



North Dakota Legislative Council

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ECONOMIC DEVELOPMENT TAX INCENTIVE STUDY - RENAISSANCE ZONE TAX CREDITS AND EXEMPTIONS

Pursuant to North Dakota Century Code Section 54-35-26, created by Senate Bill No. 2057 (2015), a variety of economic development tax incentives are to be reviewed by a Legislative Management interim committee during each 6-year review period. The purpose of the review is to ensure economic development tax incentives are serving their intended purposes in a cost-effective and equitable manner. This memorandum is provided to assist in the review of renaissance zone tax credits and exemptions and provides an explanation of the incentives, the perceived goals of the Legislative Assembly in creating or altering the incentives, and the data and testimony that will be required to conduct an effective analysis of the incentives.

EXPLANATION OF RENAISSANCE ZONE TAX CREDITS AND EXEMPTIONS

Pursuant to Chapter 40-63, any incorporated city may apply to the Department of Commerce's Division of Community Services to designate a portion of the city as a renaissance zone. The application must specify the proposed duration of the zone, which may not exceed 15 years, include a resolution from the governing body of the city stating persons and property within the zone will be exempt from taxes pursuant to Sections 40-63-04 through 40-63-07 if the renaissance zone designation is granted, and include a development plan consisting of:

- A map of the proposed zone, which identifies geographic boundaries and blocks, a description of the properties and structures on each block, a listing of the properties and structures to be targeted for potential zone projects, and the present use and condition of those properties and structures;
- A description of the existing physical assets in the zone, particularly natural or historical assets, and a plan for incorporating or enhancing those assets;
- An outline of the goals, objectives, and proposed outcomes for the zone to be used to gauge the success of the completed zone;
- A description of the promotion, development, and management strategies that will be used to maximize investment in the zone;
- A plan for the development, promotion, and use of a renaissance fund organization or, if the city is not ready to commit to establishing a renaissance fund organization, a statement indicating the city's desire to submit a plan for approval of a renaissance fund organization at a later date; and
- Evidence of community support and commitment from residential and business interests, which must include letters of support from the governing bodies of each county and school district that contain property located within the boundaries of the proposed zone.

The proposed zone must be located wholly within the boundaries of the city submitting the application, contain both residential and commercial property, and not be in excess of 34 square blocks unless the population of the city exceeds 5,000. If the population of a city exceeds 5,000, a zone may be expanded at a rate of one additional block for each additional 5,000 in population, not to exceed a maximum size of 49 blocks. The proposed zone must have a continuous boundary and all blocks must be contiguous, except a proposed zone may have up to two exceptions to the continuous boundary and contiguous block requirement if the areas excepted do not exceed three square blocks each. A city may not propose or be part of more than one renaissance zone.

An approved zone may be extended or modified in various ways before its expiration date. If the approved zone is less than the maximum allowable size, a city may apply to the Division of Community Services to expand the zone. The blocks in an approved expansion are eligible for up to 15 years of zone status. A city also may apply to have blocks within a zone, which have either achieved the desired goals or not progressed, removed from the zone and replaced with alternative blocks contiguous to the original zone. Upon approval by the Division of Community Services, the initial 15-year duration of a zone also may be extended in increments of up to 10 years. If a zone expires, a city may reapply for a subsequent zone in the same manner an original zone is formed or for renewal of the formerly expired zone in the current manner a renewal extension is granted by state law.

The primary incentives for property owners or purchasers of renaissance zone property are income and property tax incentives. Section 40-63-04 provides income tax exemptions to individuals who purchase or rehabilitate single-family residential property for the individual's primary residence as a zone project. The amount of the exemption is up to \$10,000 of personal income tax liability for up to 8 taxable years beginning with the date rehabilitation is completed or the property is occupied. An exemption also is available for a taxpayer that purchases, leases, rehabilitates, or makes leasehold improvements to residential, public utility infrastructure, or commercial property for any business or investment purpose as a zone project. The amount of the exemption is equal to the income derived from all of a taxpayer's business or investment interests within the zone, up to a maximum amount of \$500,000 per taxable year for up to 8 taxable years beginning with the date of purchase, lease, or completion of rehabilitation. For projects that take the form of an expansion of an existing building, the amount of the exemption is equal to the income derived from the business or from the investment use of the building during the taxable year multiplied by a ratio equal to the square footage added by the expansion divided by the total square footage of the building after expansion. In lieu of the exemption on income derived from a taxpayer's business or investment locations, a taxpayer may elect to receive an income tax credit of \$2,000 per year for up to 8 taxable years if the cost of the new business purchase, leasehold improvement, or existing business expansion exceeded \$75,000 and the business is in a city with a population of 2,500 or fewer.

A property owner that is not participating in a renaissance zone project may be entitled to a tax incentive under Section 40-63-04 in the form of a credit against income tax liability if the owner is required to make changes in utility services or building structure due to changes made to property that is part of a zone project. The amount of the credit is equal to the total amount of the investment necessary to complete the changes and must be claimed in the taxable year in which the changes were completed. Any credit amount exceeding a taxpayer's liability may be carried forward for up to 5 taxable years. Investment in or ownership or lease of a parcel of property may qualify for the income tax credit more than once. If the property is transferred during the taxable years of credit eligibility, the credit transfers to a qualified user and must be prorated for the use of the property in respect to the year in which the transfer is made.

An income tax credit is available pursuant to Section 40-63-06 for investments in the historic preservation or renovation of property within a renaissance zone. The amount of the credit is equal to 25 percent of the amount invested, up to a maximum amount of \$250,000. The credit must be claimed in the year the preservation or renovation work is completed and any credit amount exceeding a taxpayer's liability may be carried forward for up to 5 taxable years.

Renaissance fund organizations and taxpayers investing in renaissance fund organizations also may qualify for income tax exemptions and credits pursuant to Section 40-63-07. A city with a designated renaissance zone may establish a renaissance fund organization to raise funds to finance zone projects. Financing may take the form of equity investments, loans, guarantees, and commitments for financing. A renaissance fund organization is exempt from income tax liability and the exemption may be passed through to any shareholder, partner, and owner if the organization is a passthrough entity. A taxpayer also may receive a credit against individual or corporate income tax liability for investments made in a renaissance fund organization. The amount of the credit is equal to 50 percent of the amount invested in the fund during the taxable year. Any credit amount exceeding a taxpayer's liability may be carried forward for up to 5 taxable years following the taxable year in which the investment was made. The

aggregate amount of credits allowed for investments in renaissance fund organizations by all taxpayers may not exceed \$10.5 million over any combination of taxable years. If an investment in a renaissance fund organization, which is the basis for a credit, is redeemed by the investor within 10 years from the date it is purchased, the credit must be disallowed and any credit amount previously claimed must be repaid.

In addition to income tax benefits, property tax incentives also are available within a renaissance zone. A city may grant a partial or complete property tax exemption for up to 8 taxable years after the purchase or completion of rehabilitation of renaissance zone property. A city may grant an exemption on single-family residential property, exclusive of land, if the property was purchased or rehabilitated by an individual for the individual's primary place of residence as a zone project. A city also may grant an exemption on buildings, structures, fixtures, and improvements purchased or rehabilitated as a zone project for a business or investment purpose. The State Board of Equalization may grant a partial or complete property tax exemption for up to 8 taxable years, following the date of rehabilitation, on public utility infrastructure rehabilitated as a zone project. A parcel of property within a renaissance zone may be exempted from property tax more than once. However, if ownership of the parcel transfers during the taxable years of eligibility for the exemption, the exemption transfers along with the transfer of the property to a qualifying user. A parcel of property which previously received the property tax exemption may not be eligible for a subsequent property tax exemption until 30 years have lapsed from the completion date of the most recent project on the property.

Taxpayers eligible for a property or income tax incentive under Chapter 40-63 for zone projects that are incomplete immediately preceding the expiration of the renaissance zone designation in the area in which the zone project is located may continue to receive the incentive for the period during which the taxpayer was originally eligible to receive the incentive. A zone designation is considered expired when the proposed duration of the zone and any subsequently granted extensions have lapsed.

A taxpayer may not be delinquent in the payment of any state or local tax liability in order to be eligible to claim a credit or exemption under Chapter 40-63. Additionally, the use of grant funds as the sole source of investment in the purchase of a building or space in a building does not qualify a taxpayer for any tax exemption or credit available under the chapter, and grant funds may not be counted in determining if the cost of rehabilitation meets or exceeds the current true and full value of the building.

If renaissance zone property is included in a tax increment financing district, the city in which the property is located shall provide the Department of Commerce an annual report identifying the property, the expected duration the property will be included in a renaissance zone and tax increment financing district, and the property and income tax benefits of the property and expected duration of those benefits. The Department of Commerce shall provide an annual report on renaissance zone property included in a tax increment financing district to the Legislative Management interim committee on taxation issues or upon the request of any other Legislative Management interim committee.

PERCEIVED GOALS OF THE LEGISLATIVE ASSEMBLY IN CREATING OR ALTERING RENAISSANCE ZONE TAX CREDITS AND EXEMPTIONS

Provisions of Chapter 40-63 were first enacted through the passage of House Bill No. 1492 (1999). The bill authorized the governing body of a city to apply to the Office of Intergovernmental Assistance to designate a portion of that city as a renaissance zone. The bill allowed income and property tax exemptions for single-family residential property purchased in a renaissance zone and property purchased or leased for business or investment purposes. The bill also allowed an income tax credit for investment in the historic preservation or renovation of renaissance zone property and investment in a renaissance fund corporation. Upon a review of the legislative history relating to the bill, the perceived goal of the Legislative Assembly in creating renaissance zone credits and exemptions was to provide incentives to encourage the rejuvenation of inner cities. The estimated fiscal effect of renaissance zone credits and exemptions could not be determined during the 1999 legislative session.

The first amendments to Chapter 40-63 were made during the 2001 legislative session through the passage of Senate Bill No. 2033 and House Bill Nos. 1049 and 1460. House Bill No. 1049 changed multiple references to "the office of intergovernmental assistance" to "the division of community services." Senate Bill No. 2033 authorized a city to apply to the Division of Community Services at any time during the duration of a zone to expand a previously approved renaissance zone to up to 20 square blocks. The bill provided that the use of grant funds as the sole source of investment in the purchase of a building or space in a building would not qualify a taxpayer for a renaissance zone tax exemption or credit, and grant funds could not be counted in determining if the cost of rehabilitation met or exceeded the current true and full value of a building. The bill also authorized a city to request the Division of Community Services remove a portion of an approved renaissance zone that is not progressing after 5 years and make a one-time adjustment of the boundaries to add another equal, contiguous area to the original zone. The bill allowed an income and property tax exemption for a taxpayer who rehabilitated residential or commercial property as a zone project. The bill provided that if the cost to purchase a new business, or expand an existing business, exceeded \$75,000, and the business was located in a city with a population of not more than 2,500, an individual taxpayer could elect to take an income tax exemption of up to \$2,000 of personal income tax liability in lieu of the exemption on income derived from the business. The bill removed the December 31, 2004, expiration date for the historic preservation and renovation tax credit and reduced the credit from 50 percent of the amount invested to 25 percent of the amount invested, up to a maximum of \$250,000. The bill provided that a taxpayer could not be delinquent in payment of state or local tax liability to be eligible for a tax benefit provided in Chapter 40-63.

House Bill No. 1460 (2001) provided that once the initial aggregate limit of \$2.5 million in renaissance zone tax credits had been exhausted, an additional \$1 million in credits is available for investments in renaissance fund organizations for taxable years beginning after December 31, 2000, for investments permitted under the renaissance zone law if more than 65 percent of the organization's net investments received have been invested as permitted under the renaissance zone law or the organization is established after the exhaustion of the initial limit. In addition, upon exhaustion of the initial limit, an additional \$1.5 million in credits is available for investments in renaissance zone fund organizations for taxable years beginning after December 31, 2002, for investments under the renaissance zone law if more than 65 percent of the qualifying organization's net investments received have been invested as allowed under the renaissance zone law or the organization is established after the exhaustion of the initial limit. The bill also required a renaissance fund organization to secure an annual audit of its financial records, prepared by an independent certified public accounting firm.

Additional changes were made by House Bill No. 1457 (2003) and Senate Bill No. 2259 (2003). House Bill No. 1457 authorized a city with a population over 5,000 to expand a renaissance zone beyond the 20 square block maximum up to a new maximum of 35 blocks at the rate of one additional block for each additional 5,000 in population. Senate Bill No. 2259 authorized a renaissance fund organization to provide financing to businesses outside a renaissance zone. The bill increased to \$2.5 million the amount of tax credits available for investments in renaissance fund organizations and provided that a renaissance fund organization that had received investments qualifying for additional credits could not use more than 50 percent for organization investments outside a renaissance zone. The bill also provided for additional audit reporting requirements and removed provisions that restricted a renaissance fund organization from accepting new investments if the renaissance fund organization failed to invest a specified portion of previously received investments.

House Bill No. 1225 (2007) increased the maximum allowable area of a proposed renaissance zone from 20 to 23 blocks in a city with a population of 5,000 or fewer and from 35 to 38 blocks in a city with a population of greater than 5,000. The bill also allowed a single exception to the requirement that a zone consist of a continuous boundary and contiguous blocks if the excepted area did not exceed three-square blocks and the shortest distance between the boundaries of the two portions of the zone did not exceed one-half mile.

Provisions of Chapter 40-63 also were modified during the 2009 legislative session by Senate Bill No. 2060 and House Bill Nos. 1324 and 1428. Senate Bill No. 2060 expanded renaissance zone

provisions to include tax incentives for the purchase, lease, or repair of public utility infrastructure and for leasehold improvements to property. The bill allowed a property owner that is not participating in a renaissance zone project to claim state income tax credits equal to the amount invested by the property owner to complete required changes in utility services or building structure due to the property's inclusion as a zone project. The bill also allowed the State Board of Equalization to grant a full or partial property tax exemption on public utility infrastructure rehabilitated as a zone project. House Bill No. 1428 provided that if a city finds that renaissance zone projects have satisfactorily completed one or more blocks within the renaissance zone, a city may request the Department of Commerce withdraw those blocks from the renaissance zone and replace them with other blocks. The bill allowed the Department of Commerce to approve a city's request to extend the duration of renaissance zone status in increments up to 5 years. The bill also increased the total amount of income tax credits allowed for investments by all taxpayers in renaissance fund organizations to \$7.5 million. The final change made in House Bill No. 1324 (2009), removed a statutory reference to the optional long-form income tax return, which was eliminated.

The chapter was further amended in 2011 by House Bill No. 1102 and Senate Bill Nos. 2048 and 2218. House Bill No. 1102 required a taxpayer electing to receive an income tax credit in lieu of an income tax exemption for purchasing, leasing, rehabilitating, or improving renaissance zone property for a business or investment purpose to make the election on the taxpayer's return rather than the taxpayer's zone project application. Senate Bill No. 2048 required a city with a renaissance zone to file an annual report with the Department of Commerce identifying property within the zone that also is included in a tax increment financing district. The report must identify the property, provide the expected duration of inclusion of the property in the tax increment financing district and the renaissance zone, identify any property and income tax benefits of the property, and identify the expected duration of those benefits. The bill also required the Department of Commerce to deliver an annual report compiling the information to a Legislative Management interim committee on taxation issues or upon the request of any other Legislative Management interim committee.

Senate Bill No. 2218 (2011) allowed the officers and employees of a renaissance fund organization to be actively involved in the enterprises in which the renaissance fund organization invests, but prohibited the renaissance fund organization from investing in any enterprise if any one renaissance fund organization officer or employee owned more than 49 percent of the ownership interest in the enterprise. The bill also prohibited a renaissance fund organization from investing in an enterprise if the officers and employees of a renaissance fund organization collectively owned more than 49 percent of the ownership interests, either through direct ownership or through ownership of interest in a passthrough entity. The bill allowed a renaissance fund organization to finance projects other than zone projects if the projects were located within designated renaissance zones. The bill increased the total amount of income tax credits allowed for investments in renaissance fund organizations from \$7.5 million to \$8.5 million. The bill also required a renaissance fund organization that received investments qualifying for income tax credits to use the investments to finance projects within a renaissance zone.

House Bill No. 1166 (2013) limited the maximum amount of income a taxpayer could exempt from tax under the business or investment exemption for the purchase, lease, or rehabilitation of property within a renaissance zone to \$500,000 in a taxable year. The bill also provided if a zone project consisted of a physical expansion of an existing building owned and used by the taxpayer for business or investment purposes, the amount of income exempt from tax was limited to an amount equal to the income derived from the business, or from the investment use of the building, during the taxable year multiplied by a ratio equal to the square footage added by the expansion divided by the total square footage of the building after expansion.

Senate Bill No. 2329 (2015) increased the maximum allowable size of a renaissance zone to not more than 34 square blocks, except in a city with a population of greater than 5,000, in which case the zone may exceed 34 square blocks at a rate of one additional block per additional 5,000 population for a maximum size of 49 square blocks. The bill also increased the total amount of credits allowed for investments in renaissance fund organizations to \$10.5 million. Senate Bill No. 2166 (2017) required a development plan submitted by a city to include letters of support from the governing bodies of each

county and school district that contain property located within the boundaries of the proposed renaissance zone for development plans submitted after July 31, 2017.

Chapter 40-63 was most recently amended in 2023 by House Bill No. 1266 and Senate Bill No. 2391. House Bill No. 1266 allowed a city with an expired renaissance zone to apply to renew the expired renaissance zone or apply for the creation of a subsequent renaissance zone. The bill clarified a renaissance zone is not deemed expired until all subsequently granted extensions for the zone have lapsed. The bill also clarified a taxpayer eligible for property or income tax incentives for a zone project in a renaissance zone that has expired may continue to receive the incentives for the original period of eligibility.

Senate Bill No. 2391 (2023) expanded the definition of "rehabilitation" for purposes of qualifying for a property or income tax incentive under the renaissance zone program. The bill provided the term rehabilitation means repair or remodeling at a cost equal to or exceeding:

- For an income tax or property tax exemption which exceeds 5 taxable years, 75 percent of the current true and full value for residential property, excluding owner-occupied single-family residential property, or commercial property for a business or investment purpose.
- For an income tax or property tax exemption of 5 taxable years or less, 50 percent of the current true and full value for residential property, excluding owner-occupied single-family residential property, or commercial property for a business or investment purpose.
- 50 percent of the current true and full value for public utility infrastructure.
- 20 percent of the current true and full value for owner-occupied single-family residential property.

Senate Bill No. 2391 (2023) also allowed cities to create up to two renaissance zones, increased the maximum duration of a zone extension from up to 5 years to up to 10 years, and allowed a parcel to receive a subsequent renaissance zone property tax exemption if at least 30 years have lapsed since the date the previous renaissance zone project was completed on the parcel. The bill extended the eligibility period for an income tax exemption for a zone project from 5 to 8 taxable years after the purchase, lease, or completion of rehabilitation and extended the eligibility period for a property tax exemption from 5 to 8 taxable years after the date of acquisition or completion of rehabilitation. The bill also prohibited a renaissance fund organization from making additional credits available for investment in the organization once the maximum allowance of \$10.5 million in credits had been claimed.

DATA AND TESTIMONY REQUIRED TO CONDUCT AN EFFECTIVE ANALYSIS OF RENAISSANCE ZONE TAX CREDITS AND EXEMPTIONS

To effectively analyze the incentive, the committee may wish to collect data pertaining to the following items:

1. The number of claimants;
2. The fiscal impact of the incentive;
3. Employment opportunities, business growth, or diversity in the state's economy resulting from the availability of the incentive;
4. Negative impacts created as a result of the incentive; and
5. Benefits that flow to out-of-state concerns resulting from the incentive.

The committee also may wish to solicit testimony from:

1. The Department of Commerce;
2. The Tax Department; and
3. The Economic Development Association of North Dakota.