TAXATION COMMITTEE

The Taxation Committee was assigned five studies for the 2017-18 interim:

- The Legislative Management directed a study of economic development tax incentives pursuant to North Dakota Century Code Section 54-35-26.
- Section 18 of Senate Bill No. 2206 (2017) directed a study of the property tax system, with emphasis on the feasibility and desirability of providing property tax reform and relief. The study required consideration of all property classifications and taxing districts, evaluation of historical fluctuations in property values, the transparency of the property tax system, the processes and procedures available to taxpayers to contest valuations and assessments, the manner in which property tax information is provided to taxpayers, the process for determining taxing district budgets, and taxpayer participation and input in the property tax system.
- Section 7 of Senate Bill No. 2166 (2017) directed a study of the duplicative application of property tax incentives. The study required consideration of the benefits received by properties located in both a tax increment financing (TIF) district and a renaissance zone, the duration for which a single property may benefit from the use of multiple property tax incentives, and the impacts of property tax incentives on the remainder of the property tax base that is not receiving incentives.
- Section 6 of Senate Bill No. 2166 (2017) directed a study of the manner in which city growth and infill development affects property taxes and an evaluation of the return on investment for state and community projects. The study required an examination of various policies affecting city development patterns, including the impact of transfer payments between state and local governments; the cost of government services and infrastructure, including future liability; the amount of tax revenue generated per increment of assumed liability for downtown areas; and whether certain areas of a city generate more revenue than expenses while other areas generate more expenses than revenue.
- Section 1 of Senate Bill No. 2230 (2017) directed a study of the feasibility and desirability of providing an income tax credit to individuals for premiums paid for hybrid long-term care partnership plan insurance coverage and the feasibility and desirability of incentivizing asset protection that may be equal to the amount paid out by the hybrid long-term care partnership plan.

The Legislative Management directed the committee to receive five reports:

- A compilation and summary of state grantor reports filed annually by the Department of Commerce and the reports of state agencies that award business incentives for the previous calendar year, pursuant to Section 54-60.1-07.
- An annual report from the Department of Commerce's Division of Community Services on renaissance zone progress, pursuant to Section 40-63-03(2).
- An annual report from the Department of Commerce compiling reports from cities that have renaissance zone property included in a TIF district, pursuant to Section 40-63-03(10).
- Reports from the Tax Commissioner from compiled reports from counties and school districts receiving allocations of oil and gas gross production tax revenues describing funds received, expended, and unexpended, pursuant to Section 57-51-15.
- A report from the Department of Human Services on the status of the state-paid economic assistance and social service pilot program and the development of a plan for permanent implementation, pursuant to Section 50-34-01.

Committee members were Senators Jessica Unruh (Chairman), Brad Bekkedahl, Dwight Cook, Jim Dotzenrod, Lonnie J. Laffen, and Scott Meyer and Representatives Thomas Beadle, Jason Dockter, Sebastian Ertelt, Jim Grueneich, Ron Guggisberg, Patrick Hatlestad, Craig Headland, Jim Kasper, Ben Koppelman, Alisa Mitskog, Emily O'Brien, Randy A. Schobinger, Vicky Steiner, and Nathan Toman.

The committee submitted this report to the Legislative Management at the biennial meeting of the Legislative Management in November 2018. The Legislative Management accepted the report for submission to the 66th Legislative Assembly.

ECONOMIC DEVELOPMENT TAX INCENTIVES STUDY

Background

Section 54-35-26, enacted through the passage of Senate Bill No. 2057 (2015), provides for the review of a specified list of economic development tax incentives and requires each incentive be reviewed at least once every 6 years. The Legislative Management selected the interim Taxation Committee to review tax incentives during the 2017-18 interim.

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

In 2012 The Pew Charitable Trusts (Pew) began tracking the progress states were making in evaluating tax incentives and published a report entitled *Evidence Counts: Evaluating State Tax Incentives for Jobs and Growth*. The report identified those states leading the way in evaluating the effectiveness of tax incentives, states meeting some of the criteria for effective evaluations, and states not meeting any criteria in terms of the scope or quantity of evaluations. Pew's 2017 report, entitled *How States Are Improving Tax Incentives for Jobs and Growth: A National Assessment of Evaluation Practices*, identifies 10 states leading the way in evaluating incentives, 18 states making progress, and 23 states trailing behind. The report describes the leading states as having well-designed plans for regular reviews, experience in producing quality evaluations that measure economic impacts, and a process for applying the results of evaluations to inform policy decisions. North Dakota is identified as a state making progress in evaluating incentives.

Tax Incentive Evaluation Law

Section 54-35-26 directs a review of economic development tax incentives by an interim committee selected by the Legislative Management. The review entails an assessment of whether a specified list of 20 economic development tax incentives are serving the purposes for which the incentives were enacted in a cost-effective and equitable manner. The statute requires each incentive be reviewed at least once every 6 years and lists the following eight items a committee may consider when evaluating incentives:

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

Interim Committee Review of Incentives

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

This committee was selected to conduct the second round of incentive evaluations during the interim, and selected seven incentives to review from the list provided in Section 54-35-26. The committee selected the new jobs credit from income tax withholding, the internship program credit, the workforce recruitment credit, the research expense tax credit, new or expanding business exemptions, renaissance zone tax credits and exemptions, and development or renewal area incentives including TIF incentives. Development or renewal area incentives were added to the list of incentives in Section 54-35-26 by Senate Bill No. 2166 (2017). The interim committee selected by the Legislative Management during the 2019-20 interim is required to complete a review of the remaining incentives listed in Section 54-35-26 before the end of the first 6-year review cycle.

The committee received background information for each of the selected incentives which provided an explanation of the incentive, the perceived intent of the Legislative Assembly in creating or altering each incentive, and the data and testimony required to effectively review each incentive. The committee received information from representatives of the Tax Department and the Department of Commerce regarding the number of claimants and amounts claimed for each incentive and information regarding any complimentary or duplicative incentives to those selected for review. The Bank of North Dakota provided a dynamic revenue analysis for the new jobs credit from income tax withholding, the research expense tax credit, new or expanding business exemptions, and renaissance zone tax credits and exemptions. The committee also solicited testimony from interested parties regarding the use of the incentives selected for study.

New Jobs Credit from Income Tax Withholding

Explanation of the Credit

Chapter 52-02.1 allows an employer engaged in a primary sector business to enter an agreement with Job Service North Dakota for the establishment of training and education programs directed at new jobs within the employer's business. The agreement must specify the date the program will commence, identify program costs, and provide a guarantee by the employer for payment of program costs and an assurance that any deferral of payment will not exceed 10 years from the date the program commences. The agreement also must provide an assurance that every employee participating in the program will be paid at least $10 per hour, plus benefits, by the end of the 1st year of employment and for the life of the loan; list the maximum amount of the credit from withholding or tuition and fee payments allowed for the project; and specify on-the-job training costs for employees may not exceed 50 percent of the annual gross wages and salaries for the new jobs in the 1st full year following the date the project commences. If program costs require financing, the loan or grant must be secured and payable from a sufficient portion of future receipts of payments authorized by the agreement. Job Service North Dakota may not enter an agreement until an employer requiring financing has sufficiently qualified for financing.

Once the agreement is executed, Job Service North Dakota notifies the Tax Commissioner who is required to credit the income tax withholding on wages paid by the employer to each new employee participating in the program. An amount equivalent to the credited amount must be transmitted to the State Treasurer for allocation to a special fund from which payments are made to the lender that provided the program loan or to the employer if the program costs were self-funded. When the program costs have been satisfied, the employer's credits must cease. A new employee participating in a program receives full credit for the amount withheld while the cost of the program is being reimbursed.

Perceived Goals in Creating or Altering the Credit

Provisions of the new jobs credit from income tax withholding were enacted through the passage of House Bill No. 1518 (1993). The perceived goal of the Legislative Assembly in creating the credit was to encourage community economic development by incentivizing businesses to locate to or expand within North Dakota by providing government-assisted new jobs training. The credit was viewed as a way to reward employers for training workers for new, skilled, and higher paying jobs and as a way for North Dakota to compete with other states for new businesses. The credit was amended in 1999 to add a reimbursement option for employers that self-financed training costs, and in 2017 to add a uniform definition of "primary sector business" to include a definition of "new wealth."

Testimony and Committee Considerations

The committee received information from a representative of the Tax Department indicating $1,470,239 in withholding collections was allocated to the new jobs credit program in fiscal year 2016 and $1,574,425 was allocated in fiscal year 2017. The committee received an evaluation of the credit from a representative of the Bank of North Dakota, using REMI software, which indicated the incentive created almost 16,000 full-time jobs from 1999 through 2013 and 630 new jobs from 2014 to 2015. Wages for new employees grew an average of 87 percent over 10 years and the incentive increased the state's population by 26,000. The evaluation noted the incentive's use over a 20-year period beginning in 1996 and ending in 2016 cost the state $7.6 billion in direct and indirect costs but generated $8.6 billion in revenues. State expenditures related to the program primarily relate to the costs needed to maintain an increased population.

The committee received testimony in favor of retaining the credit from representatives of the Economic Development Association of North Dakota. According to the testimony, 350 companies have used the new jobs credit program since 2005. Nearly 100 agreements are in place under the new jobs credit program and 4,332 of the 5,800 new jobs created as a result of these agreements have been filled. The committee did not receive any testimony in opposition to retaining the credit.

Conclusions

The committee makes no recommendation regarding the new jobs credit from income tax withholding.

Internship Program Credit

Explanation of the Credit

Section 57-38-01.24 provides for an internship program income tax credit. The credit is available to income taxpayers that are employers in this state and have a qualifying internship program. A qualifying internship program must be located in this state and requires the taxpayer to supervise and evaluate an intern enrolled in an institution of higher education or in a vocational technical education program in North Dakota and who is seeking a degree or certification in a field closely related to the work being undertaken during the internship. The internship also must provide academic credit or count toward the completion of a vocational technical education program being pursued by the intern. The amount of the credit is equal to 10 percent of the stipend or salary paid to an intern employed by the taxpayer. A taxpayer may claim no more than $3,000 in credits over any combination of taxable years and may claim a credit for up to five interns employed at the same time. A passthrough entity entitled to the credit must be considered the taxpayer for purposes of the credit and the amount of credit allowed must be determined at the passthrough entity level and passed through to the entity's partners, shareholders, or members in proportion to their respective ownership interests in the passthrough entity.

Perceived Goals in Creating or Altering the Credit

The internship program credit was enacted with the passage of House Bill No. 1018 (2007). The perceived goal of the Legislative Assembly in creating the credit was to encourage businesses to establish internship programs that potentially could lead to the retention of more North Dakota college graduates in the North Dakota workforce. The only changes made to the credit following its enactment were technical in nature and related to the elimination of the optional long form filing method, in 2009, and the streamlining of the description of a passthrough entity, in 2013.

Testimony and Committee Considerations

The committee received information from a representative of the Tax Department indicating less than $50,000 in internship program credits were claimed from 2011 to 2016, excluding years in which there were fewer than five claimants. The committee also received information regarding the department's efforts to publicize the availability of the credit, which included mailing information pamphlets to local economic developers. The committee considered a bill draft that would have repealed the internship program credit in hopes of eliciting testimony from parties that wished to retain the credit. Representatives from the Economic Development Association of North Dakota testified in support of eliminating the credit. The committee did not request an evaluation of the credit using REMI software due to the minimal use of the credit.

The committee received information from a representative of the Department of Commerce regarding other state-administered programs that may have complimentary or duplicative effects to the internship program credit. The committee received information regarding the operation intern program, which is a state-funded program that provides up to $3,000 in matching funds per student, per term, to meet various costs including reimbursing salaries and wages. The Legislative Assembly awarded $1.5 million in funding to the program for the 2013-15 biennium and $950,000 in funding for the 2017-19 biennium, and the program has matched over 2,200 interns with over 600 businesses since its inception. The committee also received information regarding internship and apprenticeship requirements and opportunities at the university level and learned various programs are offered in conjunction with the community of Grand Forks, economic development corporations, and the Energy and Environmental Research Center.

Conclusions

The committee did not recommend the elimination of the internship program credit. The committee acknowledged while the credit has not been used widely in the past, it may be used in the future considering the state's increasing workforce needs.

Workforce Recruitment Credit

Explanation of the Credit

Section 57-38-01.25 provides for a workforce recruitment credit. The income tax credit is available to income taxpayers that are employers in this state and have incurred costs to recruit and hire employees for hard-to-fill employment positions in North Dakota. The credit is equal to 5 percent of the first 12 months of salary paid by the employer to an employee hired to fill a hard-to-fill position for which the annual salary meets or exceeds the state average wage. For purposes of the workforce recruitment credit, the state average wage is equal to 125 percent of the state average wage amount published by Job Service North Dakota at the time the employee is hired.

The credit may be claimed in the tax year following the employee's completion of the first 12 consecutive months of employment. The amount of credit exceeding a taxpayer's liability may be carried forward to each of the 4 succeeding taxable years. A "hard-to-fill employment position" is defined as a position that requires an employer to use extraordinary recruitment methods and a position an employer has been unsuccessful in filling for 6 consecutive months. An employer must use a fee-based recruiter, advertise the position in a publication directed at a particular profession and on a fee-based employment website, and pay a signing bonus, moving expenses, or nontypical fringe benefits to meet the requirement of having used extraordinary recruitment methods.

Perceived Goals in Creating or Altering the Credit

The workforce recruitment credit was created with the passage of House Bill No. 1018 (2007). The perceived goal of the Legislative Assembly in creating the credit was to address the shortage of workers in North Dakota and incentivize employers in this state to use extraordinary recruitment methods to fill high-paying, hard-to-fill positions. The credit was seen as a tool to help stimulate an influx of workers into the state and promote increased business and economic development. The only changes made to the credit following its enactment were technical in nature and related to the elimination of the optional long form filing method, in 2009, and the streamlining of the description of a passthrough entity, in 2013.

Testimony and Committee Considerations

The committee received information from a representative of the Tax Department indicating less than $13,000 in workforce recruitment credits were claimed from 2007 to 2016, excluding years in which there were fewer than five claimants. The committee also received information regarding the department's efforts to publicize the availability of the credit, which included mailing information pamphlets to local economic developers. The committee did not request an evaluation of the credit using REMI software due to the minimal use of the credit. The committee considered a bill draft that would have repealed the workforce recruitment credit in hopes of eliciting testimony from parties that wished to retain the credit. Representatives from the Economic Development Association of North Dakota testified in support of eliminating the credit.

Conclusions

The committee did not recommend the elimination of the workforce recruitment credit. The committee acknowledged while the credit has not been used widely in the past, it may be used in the future considering the state's increasing workforce needs.

Alternative Approaches to Addressing the State's Workforce Needs

The review of the internship program credit and the workforce recruitment credit prompted discussion of the state's broader workforce needs. The committee sought testimony from agencies with expertise in areas concerning workforce and economic development, including the Department of Labor and Human Rights and the Economic Development Association of North Dakota, regarding recommendations for a more effective approach to addressing the state’s workforce needs in light of the low volume of taxpayers using the existing credit programs.

The committee received testimony from a representative of the Department of Labor and Human Rights regarding the Workforce Development Council's efforts to address the state's workforce needs. According to the testimony, the state has a 2.9 percent unemployment rate, compared to a 3.9 percent rate nationally, and has over 14,000 unfilled jobs. The testimony indicated the Workforce Development Council has been working to collect data, evidence, and stakeholder input to help understand the state's current and future workforce needs. The Workforce Development Council indicated it would provide recommendations before the 2019 legislative session.

The committee received testimony from representatives of the Economic Development Association of North Dakota regarding the association's recommendations for a more effective approach to addressing the state's workforce needs. The association recommended a talent attraction and retention scholarship program and a 21st century manufacturing automation tax credit. The committee considered a bill draft containing both incentives, which was later revised to split the two incentives into separate bill drafts. The committee reviewed two versions of the scholarship incentive.

The committee considered a bill draft that would have created a North Dakota talent attraction and retention scholarship program, administered by the Bank of North Dakota in conjunction with the North Dakota University System. The scholarship would have been offered in the form of a forgivable loan and would have required an individual receiving the scholarship to work in the state for 3 years following graduation. An individual would have been able to qualify for up to $8,500 per year for 2 years and the program would have required a dollar-for-dollar, public-private match.

The committee considered an alternative version of the bill which provides a skilled workforce scholarship program that more closely mirrors South Dakota's Build Dakota Scholarship Program. The skilled workforce scholarship program created by the bill would be administered by the Bank of North Dakota in conjunction with the University System and the Workforce Education Advisory Council for the purpose of attracting and retaining students in high-demand workforce areas. The bill requires the University System and the Workforce Education Advisory Council to publish a list of qualifying programs by August 1 of each year. The program, which would be funded with up to $10 million from the Bank of North Dakota, requires a dollar-for-dollar private match. Scholarships would be provided for designated educational programs that can be completed within 2 years. Scholarship funds would be paid directly to the institution administering the educational program and cover tuition, fees, books, and supplies required to complete the program. The bill would require a scholarship recipient to maintain a 2.5 grade point average and remain and work in the state for 3 years following the receipt of the recipient's degree or certificate. An individual who fails to meet these requirements would be subject to the repayment provisions specified in the individual's scholarship award agreement.

Committee members expressed concerns regarding offering a scholarship program that does not have need-based requirements and apprehension the program would become an entitlement over time. The committee acknowledged the state's workforce needs but questioned whether there is an alternative way to encourage students to pursue high-demand trades without paying a student's costs upfront. Other committee members noted loan forgiveness programs are less effective at enticing students than grant programs that pay a student's costs upfront. Committee members raised concerns regarding incentives offered by surrounding states to encourage students to pursue high-need degree fields and noted this state needs to remain competitive or risk losing North Dakota graduates to educational institutions in other states.

Committee members reviewed a bill to create a 21st century manufacturing workforce incentive. The bill provides a slight rework of the income tax credit that expired in 2017 for automating a manufacturing process. The bill provides an income tax credit equal to 20 percent of the amount expended to purchase manufacturing machinery and equipment to automate a manufacturing process to improve productivity or increase job quality. The credit contains reporting requirements and credit clawback provisions that allow the Tax Department to recoup the credits awarded if a claimant fails to meet required increased productivity or job quality thresholds. The credit amount that may be awarded among all claimants would be limited to $2 million per year. The committee was informed manufacturers had emphasized the importance of the credit in light of the state's inadequate workforce.

Recommendations

The committee recommends Senate Bill No. 2039 to create a skilled workforce scholarship program.

The committee recommends House Bill No. 1040 to create a 21st century manufacturing workforce incentive.

Research Expense Tax Credit

Explanation of the Credit

Section 57-38-30.5 provides for a research expense tax credit. The incentive is available to all income taxpayers and allows for a credit against state income tax liability for expenditures related to conducting qualified research in this state. The amount of the credit is equal to a percentage of qualified research expenses which exceed a defined base amount. The definitions of "qualified research expenses" and "base amount," for purposes of Section 57-38-30.5, have the same meaning as provided in Section 41 of the Internal Revenue Code [26 U.S.C. 41]; however, any expenses incurred for research conducted outside North Dakota are excluded. The credit is equal to 25 percent of the first $100,000 in qualified expenses which exceeds the base amount and a varying percentage of any amounts exceeding the first $100,000. The percentage credit allowed on amounts exceeding the first $100,000 in excess qualified expenses varies based on the year in which a taxpayer first began conducting qualified research in this state.

For qualified research in North Dakota which began before 2007, the percentage credit allowed on amounts exceeding the first $100,000 in excess qualified expenses is 7.5 percent for tax year 2007, 11 percent for tax year 2008, 14.5 percent for tax year 2009, 18 percent for tax years 2010 through 2016, and 8 percent for tax year 2017 and any subsequent tax years. A taxpayer qualifying for the credit under these conditions is limited to claiming no more than $2 million in credits in any taxable year and may not apply the amount of any unused credits in any other taxable year.

For qualified research in North Dakota which began on or after January 1, 2007, and before January 1, 2011, the percentage credit allowed on amounts exceeding the first $100,000 in excess qualified expenses is equal to 20 percent for taxable years 2007 through 2016. For qualified research in North Dakota which began on or after January 1, 2011, the percentage credit allowed on amounts exceeding the first $100,000 in excess qualified expenses is 8 percent. The percentage of allowable credit on amounts exceeding the first $100,000 in excess qualified expenses also is 8 percent for any credits claimed in taxable years after 2016, regardless of when the taxpayer first began conducting qualified research in this state.

For a taxpayer that began conducting qualified research in this state on or after January 1, 2007, any credit amount exceeding a taxpayer's liability may be carried back to each of the 3 preceding taxable years or carried forward to each of the 15 succeeding taxable years. A taxpayer certified by the Department of Commerce as a primary sector business, with annual gross revenues of less than $750,000, which did not conduct qualifying research in this state until after December 31, 2006, may elect to sell, transfer, or assign up to $100,000 of unused credits to another taxpayer. The transferee must claim the credit in the year in which the purchase agreement is executed and may carry forward any unused credits to each of the 15 succeeding taxable years. The transferee may not carry unused credits back to prior tax years nor may the transferee sell, assign, or transfer the credit. The transferor must assign any gross proceeds received as a result of the credit transfer to North Dakota for purposes of taxation.

Perceived Goals in Creating or Altering the Credit

Section 57-38-30.5, which provides for a research expense tax credit, was created by the passage of House Bill No. 1645 (1987). As enacted, Section 57-38-30.5 provided for a corporate income tax credit equal to 8 percent of the first $1.5 million of North Dakota qualified research expenses in excess of base period research expenses, and 4 percent of any amount exceeding $1.5 million in excess research expenses. The 1987 legislation was patterned after a Minnesota law that had proved to be very successful for that state. The perceived goal of the Legislative Assembly in creating this credit was to encourage new and existing North Dakota corporations to undertake research and development. The credit was seen as a tool to help stimulate economic development. The credit was expanded to limited liability companies in 1993 and to passthrough entities and individuals in 2007. Legislation passed in 2007 also broadened the scope of the credit by allowing a taxpayer to sell, transfer, or assign up to $100,000 in unused credits. The goal of expanding the credit in 2007 was to attract new businesses to this state to conduct research activity and retain those businesses already present. Additional technical corrections pertaining to definitions and filing methods were made in 2009 and safeguards were added in 2013 to prevent references to federal definitions from becoming ineffective should the federal research tax credit be discontinued. The most recent change to the credit was made in 2017 to create a uniform definition for "primary sector business."

Testimony and Committee Considerations

The committee received information from a representative of the Tax Department regarding the number of claimants and the amounts claimed on individual and corporate income tax returns from 2007 to 2016. According to the testimony, approximately 1,800 taxpayers claimed the credit from 2007 to 2016. Individuals claimed over $4.5 million and corporations claimed over $500,000 for the research expense tax credit in the 2016 tax year. The committee received an evaluation of the credit from a representative of the Bank of North Dakota, using REMI software which indicated the credit added 1,100 jobs and 1,000 individuals to the state's population at its peak and which resulted in a medium-term positive economic and demographic impact for the state. It was noted jobs associated with the credit are concentrated mainly in the professional services industry and do not result in local displacement because research and development activities generally do not take business or money away from existing employers. The credit's impact on the state's gross domestic product is about $80 million per year and the state will receive about $213 million in revenue as a result of the credit over a 20-year period. The state will expend $66 million for the direct cost of the credit and $182 million in indirect costs as a result of maintaining an increased state population over the same 20-year period. The net result is the state having $30 million less than it would have had if the credit had not been provided. It was noted the credit is a net liability in terms of the state's budget but has a positive impact on the state's economy.

The committee received testimony in favor of retaining the credit from a representative of Basin Electric Power Cooperative. The testimony indicated the cooperative averaged 529 employees allocating work time to research and development activities from 2014 through 2016. The main research and development activities undertaken by the cooperative include the development of new methods and processes to comply with environmental regulations, new products, and safer ways to produce existing products. The cooperative has accumulated $10.3 million in credits, has carried forward $8.7 million in unused credits, and has had $1.6 million in credits expire. The cooperative was not able to use all the earned credits because the cooperative is a capital-intensive company with large depreciation deductions resulting in net operating losses. The testimony explained how the credit operates in other states and the committee received suggested ways North Dakota's credit could be enhanced. Suggested enhancements included allowing the credit to be applied against withholding or other taxes, increasing the carryforward period for unused credits, allowing a portion of the credits to be refunded, and improving the disclosure of information related to the credit. The committee did not receive testimony in opposition to retaining the credit.

Conclusions

The committee makes no recommendation regarding the research expense tax credit.

New or Expanding Business Exemptions

Explanation of the Exemptions

The primary economic development tool in Chapter 40-57.1 authorizes cities or counties to grant the operator of a new or expanding business a partial or complete property tax exemption or the option to make payments in lieu of taxes. Property tax exemption also may be granted for property owned by a local development organization for the purposes of attracting new industry to the state. For purposes of the exemption, a "project" must be a revenue-producing new or expanding primary sector business. A project also may include projects in the retail sector in cities or counties with a population of less than 40,000 if the voters have provided the governing body authority to grant retail exemptions and the governing body has established criteria for granting those exemptions.

Under Chapter 40-57.1, if a project has local competitors, the project operator is required to notify competitors of the project owner's pending application for an exemption in the official newspaper of the city or county. Additional hearing and notice requirements must be met if the Department of Commerce determines the total cost of the project is estimated to exceed $1 billion. Impacted school districts and townships are included in any exemption or payment in lieu of tax negotiations and deliberations and notice must be sent to affected counties and school districts if a city anticipates a property will receive an incentive for more than 5 years. The affected county or school district may elect to disallow the incentive from applying to its portion of the property tax for incentives granted after July 31, 2017.

A city or county may grant a partial or complete property tax exemption for up to 5 years and may extend the exemption for up to 5 additional years if the project produces or manufactures a product from agricultural commodities produced in this state or the project is situated on property leased from a government entity. The option to make payments in lieu of taxes may be extended to a project operator through the 20th year following the date the project commenced. The governing body of a city or county may revoke or reduce a property tax exemption or revoke or increase a project operator's payments in lieu of taxes if the governing body finds the project operator provided inaccurate or untrue information, used the property for purposes other than anticipated, improved the property to a greater extent than what was anticipated, or if ownership of the property changed since the incentive was approved.

A project owner also may receive an income tax exemption for up to 5 years from the date the project commenced pursuant to Section 40-57.1-04. The income tax exemption is equal to the amount of net income realized by the project, or in the case of an expansion, the net income generated by the expanded portion of the business. A project owner shall submit an application for the income tax exemption to the State Board of Equalization within 1 year of commencing project operations and provide notice of the potential exemption to competitors as directed by the State Board of Equalization. For purposes of the income tax exemption, a "project" is defined as any new or expanding revenue-producing tourism or primary sector business. The Department of Commerce reviews applications to verify a project's eligibility as a primary sector or tourism business. The exemption is granted if the State Board of Equalization finds it is in the best interest of the people of North Dakota. A project is not eligible for a property or income tax exemption under Chapter 40-57.1 if it has an outstanding lien for unpaid state or local taxes, if granting the exemption would endanger existing businesses or foster unfair competition, or if the business is receiving a property tax exemption under TIF. A project operator is required to provide state and property tax clearance records for exemptions granted after July 31, 2017.

Perceived Goals in Creating or Altering the Exemptions

Provisions of new or expanding business property and income tax exemptions were enacted in 1969 by the passage of Senate Bill No. 39 and the creation of Chapter 40-57.1. As enacted, Chapter 40-57.1 only applied to new businesses and required a project operator to receive a property tax exemption as a condition to qualifying for an income tax exemption. A city or county also was required to apply to the State Board of Equalization for the income tax exemption on behalf of the project operator. The intent of the Legislative Assembly in creating the new business income and property tax exemption was stated clearly in the bill. Section 1 of the bill provided, in pertinent part, the purpose of the newly created chapter was:

> [T]o sanction, authorize, and encourage activities in the public interest and for the welfare of the state of North Dakota, its subdivisions and people by assisting in the establishment of industrial plants and promotion of economic activities within the state, and thereby increasing production of wealth, and adding to the volume of employment, particularly during those seasons when employment in farming and ranching is slack, thus alleviating unemployment among the people of the state.

Chapter 40-57.1 was amended in the 1970s to add notice requirements for local competitors; in the 1980s to extend the property tax exemption to revenue-producing entities and property owned by a local development corporation and restrict the property tax exemption from applying to certain large industrial projects, and in the 1990s to allow the property tax exemption to apply to the expansion and retention of existing buildings and the income tax exemption to apply to primary sector businesses and tourism businesses. Requirements also were added in the 1990s mandating a project owner to verify the owner's state and local tax liens have been satisfied as a condition to receiving the income tax exemption. Legislation enacted since 2001 allowed small cities and counties to grant the exemption to retail businesses, required enhanced notice for competitors for projects estimated to exceed $1 billion, and required cities that anticipated granting a property tax incentive for more than 5 years to notify impacted counties and school districts and allow those taxing districts to prohibit the incentive from applying to their portion of the property tax.

Testimony and Committee Considerations

The committee received information from a representative of the Tax Department regarding the number of individual and corporate income tax returns on which the income tax exemption was claimed and the estimated reduction in tax from tax years 2006 through 2016. The committee received an evaluation of the income tax exemption from a representative of the Bank of North Dakota, using REMI software, which indicated 48 new or expanding business projects received the exemption between 2006 and 2017. The use of the incentive closely correlated with the state's economy--increasing or decreasing as the state's economy expanded or contracted. The incentive was used heavily by the manufacturing sector. The number of jobs created as a result of the incentive peaked in 2014 with the creation of 1,400 jobs. The incentive generated $1.03 for every dollar invested when subtracting the cost of providing the income tax incentive, and the cost of other state expenditures related to the incentive, from the revenues generated by the incentive. According to the testimony, the incentive is working as intended. Representatives of the Economic Development Association of North Dakota and the City of Fargo provided testimony in support of retaining the exemptions. The committee did not receive testimony from parties opposed to new or expanding business exemptions.

State Grantor Reports

The committee was assigned the responsibility to receive a compilation and summary of state grantor reports filed annually by the Department of Commerce and the reports of state agencies that award business incentives for the previous calendar year, pursuant to Section 54-60.1-07. According to the report, the business incentive accountability law became effective January 1, 2006, and two of the incentives the committee is reviewing, the renaissance zone and new or expanding business incentives, are subject to the law. The law applies to businesses that receive incentives totaling $25,000 or more in a given year from state or local grantors. The law requires the recipient business to enter a business incentive agreement with the grantor, which must provide a description of the incentive to be granted as well as the job goals the business seeks to achieve within the first 2 years. A recipient business must report progress toward achieving stated goals. The report indicated 841 business incentive agreements were entered from 2013 to 2017 totaling an incentive value of $113,375,323. The report detailed the distribution of business incentives by type, public purpose, and type of business. The report also provided the number of agreements entered by year and identified whether the goal was to create jobs, retain jobs, or neither. According to the report, 2,534 jobs were created and retained over the last 5 years compared to a goal of 2,000 jobs.

Conclusions

The committee makes no recommendation regarding new or expanding business exemptions.

Renaissance Zone Tax Credits and Exemptions

Explanation of the Incentive

Chapter 40-63 provides for various renaissance zone tax exemptions and credits. Section 40-63-04 provides income tax exemptions to an individual who purchases or rehabilitates 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 5 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 purposes as a zone project. The amount of the exemption is equal to the income derived from the business or investment locations within the zone, up to a maximum amount of $500,000 per taxable year for 5 taxable years beginning with the date of purchase, lease, or completion of rehabilitation. For projects that expand an existing building in the zone, the amount of the exemption is equal to the income derived from the portion of the business relating to the expansion. In lieu of the previous exemption, a taxpayer in a city with a population of 2,500 or less may elect to exempt up to $2,000 of individual income tax liability if the cost of a new business purchase, leasehold improvement, or existing business expansion exceeds $75,000.

A property owner not participating in a renaissance zone project is eligible for a credit against income tax liability if the owner is required to make changes in utility services or in a building structure due to changes made to property part of a zone project. The amount of the credit is equal to the total amount of the investment necessary to complete the changes. Any credits exceeding a taxpayer's liability may be carried forward for up to 5 taxable years. A renaissance zone credit also is offered in Section 40-63-06 for investments in historic preservation or property renovation 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. Any credits exceeding a taxpayer's liability may be carried forward for up to 5 taxable years.

Exemptions are available under Section 40-63-07 for renaissance fund organizations. A city with a designated renaissance zone may establish a renaissance fund organization to raise funds to finance zone projects. A taxpayer may receive a credit against income tax liability equal to 50 percent of the amount invested in a renaissance fund organization. The maximum amount of credits awarded to all taxpayers is limited to $10.5 million and any credit amount exceeding a taxpayer's liability may be carried forward for up to 5 taxable years.

Property tax incentives also are available within a renaissance zone. A city may grant a partial or complete property tax exemption for up to 5 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 5 taxable years, following the date of rehabilitation, on public utility infrastructure rehabilitated as a zone project. A taxpayer may not be delinquent in the payment of any state or local tax liability to be eligible to claim a renaissance zone credit or exemption.

Perceived Goals in Creating or Altering the Incentive

In 1999, provisions relating to renaissance zones were enacted to allow a governing body of a city to apply to designate a portion of the city as a renaissance zone. Income and property tax exemptions were created for taxpayers investing in real property within a renaissance zone. A historic preservation and renovation tax credit also was created for investment within a renaissance zone. 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. Various changes were made to renaissance zone provisions in later years, including granting the ability to expand the boundaries of an existing renaissance zone or remove portions of a renaissance zone which were not progressing in 2001, authorizing a renaissance fund organization to provide financing to businesses outside a renaissance zone in 2003, authorizing the Department of Commerce to approve a city's request to extend the duration of a renaissance zone in 2009, modifying provisions related to investments in renaissance zone organizations in 2011, changing the manner in which income related to a business expansion is attributed in 2013, increasing the maximum allowable size of renaissance zones in 2015, and requiring letters of support from the governing bodies of each county and school district impacted by a proposed zone be submitted with a city's development plan in 2017.

Renaissance Zone and Tax Increment Financing Reports

The committee was assigned the responsibility to receive an annual report from the Department of Commerce, Division of Community Services, on renaissance zone progress, pursuant to Section 40-63-03(2), and a report compiling reports from cities that have renaissance zone property included in a TIF district, pursuant to Section 40-63-03(10). According to the report on renaissance zone progress, there were 58 renaissance zones in the state in 2017, and 1,665 projects have been approved and 1,314 projects have been completed since the inception of the renaissance zone program. A survey of renaissance zone communities conducted in 2017 indicated renaissance zones created 10 new businesses, 5 business expansions, and 189 new jobs. The benefits realized by the 46 projects that reached completion in 2017 amounted to $913,316 in income tax exemptions and $2.97 million in property tax exemptions. Information contained in the second report indicated the cities of Hazen and Mandan have properties located in both a renaissance zone and a TIF district. Mandan is the only city with properties receiving benefits from both the renaissance zone program and TIF program.

Testimony and Committee Considerations

The committee received information from a representative of the Tax Department regarding the number of claimants and the amount of income tax credits or deductions claimed through the renaissance zone program from 2006 through 2016. The committee also received information from a representative of the Department of Commerce regarding project-specific claimant and benefit data for properties located in a renaissance zone and a TIF district. The committee received an evaluation of the credit from a representative of the Bank of North Dakota, using REMI software, which indicated the renaissance zone program generated over 600 jobs and $47 million in annual gross domestic product during its peak in 2016. Industries that received the greatest benefit from the program were banking, retail, food service, agricultural support, and professional services. The direct cost to the state of providing renaissance zone tax benefits was $6.9 million for the 2013 through 2016 period. After offsetting additional revenues, the renaissance zone program cost the state $1.9 million for the 2013 through 2016 period. Assuming the program was discontinued at the end of 2017, the continued costs to the state for the 2017 through 2022 period would be $2.4 million, resulting in a total net loss to the state of $4.3 million for the 2013 through 2022 period.

The committee considered a bill draft that would have sunset the renaissance zone program effective January 1, 2020. The bill draft would have allowed a taxpayer to claim the remaining portion of any incentive earned before the program's sunset date. Representatives from the Economic Development Association of North Dakota, the North Dakota League of Cities, and the Cities of Bismarck, Fargo, Grand Forks, Mandan, Minot, and Milnor provided testimony in favor of retaining the credit. The testimony asserted the renaissance zone program is a vital tool cities use to meet infill and infrastructure needs. The committee received additional information regarding renaissance zones and TIF districts during its study of the property tax system, which included an assessment of the duplicative impact of property tax incentives and incentives impact on the remainder of the property tax base.

Conclusions

The committee makes no recommendation regarding renaissance zone credits or exemptions.

Tax Increment Financing Districts

Explanation of the Incentive

Chapter 40-58 allows a city to establish a TIF district by adopting a resolution finding one or more slum or blighted areas or industrial or commercial properties exist which require development, rehabilitation, or conservation in the public interest. The city must prepare a development or renewal plan and hold a public hearing for consideration of the plan. Approved development or renewal plans must be filed with the Department of Commerce. To implement the plan, the city may borrow money and accept financial assistance from any available source. The city may appropriate funds and make expenditures to carry out the plan. The city may issue bonds to finance the project and may issue refunding bonds to retire bonds previously issued.

Tax increment financing is used as the repayment mechanism for bonds issued for a development plan. Property values within the TIF district are "frozen" for property tax purposes at the time the district is established. Taxing districts with taxable property situated in a TIF district may continue to levy property tax against the frozen value of the properties. As the district is developed and property values increase, the city may impose a TIF district special fund levy against any valuation exceeding the frozen value of properties in the district. The valuation exceeding the frozen value is referred to as the "incremental value" of the property. Revenue from the TIF district special fund levy is placed in a special fund and used to repay bonds or other financing for TIF district projects. As an alternative to sale of bonds for a TIF district, the city may grant a total or partial property tax exemption for the project to provide assistance to a project developer. The property tax exemption only applies to the incremental value of the property and may not extend for more than 15 years.

Perceived Goals in Creating or Altering the Incentive

Chapter 40-58, regarding urban renewal law, was enacted in 1955 with the passage of House Bill No. 774. The bill contained provisions noting slum and blighted areas exist in cities which contribute to the spread of disease and crime and substantially impair the sound growth of municipalities. The bill further provided these areas contribute little in tax revenue while consuming an excessive portion of revenue for police, fire, and other forms of public protection and services. The statement of necessity contained in the bill provided slum and blighted areas are a matter of state policy and state concern. The bill encouraged cities to provide maximum opportunity for the "rehabilitation or redevelopment of the urban renewal area by private enterprise." The bill also allowed a city to formulate a workable program for utilizing appropriate private and public resources to "eliminate, and prevent the development or spread of, slums and urban blight, to encourage needed urban rehabilitation."

Specific provisions relating to TIF districts were added in 1973 to allow for the computation, certification, and remittance of tax increments resulting from urban renewal for reimbursement of the cost of urban renewal and the interest and redemption premiums on obligations issued to pay urban renewal costs. Testimony provided during the 1973 legislative session indicated urban renewal efforts had been discontinued at the national level and a need existed for local communities to take on renewal projects. Various legislative changes relating to TIF districts were made in later years, including an expansion of the use of TIF districts to develop unused or underutilized industrial commercial property and the exclusion of agricultural property from the definition of a blighted area. Revisions in 2011 included limiting the base year used in computing tax increments to no more than 25 taxable years. Revisions in 2017 required a city to notify impacted counties and school districts if the city was considering providing a property tax incentive on any parcel for more than 5 years. A county or school district receiving notice has the option of disallowing the incentive from impacting its portion of the tax on the property.

Testimony and Committee Considerations

The committee received information from a representative of the Department of Commerce regarding project-specific claimant and benefit data for properties located in a TIF district and a renaissance zone. The committee did not receive an analysis of TIF districts using REMI software because the software is limited to analyzing state economic factors, not local economic factors. The committee received testimony from representatives of the Economic Development Association of North Dakota in support of retaining TIF districts. The committee was informed TIF is available in 49 states and is a back-loaded incentive that provides a good return on investment. City representatives emphasized TIF is a local development tool and decisions regarding the use of TIF should remain within the purview of local communities that best understand community needs. It was the consensus of the committee that TIF districts should focus on redevelopment and avoid promoting sprawl. The committee did not receive testimony in opposition to retaining TIF.

Conclusions

The committee makes no recommendation regarding the use of TIF districts.

PROPERTY TAX SYSTEM STUDY

Three of the committee's studies pertained to a study of the property tax system. Section 18 of Senate Bill No. 2206 (2017) directed a study of the property tax system, with emphasis on the feasibility and desirability of providing property tax reform and relief. The study required consideration of all property classifications and taxing districts and evaluation of historical fluctuations in property values, the transparency of the property tax system, the processes and procedures available to taxpayers to contest valuations and assessments, the manner in which property tax information is provided to taxpayers, the process of determining taxing district budgets, and taxpayer participation and input in the property tax system. Section 7 of Senate Bill No. 2166 (2017) directed a study of the duplicative application of property tax incentives. The study required consideration of benefits received by properties located in both a TIF district and a renaissance zone; the duration for which a single property may benefit from the use of multiple property tax incentives; and the impacts on the remainder of the property tax base that is not receiving incentives created as a result of offering property tax incentives. Section 6 of Senate Bill No. 2166 (2017) directed a study of how city growth and infill development affects property taxes, and an evaluation on the return on investment for state and community projects. The study required an examination of various policies affecting city development patterns, including the impact of transfer payments between state and local governments; the cost of government services and infrastructure, including future liability; the amount of tax revenue generated per increment of assumed liability for downtown areas; and whether certain areas of a city generate more revenue than expenses while other areas generate more expenses than revenue.

Background

Property tax is levied in every state and provides a vital source of revenue for local governments. In North Dakota, nearly $969 million in property tax was levied for payment in 2016. Property tax is levied on real property, personal property, or both, depending on the state. The tax on personal property was abolished in North Dakota in 1970. Classification and valuation marks the first step in the property tax cycle. Property is classified as either residential, commercial, agricultural, or centrally assessed. Assessors apply various calculations to the true and full value of property in each classification to arrive at a property's taxable value.

A property owner dissatisfied with the valuation of property has the right to contest the assessment to the local, county, and state boards of equalization or through the tax abatement process. Equalization is the process provided by law to adjust property assessments to be consistent with market value or agricultural value. A property owner may present evidence to the local board of equalization to argue for a reduction in the valuation of the person's property. In place of the equalization process, a property owner may elect to use a more formal abatement process in contesting a property tax assessment. Several layers of review are involved in the abatement process, which may culminate in appeal of the decision of the board of county commissioners to the district court and then to the North Dakota Supreme Court.

Once valuations are finalized following the equalization process, each taxing district prepares a preliminary budget based on anticipated expenditures for the upcoming year. The amount budgeted by a taxing district may not result in a tax levy exceeding levy limitations established by statute. The county treasurer has until December 26 to mail a property tax statement to the owner of each parcel of real property. Property statements must include the true and full value of the property; the total mill levy applied to the property; the amount of tax levied in dollars against the parcel by the county, school district, city, and township for the current year and the 2 immediately preceding taxable years; and the dollar amount of property tax savings realized by the property owner through legislative tax relief. Property taxes are due January 1 following the year of assessment and are payable without penalty until March 1 of the year in which due.

Testimony and Committee Considerations

Taxing District Budgets and Taxpayer Involvement

A taxing district must deliver its preliminary budget to the county auditor by August 10, along with notice of the date, time, and location of the taxing district's public budget hearing. The county treasurer provides written notice of taxing district budget hearings to property owners on or before August 31. The written notice contains information regarding the location at which a property owner may view the taxing district's preliminary budget, the estimated true and full value of the owner's property, the dollar amount of tax levied against the property in the immediately preceding taxable year and the estimated amount to be levied for the current taxable year, the difference between the prior year levy and current year estimated levy in dollars, information regarding state-provided property tax savings, and notice that citizens may present oral or written comments regarding each taxing district's property tax levy. The combined and enhanced notice requirements were enacted by Senate Bill No. 2288 (2017).

The committee received testimony from multiple city and county representatives regarding budgeting processes and implementation of the new notice requirements. According to the testimony, steps were taken by cities and counties throughout the budgeting process to keep taxpayers informed in the process. The committee received testimony from a representative of Cass County regarding the county's implementation of the new notice requirements. According to the testimony, the county received 30 calls and emails as a result of the 60,000 notices sent to taxpayers. County representatives attributed the low number of inquiries to the notices being easy to understand. County and city representatives noted low attendance at budget meetings persists despite enhanced efforts to educate and notify the public.

The committee discussed the possibility of using social media to enhance notification of public hearings and budget meetings. The committee acknowledged younger generations of taxpayers use social media as a platform to communicate, and discussed the use of social media by other entities, including the Fargo Police Department. City and county representatives acknowledged more taxpayers may be reached through the use of social media, but were hesitant about mandating the use of social media. The committee received a demonstration of OpenGov software, which is being used by Morton and Cass Counties. The software provides transparency relating to a political subdivision's budget information and provides the public a user friendly platform on which data may be viewed and analyzed.

The committee received information regarding the new online levy lookup tool created by the Tax Department and received a state-wide property tax increase report prepared using the online tool. The committee received information regarding recent township mill levy errors and reviewed the process in which political subdivisions are audited. Testimony provided by a representative of the State Auditor's office indicated the office is required to audit various political subdivisions once every 2 years. Cities with a population of fewer than 500 may file an annual audit report in lieu of receiving a biennial audit. According to the testimony, 263 of the 357 incorporated cities in the state fall below the audit threshold.

Impact of Property Tax Incentives

The committee reviewed information regarding property tax exemptions and the date each tax exemption was enacted. The committee received information from city representatives regarding the total amount of property tax exempted by cities on a discretionary and nondiscretionary basis. The committee reviewed the use and impact of various tax incentives, including new residential and builder owned exemptions and tax incentives available through the use of TIF districts and renaissance zones. The governing body of a city or county may approve a property tax exemption for up to $150,000 of the true and full value of a new single-family, condominium, or townhouse residential property for the first 2 taxable years after the residence is occupied for the first time. The governing body of a city or county also may approve a property tax exemption for new single-family residential property which applies for the taxable year in which construction began on the property and the next 2 taxable years if the property remains unoccupied and owned by the builder. Currently 1,734 properties are receiving the new residential property tax exemption statewide and 119 properties are receiving the builder-owned property tax exemption. The committee questioned the use of these incentives as the incentives are offered to encourage growth, and testimony from city representatives illustrated the challenges cities are facing to pay for infrastructure associated with new growth.

The committee received detailed information regarding incentives tied to renaissance zones and TIF districts and the impact these incentives had on the remainder of the property tax base. The committee received a listing of the properties that received a TIF incentive following the receipt of a renaissance zone incentive. The information indicated only two properties in the state currently are slated to receive a TIF incentive following the receipt of a renaissance zone incentive. According to information received from a representative of the City of Fargo, the value of exempt property in the city is equal to 2.57 percent of the total taxable value of property in the city, with renaissance zone property accounting for .084 percent of the total amount of exempt property. The testimony indicated new industry and renaissance zone incentives provide a positive return on investment and spur activity that would not have occurred otherwise. Property values in Fargo's downtown area increased by 4 percent over the increases in property values in the nondowntown area in 2017. The committee received information from a representative of the City of Bismarck which indicated 4 percent of the 25,255 parcels in the city receive some type of full or partial property tax exemption. According to the information, using the 2018 exempted market value and the 2017 mill levy, the estimated amount of property tax not being collected from renaissance zone properties in Bismarck in 2018 is $307,596. Information received regarding the use of renaissance zones in Minot indicated 91 projects have been approved since the city established its renaissance zone in 2001. Of the completed projects, the total assessed value has increased from $6,150,700 to $26,532,200, representing an increase of approximately 330 percent. The committee received testimony expressing wide support from city representatives regarding the use of renaissance zones.

Committee members noted incentives offered through the use of TIF districts and renaissance zones are temporary but the increased value added to the property tax base is permanent. Committee members indicated property owners that do not receive a property tax incentive through these programs still receive a benefit through the increased tax revenue ultimately generated by the properties that received the incentive.

City Growth and Infill Development

The committee received information regarding city growth and development, the delayed infrastructure maintenance costs associated with rapid growth outside a city's downtown area, and city development plans that will bolster a city's tax base. The committee received a presentation regarding methods to build strong cities. The presentation indicated growth creates the illusion of wealth because cities realize a windfall in property tax when a developer assumes all the costs of building new residential property. Cities suffer when the cities have to assume all the maintenance costs for infrastructure that cannot be supported by the existing tax base. The more areas grow, the poorer the areas become and cities are forced to absorb the costs of the city development plans. The cities that used to be built incrementally over time are now built in large blocks. The benefits to building incrementally is that infrastructure also ages incrementally. Building new developments in large blocks results in all maintenance being required at the same time. According to the presentation, cities build wealth by making modest investments over a broad area over a long period of time. Cities need to make high-return investments to remain solvent. Decisions, such as replacing old multi-unit structures with single-unit structures with a large amount of green space, degrade the higher value tax base.

The presentation noted city officials must think in terms of value per acre and focus on high-intensity development. A ratio of $20 of private investment for every $1 of public investment leads to a stable environment. The committee reviewed the value per square foot of properties in Fargo. The downtown area of Fargo has the highest property values per square foot, with many properties valued at over $100 per square foot. Commercial properties on the western edge of the downtown area ranged in value from $50 to $100 per square foot and single family homes and residential apartment buildings ranged in value from $26 to $52 per square foot. Apartment buildings valued at over $50 per square foot keep pace with service costs. Owners of higher-value commercial buildings generally pay more in property taxes than the buildings require in services. Lower-density subdivisions consisting of $300,000 homes on 2-acre lots likely will need to rely on the broader community to help subsidize the costs of services. The committee also received information regarding the value per square foot of properties in Bismarck. The property that generated the most tax dollars in

Bismarck is the Sanford Medical Center. The committee saw similar patterns of high value per square foot concentrations in the downtown areas in Bismarck with lower value per square foot concentrations on the outskirts of the city.

The committee received information from a representative of the Bank of North Dakota regarding partnership for assisting community expansion (PACE) programs. The PACE programs are administered by the bank in cooperation with communities across the state to buy down the interest rate on loans used for new or expanding business needs. The committee received testimony indicating the use of these types of loans may be preferable to using property tax incentives to encourage business and community development. The committee questioned whether incentives should be tied to the dollars of revenue generated per square foot. The committee indicated cities need to be mindful in applying a development pattern that generates enough cashflow to service its future liabilities and carefully target the manner in which property tax incentives are applied.

Special Assessments

The committee reviewed the procedures available for the imposition of special assessments by cities, counties, townships, water resource districts, and recreation service districts. The committee reviewed information relating to the prevalence of special assessments and the amount of special assessments levied by the 10 most populous cities in the state. Fargo had the highest ratio of special assessments to property tax for the 2017 tax year, certifying $32,081,933 in special assessments and levying $31,526,029 in property tax. The committee reviewed the types and amounts of special assessment fees charged in the 20 highest population cities in the state and received testimony regarding the use of special assessments from representatives of multiple cities. The testimony indicated the types and amounts of fees charged by cities for special assessments varies widely. The use of city engineers or external engineering services for special assessment projects also varies by city.

The committee reviewed the use of special assessments in other states and reviewed 2001-02 and 2011-12 interim studies relating to special assessments. Based upon legislation discussed during the 2001-02 interim to exclude property owned by a political subdivision from consideration in protests against the formation of a special improvement district, the committee considered a bill to remove property owned by a political subdivision from the total area within an improvement district for purposes of calculating whether protests were received from the owners of a majority of the area of the property included in the proposed district. Testimony regarding the bill noted protests from the owners of a majority of the property area within the proposed districts is required to bar the formation of a district. The committee determined a district could be drawn with more than 50 percent of the property area within the district owned by the political subdivision that would benefit from the creation of the district, thus effectively barring private property owners from protesting the formation of the district. The committee concluded the bill would safeguard against that result. The committee also noted the fairness principal the bill seeks to achieve is sound, but there may be some unintended consequences to excluding property owned by political subdivisions from consideration during the protest period.

The committee received information from representatives of the Bismarck-Mandan Chamber of Commerce and Bismarck-Mandan Development Association regarding a task force formed to address issues relating to infrastructure funding and special assessments. The task force recommended requiring future developers pay the aboveground and belowground costs of a project and build the costs into the purchase price of the lot, rather than using the current system that only requires the developer to pay the belowground costs, leaving the aboveground costs to be assessed to the purchaser. The new approach would eliminate special assessment districts and allow homeowners to amortize the additional lot costs over the life of their mortgage. In regard to special assessments for ongoing maintenance costs, the task force recommended the imposition of a street utility tax to replace special assessment revenue. The tax would appear as a monthly charge on all residential and commercial utility bills. The charge would be determined based on the city's road and street budget needs for each upcoming year. The task force noted the use of a street utility tax would require a legislative change because Senate Bill No. 2326 (2017) prevents political subdivisions from seeking voter approval of any funding mechanism not in a city's home rule charter before August 1, 2017. Committee members expressed concerns regarding a taxpayer's ability to weigh in on the fee in the future and that a ballot question may be structured so the fee is easy to sell on the front end but could lead to future liability. Committee members indicated legislation should require the ballot language to include certain protections.

The committee reviewed a bill draft that would have required money remaining in a special assessment fund be credited to the property owners in the special assessment district. The committee received testimony from various city representatives regarding the difficulty in administering the bill draft.

The committee also reviewed a bill draft that would have increased the amount of the homestead tax credit for special assessments from $6,000 to $15,000 and reduced the interest rate charged on the credit from 9 percent to 6 percent. A second bill was revised to retain the same credit increases from $6,000 to $15,000, but linked changes in the interest rate charged on the credit to changes in the consumer price index. The committee received information from a representative of the Tax Department indicating the estimated fiscal impact of the bill would be less than $5,000 for the 2019-21 biennium. According to the testimony, existing special assessment liens may not be satisfied when property is transferred from parent to child, or in other situations involving transfers using a quitclaim deed. It was noted additional safeguards may need to be added to protect the state's lien.

The committee also reviewed bill drafts to remove the requirement for 60 percent voter approval before the governing body of a park district may issue bonds. The bill drafts sought to clarify a previous Attorney General opinion and make bonding a more economical and viable financing option for park districts to allow park districts to move away from using special assessments. The committee considered a bill that would have allowed the issuance of bonds without an election and a bill that allows the issuance of bonds without an election but provides taxpayers with a formal protest period.

Recommendations

The committee recommends House Bill No. 1041 to increase the amount of the homestead tax credit for special assessments and tie the interest rate applied to the credit to a moving index.

The committee recommends Senate Bill No. 2040 to exclude property owned by a political subdivision from consideration in protests against the formation of a special improvement district.

The committee recommends Senate Bill No. 2041 to allow park districts to issue bonds without an election but provide for a formal protest period.

HYBRID LONG-TERM CARE PARTNERSHIP PLAN INSURANCE TAX CREDIT STUDY

Senate Bill No. 2230 (2017) directed the Legislative Management to study the feasibility and desirability of providing an income tax credit to individuals for premiums for hybrid long-term care partnership plan insurance coverage. The study required consideration of the feasibility and desirability of incentivizing asset protection that may be equal to the amount paid out by the hybrid long-term care partnership plan. As introduced, the bill would have expanded the existing provisions in Section 57-38-29.3, which provide an income tax credit of up to $250 per year for each insured individual for premiums paid for qualified long-term care partnership plan insurance coverage, to apply to premiums paid for long-term care insurance coverage that is part of a hybrid long-term care insurance policy.

Background

As an individual ages, the likelihood of being afflicted with a disability, physical illness, or cognitive impairment increases, as does the likelihood of requiring long-term care. Types of long-term care services include home health care, nursing home care, respite care, and hospice care. Services may be delivered in an individual's own home or in a nursing home or assisted living facility. Long-term care insurance may be purchased individually or through a group long-term care insurance plan offered by an employer. Long-term care insurance policies typically include certain consumer protection provisions as well as inflation protection so benefits associated with the policy increase along with the costs of long-term care. Benefits generally are paid on a reimbursement basis, as services are provided, or on an indemnity basis, which allows the insured to receive a set daily dollar amount when services are needed.

Testimony provided by a representative of the American Council of Life Insurers on Senate Bill No. 2230 indicated 35 percent of individuals age 85 or older are using some form of paid long-term care. According to the National Association of State Medicaid Directors, Medicaid pays over 40 percent of the costs of long-term care. Information published by the American Council of Life Insurers indicates 4.4 million individuals held long-term care policies in 2015. The number of seniors who will require long-term care is anticipated to grow to 15 million by 2050 when the youngest members of the baby boomer generation reach age 85.

A number of states offer either tax credits or tax deductions to incentivize the purchase of long-term care partnership plan insurance and help ease the burden on state Medicaid systems. The committee reviewed the list of states that offer a tax credit for long-term care insurance and those that offer a deduction. A deduction also is offered at the federal level, pursuant to 26 U.S.C. Section 213, for premiums for qualified long-term care insurance policies meeting the requirements under 26 U.S.C. Section 7702B. North Dakota's tax credit was enacted through the passage of House Bill No.1209 (2009).

The primary difference between traditional long-term care insurance policies and "hybrid" long-term care insurance policies is that hybrid policies often combine long-term care insurance coverage with a life insurance policy or an annuity. Hybrid policies have gained popularity in recent years as the policies allow the insured more flexibility than traditional long-term care policies. A common example of a hybrid policy is a single premium life insurance policy sold with a long-term care acceleration rider. The acceleration rider allows the insured to access death benefits for a set period in the form of level monthly payments to cover qualified long-term care service expenses. Another example of a hybrid policy is a single premium deferred annuity that allows a policyholder to make penalty-free withdrawals from the account value for qualified long-term care service expenses. The federal tax treatments of hybrid plans vary based on the policy's structure. The National Association of Insurance Commissioners issued a number of long-term care federal policy recommendations to Congress in June 2017, which included establishing more generous federal tax incentives and allowing products that combine long-term care coverage with various other insurance products.

Testimony and Committee Considerations

The committee received information from a representative of the Tax Department regarding claimant and expenditure information for tax years 2009 through 2016 for the existing income tax credit for premiums paid for long-term care partnership plan insurance. According to the testimony, a total of $548,884 in credits was claimed on 1,346 returns in tax year 2016, which indicates taxpayers are claiming the maximum amount of credits available per taxpayer.

The committee received information from a representative of the North Dakota Long Term Care Association regarding the costs of various types of long-term care services and the estimated percentage of individuals who will need long-term care services at some point in their lives. The cost of long-term care can range from $25 per day to $265 per day depending on the type of long-term care required. An individual has a 50 percent chance of requiring long-term care services in the individual's lifetime. The committee was informed Medicare and Medicaid alone will not be able to meet the long-term care needs of the state's growing elderly population.

The committee received information from a representative of the Department of Human Services regarding the costs incurred by the state in providing long-term care services. Nearly $694 million of the $2.6 billion the department received for medical assistance grants in the department's budget for the 2017-19 biennium is for long-term care services. The committee reviewed the number of individuals who receive long-term care services on a monthly basis and was informed state expenditures for long-term care have increased each biennium since the 2009-11 biennium. Committee members expressed concern at the rising costs of nursing facility rates. According to the testimony, North Dakota is one of the higher daily rates states because the state has equalized reimbursement rates for Medicaid and private pay individuals.

The committee received information from a representative of the Insurance Department indicating the number of individuals purchasing stand-alone, long-term care policies is shrinking drastically. According to the testimony, a dramatic spike in long-term care costs is due to increased life expectancies and higher quality assisted living centers. Due to rising premiums, individuals who purchased policies in the 1990s must decide whether they can afford to maintain their policies. The department noted it has received requests from insurance companies to increase the premiums on some policies by up to 300 percent. The department requires insurance companies to provide options to customers facing sharp increases to help customers retain coverage. Companies are evaluating whether these products were adequately priced when initially offered. Companies are not realizing profits on older policies and must determine how to price and model these products going forward.

According to the testimony, a definition for a "hybrid" or "combination" policy is needed to create a tax credit for premiums paid for hybrid long-term care policies because no other state has a legal definition for these types of policies. The committee received a framework that could serve as a starting point for a definition. The committee was advised other considerations may need to be taken into account if a credit is pursued, including whether a cap is placed on the credit. It was noted some polices may allow a taxpayer to overpay the premium to increase the cash value of the policy, thus generating a larger tax credit. The committee was cautioned offering a credit may prompt requests for similar treatment from those in the stand-alone long-term care market.

Conclusions

The committee makes no recommendation regarding its study of the feasibility and desirability of providing an income tax credit to individuals for premiums paid for hybrid long-term care partnership plan insurance coverage.

ADDITIONAL REPORTS

Oil and Gas Gross Production Tax Allocation Reports

The committee was assigned the responsibility to receive annual reports from the Tax Commissioner from compiled reports from counties and school districts receiving allocations of oil and gas gross production tax revenues describing funds received, expended, and unexpended. Pursuant to Section 57-51-15(6) the report pertaining to allocations received by counties is required to be provided to the Legislative Council within 45 days after the end of each calendar year. The Tax Department sent revenue and expenditure reporting forms to each county that received oil and gas gross production tax distributions. Counties are required to report the amount of revenue deposited in the county general fund, other funds, or allocated to townships. If revenue is deposited in a county's general fund, the county must further specify the percentage of the county's general fund that consists of revenue allocations and the primary categories of expenditures made from the county's general fund. The consolidated reports indicated a total of $417,083,343 was received by the 16 counties receiving oil and gas gross production tax distributions in calendar year 2016, and $115,368,880 was received in calendar year 2017. The reports indicated each responding county placed the revenue allocations its general fund.

Pursuant to Section 57-51-15(7) the report pertaining to allocations received by school districts is required to be provided to the Legislative Council within 45 days after the end of each fiscal year. The Tax Department used surveys and worked in cooperation with the Department of Public Instruction to gather the required information. The Tax Department sent revenue and expenditure reporting forms to each school district that received oil and gas gross production tax distributions. School districts are required to report whether revenue allocations were used for general operating expenses, debt service, capital projects, or other purposes. The report indicated a total of $33,676,503 was received by the 60 school districts receiving oil and gas gross production tax distributions in fiscal year 2017 and $31,208,324 was received in fiscal year 2018.

Testimony and Committee Considerations

Representatives from the agencies responsible for compiling and receiving the reports indicated outside requests for the reported information had not been received. Committee members questioned the utility of the reports as revenue allocations are commonly comingled in the political subdivision's general fund, making further determination of the exact purpose for which revenue allocations were expended nearly impossible. The committee acknowledged the state imposes a number of reporting requirements at the local level and viewed this report as one that could be eliminated. The committee determined the time county, school district, and Tax Department employees spent preparing and compiling these reports may be better directed toward other purposes and considered a bill to eliminate the revenue and expenditure reporting requirements pertaining to county and school district oil and gas gross production tax revenue allocations.

Recommendation

The committee recommends Senate Bill No. 2042 to eliminate the revenue and expenditure reporting requirements for schools and counties that receive oil and gas gross production tax allocations.

Social Service Pilot Program Report

The committee was assigned the responsibility to receive a report from the Department of Human Services on the status of the state-paid economic assistance and social service pilot program and the development of a plan for permanent implementation pursuant to Section 50-34-01. The report indicated the study conducted during the pilot program involved over 40 committee meetings of county social service directors, county staff, regional supervisors, and state policy staff. The focus while developing a plan for permanent implementation was to improve service and preserve access to services by shifting administrative resources to service delivery. The study indicated three administrative structure options for the delivery of social services:

- Allow the pilot project expire and return to a largely county-based, county-directed delivery system with the previous degree of county board control;
- Transfer all costs and all employees to the state and shift to a state administered system, like most other states, without a formal role for counties; or
- Expand the use of multi-county units or "zones" to increase the size of social service units to support the changing delivery models being proposed, while preserving county employment and guaranteeing local access and a local governance role through county or multi-county boards.

The report indicated most counties seem receptive to moving forward cautiously with more state administration as long as rural counties retain access to services. According to the report, the process of restructuring social services is ongoing and will not be completed in 1 biennium.