NORTH DAKOTA LEGISLATIVE MANAGEMENT

Minutes of the

POLITICAL SUBDIVISION TAXATION COMMITTEE

Tuesday, September 13, 2016
Harvest 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, Craig Headland, Ben Koppelman, Mike Lefor, Alisa Mitskog, Gail Mooney, Naomi Muscha, Mike Nathe, Nathan Toman, Robin Weisz; Senators Brad Bekkedahl, Randall A. Burckhard, Dwight Cook, Jim Dotzenrod, Tim Mathern, Jessica Unruh

Members absent: Representatives Mark A. Dosch, Kathy Hogan, Lawrence R. Klemin, William E. Kretschmar

Others present: See Appendix A

It was moved by Senator Burckhard, seconded by Senator Unruh, and carried on a voice vote that the minutes of the June 29, 2016, meeting be approved as distributed.

SOCIAL SERVICES FINANCING STUDY

Chairman Dockter called on Ms. Maggie D. Anderson, Executive Director, Department of Human Services, for presentation (Appendix B) of information regarding the history behind the formation of the County Social Services Finance Working Group and an overview of the working group's activities. She reviewed the provisions of 2015 Senate Bill No. 2206 pertaining to the formation of the working group and said the members of the working group collected an extensive amount of expenditure, budget, and caseload information over the course of the interim. She reviewed the criteria pertaining to human services grant awards and provided a comparison of the amounts requested and the amounts awarded pursuant to the grant program.

Chairman Dockter called on Mr. Joe Morrissette, Deputy Tax Commissioner and member of the County Social Services Finance Working Group, for presentation (Appendix C) of the final report of the working group in regard to the operation and estimated cost of the proposed social service funding formula. He said the working group held its final meeting on September 12, 2016, and reached a consensus on recommendations for a proposed transition plan for transferring the costs of operating social service programs from county property tax levies to the state. He said the driving factor behind the development of a formula for the state assumption of social service costs was the provision of property tax relief. He reviewed the operation of the formula and said the proposal advanced by the working group provides for a hold-harmless payment to ensure a county receives no less funding than the amount of property tax relief received by all taxing districts in the county in calendar year 2017 as a result of the 12 percent state-paid property tax relief credit.

In response to a question from Representative Weisz, Mr. Morrissette said the intent is that the 12 percent state-paid property tax relief credit hold-harmless payment would naturally fall off over a period of time.

In response to a question from Senator Unruh, Mr. Morrissette said if a county received more under the social service funding formula than the county actually received as a result of the state-paid property tax relief credit in 2017, the county would not receive a hold-harmless payment. He said a county receiving funds under the formula payment in excess of what the county received in 2017 as a result of the state-paid property tax relief credit would not be required to return the excess funds because funding provided under the formula is a product of the county's caseloads times a set payment rate per case.

In response to a question from Chairman Dockter, Mr. Morrissette said there are maximum and minimum thresholds built into the formula to ensure a county receives adequate funding for social services, but does not receive a windfall payment as a result of the implementation of the formula.

In response to a question from Representative Koppelman, Mr. Morrissette said the intent of the formula is to fund the same level of services counties are currently providing, which is the reason historic county expenditures were used as the basis for developing the formula's funding methodology.

In response to a question from Chairman Dockter, Mr. Morrissette said counties would be able to access county general fund dollars to supplement the social service formula payments under a limited set of circumstances.

In response to a question from Senator Cook, Mr. Morrissette said funds a county receives as a result of the 12 percent state-paid property tax relief credit hold-harmless payment must be used to reduce the county's general fund levy or other county-wide levy.

Representative Nathe said inclusion of the hold-harmless payment provisions is a good addition to the proposed transition plan.

In response to a question from Chairman Dockter, Mr. Morrissette said the funding formula accounts for a county's administrative and staffing costs as well as a portion of a county's indirect costs.

In response to a question from Representative Weisz, Mr. Morrissette said county levy authority for social services would be eliminated beginning in tax year 2017 under the proposed transition plan.

In response to a question from Senator Dotzenrod, Mr. Morrissette said the state obligation under the funding formula would grow, but the rate of growth would be more easily controlled by the Legislative Assembly.

In response to a question from Representative Mooney, Mr. Morrissette said the formula includes various mechanisms to alleviate any burden placed on a county due to unanticipated caseloads. He said counties have the ability to carry forward to the following budget year 35 percent of the previous year expenditures or $100,000, whichever is greater. He said this carry forward ability provides counties with a funding cushion that can be used to address any unanticipated increase in caseloads. He said counties also may transfer county general fund dollars into their social service funds under limited circumstances; however, any funds transferred into a county's social service fund from a county's general fund are subject to the carry forward limitations. He said the formula also provides for a true-up calculation mid-year, which recalculates a county's current year formula payment using caseload data that is 1-year newer than the data initially used to calculate the county's current year formula payment.

In response to a question from Senator Mathern, Mr. Morrissette said it would be up to county social service directors and other interested parties to advocate for proper funding level adjustments for social services each biennium similar to the manner in which school district representatives advocate for any necessary adjustments to per-pupil payments under the K-12 funding formula.

Representative Nathe said many of the same conversations regarding hold-harmless payments and advocating for future formula payment changes were discussed in the context of the K-12 funding formula. He said the K-12 funding formula has worked spectacularly, even though the formula has required a few tweaks over the years. He said if a social service funding formula is implemented, the formula likely would require adjustments over the first few years of implementation. He said considering the success of the K-12 funding formula, the social service funding proposal may be on the right track.

Mr. Morrissette said the working group noted two changes to the proposed formula at its final meeting, which included reducing the number of yearly formula payments from four to two and allowing the Department of Human Services to retain federal funds rather than funding a portion of the formula with federal funds. He said the quarterly distribution schedule would be reduced to two payments per year with the first payment occurring on or before January 10 and the second payment occurring on or before June 15. He said the working group also recommends changing the distribution date for the yearly hold-harmless payment from on or before March 15 to on or before January 31.

Mr. Morrissette reviewed the cost of the proposed funding formula and said the total cost of the formula, including estimated hold-harmless payments, would be roughly $258.7 million over the course of the 2017-19 biennium, in addition to any costs resulting from caseload growth. He said the maximum estimate for costs related to caseload growth would be $5 million to $10 million for the biennium. He said estimates for the hold-harmless portion of the costs were derived by assuming an 8 percent increase over the amount distributed for the 12 percent state-paid property tax relief credit in 2016. He said if the cost of the credit in 2017 exceeds the cost of the credit in 2016 by more than 8 percent, the cost of the funding formula would increase by a little over $1 million per year for each 1 percent increase exceeding the estimated 8 percent increase.

In response to a question from Chairman Dockter, Mr. Morrissette said funding for the 12 percent state-paid property tax relief credit is derived from oil and gas tax revenue and is set aside in advance for use in the following biennium. He said despite the current low-price environment, the full $300 million is expected to be generated for property tax relief for use in the 2017-19 biennium.

In response to a question from Representative Headland, Mr. Morrissette said he is not an expert in human services, but it is his thought that federal mandates would dictate a certain level of services rather than a certain level of funding.

In response to a question from Representative Nathe, Mr. Terry Traynor, Assistant Director of Policy and Programs, North Dakota Association of Counties, said the state and counties always have shared funding responsibility for social services, but the degree to which each has been responsible for funding has shifted back and forth over the years.

In response to a question from Senator Dotzenrod, Mr. Morrissette said all counties would receive at least what was received under the 12 percent state-paid property tax relief credit in 2017 as a result of the funding formula.

Chairman Dockter called on the Legislative Council staff for presentation of a bill draft [17.0287.01000] relating to the transition of funding responsibility for county social services from the counties to the state. She elaborated on some of the formula concepts provided by Mr. Morrissette and reiterated that the 12 percent state-paid property tax relief credit hold-harmless payment would not serve to fund county social service costs but would serve to reduce the amount paid by property taxpayers as a result of the requirement that counties reduce the total number of mills levied for county general fund purposes by an amount equivalent to the hold-harmless payment the county would receive the following calendar year. She said the resulting reduction in the number of mills a county may levy for general fund purposes, combined with the property tax savings that would result from eliminating a county's authority to levy mills for social service purposes, is the manner in which property tax relief would be provided under the proposed funding formula.

In response to a question from Representative Bellew, the Legislative Council staff said the bill draft removes the requirement that the amount of property tax savings resulting from the 12 percent state-paid property tax relief credit appear on a property taxpayer's tax statement for taxable years after the credit is repealed. She said the bill draft does not address the manner in which property tax saving resulting from the funding formula could be illustrated on a taxpayer's property tax statement as the concept has not been fully vetted by the committee or the members of the working group.

Chairman Dockter said any changes to the manner in which information appears on a property tax statement would be an issue that would need to be further discussed with the Tax Department.

Senator Mathern said it would be helpful to seek input from county auditors regarding any changes to information that appears on property tax statements.

Senator Cook said separate discussions regarding the information that appears on property tax statements, and the manner in which taxpayers are notified of proposed budget increases, have already commenced and there will be many opportunities to further discuss this issue during the legislative session.

In response to a question from Representative Headland, the Legislative Council staff said each county would receive the amount of the required mill levy reduction resulting from a county's hold-harmless payment after the county had already determined its budgeting needs for the upcoming calendar year and set mill levies. She said the required mill levy reduction would be subtracted from the predetermined county general fund mill levy.

In response to a question from Senator Cook, Mr. Morrissette said based on the assumptions applied in the formula, eight counties would receive more under the social service funding formula than they received for all taxing districts in 2017 as a result of the 12 percent state-paid property tax relief credit. He said he would need to review the data further to determine if any of those eight counties also receive a weighting factor greater than one for purposes of the funding formula.

In response to a question from Representative Mitskog, Mr. Morrissette said the working group discussed how to improve efficiencies in counties, and the funding formula contains incentives that encourage counties to consolidate. He said counties that consolidate receive the benefit of a higher weighting factor than they would otherwise receive individually as a result of their increased combined caseload. He said the higher weighting factor gradually phases down but never drops below 50 percent of the weighting factor the counties would have received had they not elected to consolidate. He said funding limitations built into the formula also encourage efficiencies because counties will have to operate within the budgetary amounts allowed under the formula. He said he is not aware of any pushback regarding consolidation language and the working group reached a consensus on all the recommendations provided to the committee.

Chairman Dockter said it is very similar to the formula in place for K-12 education. He said the formula provides for funding on a per-case rather than a per-pupil basis.

Senator Dotzenrod said he wondered if the variation seen in the concentration of case types from one county to another might be more variable than the curriculum between school districts.

Representative Nathe said the multitude of factors used in determining per-pupil payments would likely be as complicated as the determination of any factors taken into account for per-case payments.

Chairman Dockter said because the requirements for whether an individual qualifies to receive various types of social services or economic assistance largely are determined at the federal level, it is unlikely counties would be able to manipulate case counts to obtain additional funding.

Mr. Traynor said the funding formula consists of two parts. He said one part of the formula pertains to the administrative and staffing costs associated with social service cases such as foster care, in-home care, and care for the elderly. He said the other part of the formula pertains to the administrative and staffing costs associated with determining eligibility for economic assistance programs such as Medicaid and temporary assistance for needy families.

In response to a question from Senator Bekkedahl, Ms. Debra McDermott, Chief Financial Officer, Department of Human Services, said under the changes recommended by the working group, federal funds generated as a result of social service administrative costs would be retained by the Department of Human Services, similar to the manner in which federal dollars were retained by the department following implementation of the 1997 swap legislation.

In response to a question from Representative Nathe, the Legislative Council staff said formula payments are subject to minimum and maximum thresholds in comparison to the amount of a service area's adjusted base-year gross expenditures. She said an exception to the maximum threshold caps placed on formula payments relates to instances in which a service area's most recent caseload totals exceed a service area's caseload totals in the base year by more than 5 percent.

In response to a question from Representative Nathe, Ms. Anderson said publications on the Department of Human Service's website show the rate at which certain types of cases have been growing. She said she would forward the applicable links and documents indicating caseload growth to the Legislative Council staff.

In response to a question from Representative Headland, Chairman Dockter said the committee appeared to be agreeable to the changes recommended by the working group and requested the Legislative Council staff to incorporate the working group's recommendations into a new version of the bill draft.

Chairman Dockter called for comments from interested persons in attendance regarding the bill draft.

Mr. Traynor said the costs of social services are driven by federal requirements and the needs of the populations within each service area, both of which are factors over which counties have very little control. He said social service caseloads often are the highest in counties that have the lowest tax base, which makes funding social services using property tax revenues difficult. He said funding derived from a statewide tax base makes more sense in regard to the administration of these types of services. He said county auditors likely will be more appreciative of the hold-harmless approach used in regard to eliminating the 12 percent state-paid property tax relief credit as the current credit is very challenging to administer.

In response to a question from Chairman Dockter, Mr. Traynor said counties would retain as much control over the administration of social services using a state-funded revenue source as they would using funding from property tax revenues. He said a mechanism for permanent property tax relief and the ability to hold counties harmless in regard to the property tax relief received in 2017 have been achieved through the concepts advanced in the proposed formula. He said funding social services with a state-funded source is the right approach to funding social services over the long term.

ECONOMIC DEVELOPMENT TAX INCENTIVE STUDY

Chairman Dockter called on the Legislative Council staff for presentation of an updated copy of the *Economic Development Tax Incentive Study - Evaluation Chart*, the *Economic Development Tax Incentive Study - Certified Nonprofit Development Corporation Investment Credit*, the *Economic Development Tax Incentive Study - Microbusiness Income Tax Credit*, and the *Economic Development Tax Incentive Study - Wage and Salary Credit*. She 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 its previous meeting.

Chairman Dockter said the committee has made quite a bit of progress on its evaluation chart. He said incentives for which information was not collected over the course of the interim will be carried forward to future interims for further evaluation. He said the evaluation process involved a large learning curve and hopefully the committee can learn from its experiences this interim for the review of the remaining incentives.

Senator Dotzenrod said he wondered if there might be some benefit to determining a way to measure the effectiveness of projects that have already received a tax incentive.

Chairman Dockter said this committee broached this topic in its assessment of economic incentive evaluation software earlier in the interim and also will be looking at a bill draft regarding the preparation of dynamic fiscal notes. He said he agreed it is important to look forward as well as back to determine if a project or program is worthy of an incentive.

Mr. Scott Rising, Legislative Director, North Dakota Soybean Growers Association, said he would like to comment on a statement provided at a previous meeting regarding negative impacts that may be created due to increased truck traffic to a soybean processing facility. He said soybeans would be trucked to one destination or another regardless of the opening of a new processing plant.

Chairman Dockter called on the Legislative Council staff for presentation of a bill draft [17.0110.02000] relating to modified angel fund certification and reporting requirements and new requirements for investing in qualified businesses for purposes of receiving the angel fund investment tax credit. She said the revised version of the bill draft incorporates changes requested by the committee at the prior meeting. She said the changes from the previous version include a change to the amount of the tax credit to which a taxpayer is entitled and restrictions regarding a taxpayer's ability to receive a credit until funds invested by the taxpayer in an angel fund are further invested by the fund in a qualified business. She said the bill draft also contains additional angel fund reporting requirements and provides that reports requested from the Tax Commissioner by the Legislative Management are mandatory rather than discretionary.

Chairman Dockter called on Mr. Ryan Rauschenberger, Tax Commissioner, for comments regarding the angel fund investment tax credit. He commented on the administrative aspects of the bill draft and said angel funds are subject to much more robust reporting requirements under the bill draft. He said the amount of additional work the bill draft provisions would create for the Tax Department would depend on the number of individual investors investing in angel funds for purposes of Tax Department audit and compliance reviews. He provided the cost of an additional full-time equivalent position if the workload extended beyond that which could be redistributed among current employees.

In response to a question from Representative Nathe, Mr. Rauschenberger said the angel fund bill draft passed out by the committee at its previous meeting likely would be less administratively burdensome for the tax department.

In response to a question from Representative Mitskog, Mr. Rauschenberger said the bill draft would create an entirely different type of investment tax credit than the Tax Department is accustomed to administrating.

Chairman Dockter called on Mr. Paul Lucy, Director, Economic Development and Finance Division, Department of Commerce, for comments regarding the angel fund investment tax credit. He said he did not have much additional information to add in light of the summary provided by the Legislative Council staff.

In response to a question from Senator Mathern, Mr. Lucy said the Department of Commerce may need to make some adjustments to its internal website in regard to how often a list of qualified businesses is updated for viewing by the public. He said any individual who wants to specifically inquire with the department regarding the status of a qualified business can call the department and receive the information right away. He said it was his opinion that the angel fund bill draft passed out at the previous meeting was a superior bill.

Senator Cook requested a representative from the Securities Department be available to provide comments at a future meeting date.

In response to a question from Representative Mitskog, Mr. Lucy said an angel fund is not permitted to use investment funds to invest in real estate. He said an issue has been brought to the Department of Commerce's attention regarding investments by a particular angel fund. He said the department has sent inquires to the fund and also is working with the Tax Department and the Attorney General's office to follow up on the issue.

Representative Nathe said he received an email from a concerned citizen regarding an angel fund investing in real estate for purposes of receiving the credit, which is not allowed under statute. He said the information (Appendix D) provided to the committee members consists of printouts of information obtained from the angel fund's website which clearly describes investing in real estate and also advertises the ability for an investor to allow funds to remain in the angel fund without being further invested. He said this issue illustrates the need for more transparency in angel fund reporting and requirements for investments to be made in primary sector businesses. He said not all angel funds are bad actors, but this information illustrates the flaws that exist in the current credit language.

Mr. Lucy said information in the materials provided by Representative Nathe noted that certain projects were primary sector businesses, but the Department of Commerce has not certified the businesses listed in the materials as primary sector businesses.

In response to a question from Representative Nathe, Mr. Lucy said he is not aware of any restrictions preventing the use of angel funds for bridge financing or short-term debt financing.

Representative Nathe said this information helps to illustrate some of the loopholes in existing law. He said this is all the more reason to support the version of the angel fund bill draft passed out by the committee at the last meeting. He said he is not against the provision of credits for investments but wants to make sure legislators are doing right by the citizens of this state whose tax dollars are being used to fund these types of investment credits.

Representative Mitskog said this information seems to illustrate an example of a bad player. However, she said, the southern valley angel fund in her district has done great work, especially with ComDel Innovation for growing that company. She said she is hoping to clean up some issues within the credit, but the angel fund credit has merit.

Representative Dockter said the bill draft recommended by the committee at the previous meeting helps add to the restrictions that would apply to angel funds to prevent these types of abuses from occurring and ensure the state is receiving value from the availability of the incentive.

Representative Headland said the angel fund Representative Nathe referenced is blatantly taking advantage of several incentives and seems like an abuse of the credit program.

Senator Cook said it is questionable as to whether the angel fund at issue was fraudulently luring money away from investors using false information.

In response to a question from Representative Nathe, Mr. Rauschenberger said if it is determined the angel fund never met the requirements for certification, the Tax Department could seek recovery of the credits earned by the angel fund investor because the credits never should have been earned in the first place.

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

Mr. Tommy Kenville, Valley Angel Investment Fund, said all the angel fund chairs are volunteers. He said he can speak on behalf of about 12 funds that receive investment dollars and deploy those funds within 18 to 24 months. He said it would be preferable to require only that at least 50 percent of the capital be invested in a North Dakota affiliated company to allow angel funds to take advantage of a variety of investment opportunities. He said the flexibility to invest up to 50 percent of investment dollars is important for syndication purposes. He said a reduction in the amount of the credit to 35 percent is not bothersome. He said this version of the bill draft is preferable to the prior version and seems to be heading in the right direction. He provided a letter (Appendix E) from Mr. Chuck Hoge, Executive Director, North Dakota State University Research and Technology Park, which encouraged the committee to support continuation of the angel fund program, with modifications suggested by industry participants which allow for review and enforcement of current requirements.

Representative Nathe said the committee has expressed its distaste in allowing angel fund investments in business outside this state.

Mr. Dan Hodgson, Managing Director, Linn Grove Growth Funds, said he appeared before a previous interim Taxation Committee to encourage the committee to make changes to statute in areas in which it was apparent abuses were occurring. He thanked legislators for implementing changes to address the issues that were raised with real estate abuses.

In response to a question from Representative Koppelman, Mr. Hodgson said requiring 50 percent of angel fund investments be made in businesses in this state is not concerning.

In response to a question from Mr. Kenville, Chairman Dockter requested the Legislative Council staff work with representatives of the angel fund industry to prepare a bill draft containing language recommended by angel fund members.

Representative Nathe said he appreciated Mr. Kenville taking the time to come and speak to the committee and answer the hard questions.

Chairman Dockter called on Mr. Alan Anderson, Commissioner, Department of Commerce, for a presentation (Appendix F) regarding recertification of renaissance zones. He said Bismarck recently requested a 5-year extension of its renaissance zone, which was denied by the department due to lack of support from the Burleigh County Commission. He said the department has interpreted statutory requirements for "evidence of community support" for a renaissance zone to require, at a minimum, letters of support from the school district and county impacted by the zone. He said the department provided Bismarck an extension through July 31, 2017, to allow the Legislative Assembly to further address what constitutes "evidence of community support" for purposes of granting or extending a renaissance zone.

Senator Cook said it may be necessary to take a more comprehensive look at how tax increment financing districts and renaissance zones are approved.

Chairman Dockter called on Mr. Justin Dever, Co-Deputy Commissioner, Department of Commerce, for a presentation (Appendix G) regarding a return-on-investment analysis for the electrical generating facilities sales tax exemption, the telecommunications infrastructure sales tax exemption, and the manufacturing automation tax credit.

In response to a question from Representative Mooney, Mr. Dever said the acquisition of REMI software and consulting services would have assisted the committee in determining the impact of incentives.

Chairman Dockter called for comments from interested persons regarding the electrical generating facilities sales tax exemption, the telecommunications infrastructure sales tax exemption, and the manufacturing automation tax credit.

Ms. Ellen Huber, Director, Business Development and Communications, City of Mandan, and Vice President, Economic Development Association of North Dakota, provided testimony (Appendix H) encouraging the committee to recommend the extension of credits that will sunset in 2017, including the electrical generating facilities sales tax exemption, the telecommunications infrastructure sales tax exemption, and the manufacturing automation tax credit. She said an example of a success story is the use of the automation tax credit by Cloverdale Foods.

Mr. Mark Vaux, Executive Vice President, Greater Fargo/Moorhead Economic Development Corporation, said he supports extending the sunset clause on the automation tax credit and elevating the level of the tax credit to the previously available $2 million cap. He said the automation tax credit continues to add value to value-added agriculture.

Chairman Dockter requested the Legislative Council staff to prepare bill drafts to eliminate the sunset clause date on the automation tax credit and the telecommunications infrastructure sales tax exemption.

Chairman Dockter called on the Legislative Council staff for presentation of a bill draft [17.0111.01000] relating to the preparation of dynamic fiscal notes. She said the bill draft was modeled after the Texas law that was reviewed by the committee at a prior meeting. She said the bill also contains provisions for a 5-year lookback period to gauge the accuracy of the dynamic fiscal note originally prepared for a bill draft.

Senator Cook said the committee's most important task is finding money in the budget to move forward with the purchase of REMI software. He said a short-term purchase of REMI software should be made for use in evaluating economic development incentives in the following interim and the agency in which the software would be best placed is with the Legislative Council. He said if the software proves to be beneficial over the course of the trial period, the Legislative Assembly could consider purchasing the software long term for more expanded uses during the legislative session.

In response to a question from Senator Cook, the Legislative Council staff said the cost of acquiring REMI software in year one would be $136,000 and would be $28,500 for each year thereafter.

Chairman Dockter requested the Legislative Council staff to prepare a bill draft to direct the acquisition of dynamic fiscal impact software for purposes of studying economic development tax incentives.

No further business appearing, Chairman Dockter adjourned the meeting at 3:35 p.m.

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Emily L. Thompson
Counsel

ATTACH:7