill No. 2206.

In response to a question from Senator Mathern, Mr. Morrissette said his calculations take into account the amounts counties are actually levying for services they intend to provide in the ensuing budget year.

In response to a question from Representative Hogan regarding Native American counties that have higher caseloads than average counties but no property tax, Mr. Morrissette said the main comparison is found in the middle column of the chart. Mr. Morrissette said counties would either gain or lose under a uniform distribution depending on whether their social service tax is a higher or lower percentage of their total taxes.

In response to a question from Senator Bekkedahl, Mr. Morrissette said Williams County would receive $948,000 more if the state paid Williams County's social service levy rather than paying 5.4 percent of Williams County's property tax bill as a result of the credit.

Mr. Morrissette also provided information (Appendix K) pertaining to updated 2015 base-year data in regard to the social service funding formula and information detailing the amount of federal funds reflected in the total formula payment when using calendar year 2015 expenditures rather than calendar year 2014 expenditures. He said the handout illustrates the changes in caseloads and expenditures from 2014 to 2015. He said the estimated formula payment using 2014 data for the base year is $73,927,763 and the estimated formula payment using 2015 data for the base year is $79,698,317. He said this represents a 7.8 percent increase in the formula payment from 2014 to 2015. He said the growth in expenditures over this time period was a little over 8 percent, which is not inconsistent with growth in expenditures the state has experienced over the last few years. He said caseloads on the economic assistance side of the formula rose by roughly 2.3 percent and caseloads on the social service side of the formula rose by roughly 5.9 percent. He said the working group will be discussing the 2015 base year figures, and any additional considerations that may result in those figures being modified, at its next meeting. He said additional considerations include the manner in which centralized county costs and shared services will be reflected in the formula. He said the bottom portion of the handout illustrates that $16,500,000 of the total $79,698,317 formula payment consists of federal funds. He said after deducting federal funds, the remaining general fund portion of the formula payment amounts to $63,198,317 using 2015 as the base year.

In response to a question from Chairman Dockter, Mr. Morrissette said the majority of the costs that would be funded through the formula are staff costs.

In response to a question from Representative Weisz, Mr. Morrissette said the amounts reflected in the handout represent amounts actually expended by counties in 2015 to administer social service and economic assistance programs.

Chairman Dockter said the committee will continue to receive updates from the working group regarding its progress on developing the funding formula.

North Dakota Association of Counties

Chairman Dockter called on Mr. Steve Reiser, Director, Dakota Central Social Services, for a presentation (Appendix L) on behalf of the North Dakota Association of Counties regarding a breakdown of the social service budgets in each county and county input on the inflationary rate and amount of reserves that might be applied in a proposed funding formula. Mr. Reiser said the numbers in his handout represent 2016 budget numbers. He said in response to the committee's previous question regarding the counties' preferred growth or inflationary factor to be used in calculating future reimbursements, the counties would prefer a blended factor that takes into account annual growth in health insurance premiums and growth in state salaries. He said a blended factor would be a more accurate representation of the inflationary costs actually experienced by counties than a inflationary factor based on a national or regional consumer price index rate. He said in regard to the counties' preference for the amount of reserves a county might carry forward under the formula, the counties looked at the history relating to the level of reserves that can be carried forward in relation to the education funding formula. He said the counties' preference would to be to carry forward up to $100,000 in reserves, or 35 percent of a county's prior year budget amount, whichever is greater. He said only one county would currently have reserves in excess of $100,000 if that limit was incorporated into the formula.

In response to a question from Chairman Dockter, Mr. Reiser said 11 counties currently self-fund or use a provider other than the Public Employees Retirement System. Mr. Reiser said the employees in those 11 counties make up 40 percent of all social service employees in the state.

In response to a question from Representative Weisz, Mr. Reiser said the working group has discussed how any amounts exceeding reserve limits would be addressed. Mr. Reiser said, similar to the school funding formula, any state payment due a county under the formula would be reduced by the amount of a county's reserves that exceed the limit defined in statute. He said most counties would have some level of reserves to carry into the first year the formula is implemented. He said counties that do not have any reserves could potentially access a grant program similar to that found in 2015 Senate Bill No. 2206.

Representative Nathe said he viewed the issue as pertaining more to allowing a county to retain a certain amount of reserves rather than building a county's reserves up to the level allowed under the cap.

Representative Hogan said a common way counties accumulate reserves is through staff vacancies.

Representative Weisz said he wanted to caution the committee in making too many comparisons to the education funding formula because the education funding formula allows school districts to retain some levy authority whereas the social service funding formula would eliminate a county's social service levy authority entirely. He said the operation of the formulas are not entirely an apples-to-apples comparison.

Senator Bekkedahl said he thought any excess funds derived from taxpayer dollars should go back to the taxpayers rather than the state.

Treatment of Excess Funds

Chairman Dockter called on the Legislative Council staff for a presentation of options regarding the treatment of funds exceeding defined carryforward limits should the formula allow a county to carry funds forward to a future budget year. The Legislative Council staff said when discussing this topic it is helpful to first draw a distinction between the source of any funds being carried forward. She said if a funding formula was implemented to provide for a state assumption of social service costs beginning in budget year 2018, any excess funds being carried forward from budget year 2017 would consist of county dollars derived from property tax levies. She said any funds carried forward from budget year 2018, and any future years in which the formula remains in effect, would consist of general fund dollars. She said it is important to note the source of any excess funds because the source of the funds might impact the committee's wishes regarding the treatment of any amounts exceeding a set carryforward limit.

The Legislative Council staff said there was some discussion at the previous meeting regarding the ability to return any funds exceeding a carryforward cap to the taxpayers from which the funds were originally derived. She said refunding tax dollars has always been somewhat of a tricky situation and referenced 2007 Senate Bill No. 2032 as an example. She said Senate Bill No. 2032 dealt with the homestead tax credit and provided taxpayers the option of either carrying forward any credit amount exceeding a taxpayer's income tax liability to offset a taxpayer's income tax liability in future years or receiving a certificate for the excess amount which a taxpayer could then apply to offset the taxpayer's property tax liability for the ensuing taxable year. She said the process proved to be quite cumbersome and involved the taxpayer delivering the certificate to the county treasurer in the county in which the property was located and then having the county treasurer forward the redeemed certificate to the Tax Commissioner who would then issue payment to the county for the amount of the certificate. She said the process was also costly as seen by the $1.1 million appropriated to the Tax Department to implement Senate Bill No. 2032. She said another example pertaining to the treatment of funds was seen in 2007 Senate Bill No. 2205. She said Senate Bill No. 2205 pertained to the transition of child support enforcement from the county level to the state level. She said the bill required counties to adjust their maximum property tax levy to reduce taxes in an amount that would reflect the transfer of employees and equipment from the regional child support enforcement agencies to the Department of Human Services. She said the process used in Senate Bill No. 2205 might be a more simplified approach to crediting funds exceeding a county's carryforward limit to the taxpayers within a county.

The Legislative Council staff said various options regarding the treatment of funds derived from state general fund dollars which exceed the carryforward limit have also been discussed by the committee and the working group. She said one option regarding the treatment of excess funds would be to simply deduct any amount exceeding an allowable carryforward limit from a county's future formula payments. She said another option that has been discussed is to siphon off any amounts exceeding an allowable carryyforward limit into a separate fund used to provide grants to counties experiencing an unusual or unanticipated growth in caseloads, similar to the grant process provided in 2015 Senate Bill No. 2206. She said various other options could be applied to the treatment of excess funds, but these examples provide a brief historical overview of some approaches that have been used in the past. She said it is likely this topic will continue to be discussed by the working group and the committee until the funding formula is further refined.

Senator Cook said he recalled the 2007 legislation and how miserable a process it was trying and figure out how to give taxes back to taxpayers. He said the simplified option would be to require counties to lower property taxes in an amount equivalent to any amount exceeding set carryforward limits for a 1-year period following the year in which funds exceeding the cap were carried forward. He said this would provide a refund to taxpayers in a round about way by lowering taxpayers' property tax bills in a future calendar year.

Senator Bekkedahl said he agreed that the easiest method would be to allow counties to transfer any excess funds into their general fund and then reduce their general fund levy accordingly for the following year. He said the committee needed to remember there may be a time lag from when county budgets are submitted in October to when a county would know the amount that exceeds its carryforward limit so timing issues would need to be taken into account.

Chairman Dockter said the treatment of excess funds is an issue that can be further addressed by this committee and the working group.

Representative Klemin said another option would be to let counties decide what to do with any amounts exceeding the cap as counties may be in the best position to determine the most appropriate use of the funds based on each individual county's needs.

Committee Discussion and Directives

Chairman Dockter said the committee still has a lot of work ahead. He said it is his intention to meet again in roughly 6 weeks and said the committee will switch back to holding 2-day meetings if necessary.

Senator Mathern said he received some information regarding the quality of service the state is providing through its human service system that he would like to discuss at the next meeting.

Chairman Dockter requested the Legislative Council staff include this item on the committee's next meeting agenda.

No further business appearing, Chairman Dockter adjourned the meeting at 4:15 p.m.

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Emily L. Thompson
Counsel

ATTACH:12