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Practitioners' Newsletter

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We're now home—on the Web, that is!

The Office of State Tax Commissioner has established a home page on the Internet. The address is: <http://www.state.nd.us/taxdpt>.

With a personal computer and Internet access, you may download North Dakota tax forms and instructions and print them out on your printer. The downloadable documents are stored in the Portable Document Format (PDF).

Each year's North Dakota income tax forms and instructions will be available to the public much earlier through the Tax Commissioner's home page, and you will be able to obtain them when you need them, 24-hours a day, seven days a week. This provides a real convenience, one which should be especially useful during the busy tax season, allowing you to give your clients the best service possible.

The 1997 forms and instructions are now being placed on the Tax Commissioner's home page, so they should be available to you by the time you receive this newsletter.

You will need to download software called Adobe Acrobat Reader to view and print the tax forms and instructions. This software is available free-of-charge from Adobe Systems, Incorporated, through Adobe's Internet home page. A direct link to Adobe's home page is provided on the Tax Commissioner's home page to make it easy for you to obtain this software.

In addition to tax forms and instructions, the Tax Commissioner's home page provides information about the Office of State Tax Commissioner, including phone numbers and addresses, and an on-line message service through which you may contact our office to ask questions or provide comments and suggestions.

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New tax credit for home care expenses

A new income tax credit is available this year to individual taxpayers who pay qualified expenses to care for a qualified family member at home. Unlike most other income tax credits, this credit is allowed on both Form 37-S (Short Form) and Form 37 (Long Form).

Qualified care expenses include expenses for home health agency services, companionship services, personal care attendant services, homemaker services, adult day care, respite care, and health care equipment and supplies, and other similar goods and services. The expenses must be necessary to avoid the placement of the family member in a long-term care facility, and they must be provided by an organization or individual unrelated to both the taxpayer and the family member.

To qualify the taxpayer for the credit, the family member for which care is provided must: (1) Be related to the taxpayer by blood or marriage; (2) Be either at least 65 years old or disabled as determined by the Social Security Administration; and, (3) Have a federal taxable income equal to or less than \$15,000, if not married, or \$30,000, if married (include income of both spouses).

In general, the credit is equal to 30% of the eligible expenses; however, the 30% rate is phased out at the rate of 1% for each \$2,000 (or fraction thereof) by which the taxpayer's federal taxable

income exceeds \$25,000. The maximum credit allowed per eligible family member is \$2,000. The amount of the credit otherwise determined must be reduced by an amount equal to the excess of the taxpayer's federal taxable income over \$50,000 (\$25,000, if the taxpayer is married and required to file a separate North Dakota return).

New schedule. A new schedule, Schedule FC, must be completed and attached to either Form 37-S or Form 37 to claim the credit. If qualified care expenses are paid for the care of more than one qualified family member, a separate Schedule FC must be completed and attached for each one.

Multiple taxpayers. More than one taxpayer may claim the credit with respect to the same qualified family member; however, the credit allowed to each taxpayer may be subject to special limitations. A multiple taxpayer schedule on Schedule FC must be completed in this case.

Additional details. Additional details on qualified care expenses, especially companionship services, and other limitations on the credit are contained in the instructions to Schedule FC.

1997 Order Blank Enclosed
Enclosed with this newsletter is an order blank for ordering the 1997 North Dakota income tax forms and instructions.

State withholding from federal civil service annuities will soon be allowed

North Dakota's federal civil service retirees will soon be able to have North Dakota income tax withheld from their retirement checks. The Office of State Tax Commissioner is working on finalizing a withholding agreement with the U.S. Office of Personnel Management (OPM) that will allow the retirees to elect to have state income tax withholding.

Federal retirees have desired and requested this option which would provide a convenient way to pay their state income tax. However, until this year, North Dakota as well as about half of the other states have not entered a withholding agreement with OPM because of the complex and time-consuming procedures required by OPM.

Starting this year OPM launched a new simplified state income tax

withholding program for its retirees, and a majority of the states have already entered an agreement with OPM to participate in it. The Office of State Tax Commissioner anticipates having its agreement with OPM in place by the end of November 1997.

As soon as the agreement is in place federal retirees may initiate or change their North Dakota income tax withholding by contacting OPM in one of the following ways:

- Call toll free 1-800-409-6528 to access OPM's "Annuitant Express," an automated voice response system, or
- Call OPM's Retirement and Insurance Service directly at (202)606-0500, or
- Write to: OPM, P.O. Box 961, Washington, DC 20044-0001.

Withholding return streamlined

Employers and their tax preparers may have noticed a change in the 3rd quarter North Dakota income tax withholding return. Two lines were removed from North Dakota Form F-306 to make it easier to complete and to streamline it for future electronic processing.

The amount of wages paid to employees and the amount of federal income tax withheld from such wages no longer have to be reported by employers. These changes were authorized by the 1997 legislature at the request of the Office of State Tax Commissioner.

New hires must be reported to ND Human Services

As of October 1, 1997, federal and state laws require employers to provide information about newly hired employees to the North Dakota Department of Human Services. In addition to employer identification information, an employer must report the name, address and social security number of the new employee.

Employers have been contacting the Office of State Tax Commissioner about this new reporting requirement, largely due to the inclusion of a Department of Human Services notice in the 3rd quarter income tax withholding return mailing to employers. The inclusion of the Human Services notice in the withholding mailing was only to assist Human Services in getting information about the new reporting requirement to employers.

The required information about new employees should not be sent to the Office of State Tax Commissioner. This information along with any questions or concerns must be directed to:

Address

Child Support Enforcement Unit
ND Department of Human Services
P.O. Box 7369
Bismarck, ND 58507-7369

Telephone

(701)328-3582
1-800-755-8530 (toll free in ND)
1-800-366-6888 (TDD/TTY toll free)

Fax

(701)328-5497

Tips on preparing corporate Schedule CR

Schedule CR, a four-part, supplemental schedule to Form 40, was introduced as part of the corporation income tax booklet in 1996. Experience with the schedule so far indicates that there is some misunderstanding in how the schedule should be completed if a consolidated North Dakota corporation income tax return is filed.

In the case of a consolidated North Dakota corporation income tax return—that is, a single corporation income tax return reporting the tax liability of two or more corporations having a filing requirement in North Dakota and using the combined report method of filing—the following guidance is provided for the proper completion of Schedule CR as well as the other pertinent parts of Form 40:

1. Complete lines 1 through 5 of Form 40.
2. **Do not** complete Schedule A or B on page 2 of Form 40.
3. **Do not** complete Schedule E on page 3 of Form 40.
4. **Do not** complete Schedule AMT-R on page 4 of Form 40.
5. Complete either Schedule WW on page 5 or Schedule WE on page 6 of Form 40.
6. Complete all four parts of Schedule CR on pages 7 through 10 of Form 40 as follows:
 - a. Enter the name and federal identification number of each corporation having activity within

North Dakota. Add additional pages if there are more than three corporations. **Do not list any corporation that does not have activity within North Dakota.**

- b. In the space provided for each listed corporation, enter the amount from Form 40, page 1, line 5 on Part I (page 7), line 5.
- c. Complete Part II (page 8) as follows:
 - (1) Compute property, payroll and sales factors for **each** listed corporation.
 - (2) Enter the sum of the separately computed property factors for all listed corporations on line 7b.
 - (3) Enter the sum of the separately computed payroll factors for all listed corporations on line 8b.
 - (4) Enter the sum of the separately computed sales factors for all listed corporations on line 12a.
 - (5) Enter the sum of the property, payroll and sales factors for **each** listed corporation on line 14.
 - (6) Add the totals on line 14 and divide the result by three, and enter the result on line 14a.
- d. Complete Part III (page 9).
- e. Complete Part IV (page 10).

If you have any questions about the proper completion of Schedule CR, contact the Corporation Income Tax Section at (701)328-2046.

New financial institution tax law developments

Financial institution defined

In the *Practitioners' Newsletter* dated July 3, 1997, the lead article informed practitioners about the passage of Senate Bill 2331 (1997 S.L. ch. 490) which enacted new law provisions covering financial institutions. This legislation repealed North Dakota Century Code chs. 57-35, 57-35.1 and 57-35.2 and replaced them with a new chapter, N.D.C.C. ch. 57-35.3, effective for taxable years beginning after December 31, 1996.

It is important to note that this legislation not only affects the entities covered by the repealed chapters—that is, banks, trust companies, and building and loan associations—it also extends to certain entities that have been covered by the income tax laws under N.D.C.C. ch. 57-38, requiring them to file a financial institution tax return instead of an income tax return starting with the 1997 tax year.

Entities subject to the new financial institution tax under N.D.C.C. ch. 57-35.3 include the following:

1. Corporation or other business entity registered under state law as a bank holding company, registered under the Bank Holding Company Act of 1956, as amended, or registered as a savings and loan holding company under the National Housing Act, as amended;
2. National bank organized and existing as a national bank under the National Bank Act;
3. Savings association or federal savings bank as defined under the Federal Deposit Insurance Act;
4. Bank or thrift institution incorporated or organized under the laws of any state;
5. Trust company organized under the laws of any state, the United States, a dependency or insular possession of the United States, or a foreign country;
6. Corporation organized under Public Law 63-6, § 25A (relating to foreign banking);
7. Agency or branch of a foreign depository as defined under Public Law 95-369;
8. Production credit association organized under the Farm Credit Act of 1933;
9. Corporation whose voting stock is more than 50% owned directly or indirectly by any of the entities described in 1 through 8 above. *This*

Adjustment for income (loss) from S corporation subject to financial institution tax

Under North Dakota Century Code §§ 57-38-01.2(1)(t), 57-38-30.3(3)(c) and 57-38-30.3(4)(c), an adjustment in determining an income tax liability must be made by an individual, estate or trust that is a shareholder of a Subchapter S corporation subject to North Dakota's financial institution tax under N.D.C.C. ch. 57-35.3. In general, the purpose of the adjustment is to remove the shareholder's pro rata share of the corporation's income or loss for financial institution tax purposes from the computation of the shareholder's income tax liability.

The adjustment amount may differ from the amount of income or loss the shareholder reports for federal income tax purposes, so the shareholder may not rely on the information reported in the shareholder's federal income tax return to determine the proper

amount of the adjustment. In addition, the adjustment will either *decrease* or *increase* the shareholder's North Dakota income tax liability, depending on whether the corporation's operations generated an income or a loss for the year.

Shareholder statement. The corporation must provide a year-end statement to its shareholders informing them about the adjustment and the amount of the adjustment each one must make.

New guideline. A new income tax guideline entitled *Adjustment For Income (Loss) From S Corporation Subject To North Dakota Century Code ch. 57-35.3* is available which explains the adjustment in more detail, including how to properly report the adjustment on the North Dakota individual and fiduciary income tax returns.

does not include an insurance company taxable under N.D.C.C. § 26.1-03-17 or a corporation taxable under N.D.C.C. ch. 57-38;

10. Corporation or other business entity deriving more than 50% of its total gross income for financial accounting purposes from finance leases; and
11. Any other person or business entity deriving more than 50% of its gross income from activities that entities described in 2 through 8 and 10 above are authorized to transact. *This does not include an insurance company taxable under N.D.C.C. § 26.1-03-17, a real estate broker, a securities dealer, or a person or entity taxable under N.D.C.C. ch. 57-38.*

New form

Form 35, North Dakota Financial Institution Tax Return, has been developed for use by taxpayers subject to the financial institution tax. The form and instructions for 1997 will be available at the end of December of this year. They will also be available on the Office of State Tax Commissioner's Internet home page in January 1998.

Electronic filing method under consideration

To meet the financial institution tax filing requirement, the Office of State Tax Commissioner is currently developing and testing a computer program application that a taxpayer could use in a personal computer to complete Form 35. The taxpayer would then save the information to a standard 3.5 inch diskette and send the diskette along with certain required documentation to the Office of State Tax Commissioner.

Financial institution tax law and forms available on Internet

The statutory provisions of N.D.C.C. ch. 57-35.3, the financial institution tax law, are available on the Office of State Tax Commissioner's Internet web site. Form 35 and instructions will also be available in January 1998.

**The web site address is:
<http://www.state.nd.us/taxdpt>**

Income tax forms changes to note for '97

Form 37-S (Short Form)

Two lines were added to Form 37-S to accommodate the new family member care credit (*see article on page 1*). See lines 12 and 13. The instructions to Form 37-S were changed to:

- Make the schedule in the line 1 instructions clearer;
- Add an instruction to line 5 for the new adjustment for certain S corporation shareholders (*see article on page 3*); and
- Add a new instruction covering the family member care credit on line 12 .

Form 37 (Long Form)

Lines 1 through 8 on page 1 of Form 37 were reconfigured to reposition the line for the credit for income tax paid to another state. This change was made to give the credit for income tax paid to another state priority over the other credits on Form 37, ensuring that the amount of the credit for income tax paid to another state is the same regardless of whether Form 37-S or Form 37 is used.

Unlike Form 37-S, a separate line for the new family member care credit was not added to page 1 of Form 37. On Form 37, this credit must be entered on line 7. In addition, an instruction covering the new family care credit was added to the instructions to page 1 of Form 37.

Schedule 2 instructions. An instruction covering a new adjustment for certain S corporation shareholders (*see article on page 3*) was added to lines 4 and 23 of Schedule 2 (Form 37).

Schedule 3 instructions. An instruction covering a new adjustment for certain S corporation shareholders (*see article on page 3*) was added to lines 8 and 15 of Schedule 3 (Form 37).

Schedule 4 (Form 37-S or Form 37)

As part of the changes made to page 1 of Form 37 with respect to the credit for income tax paid to another state, the instructions on line 4 of Schedule 4 were changed to revise the Form 37 line reference. The amount to enter on line 4 of Schedule 4 is to be taken from line 2 of Form 37.

Form 38

Schedule 2 (Long Method) on Form 38 was revamped to remove nine lines. Various deductions and credits were

consolidated into fewer lines to streamline the schedule. In addition to revising the instructions to conform to the changes made to the form, the instructions to Schedule 2 were revamped top to bottom to make them more complete.

A new schedule, Schedule 4, was added to page 2 of Form 38 for computing a credit for income tax paid to another state. Comparable to the Schedule 4 used for individual income tax purposes, the new Schedule 4 on Form 38 may be used by both short method and long method filers. Previously, a fiduciary for a resident estate or trust was instructed to complete the Schedule 4 used for individual income tax purposes; however, this was both inconvenient and confusing for the fiduciary.

A new paragraph was added to the instructions to line 1 of Schedule 1 (Short Method) covering the situation where a fiduciary for a nonresident estate or trust may have to recompute the federal income tax liability. Under certain conditions, Schedule 7 (*see below*) must be completed and attached to Form 38 by a fiduciary for a nonresident estate or trust.

The instructions to line 5 of Schedule 1 (Short Method), and the instructions to lines 4 and 6 of Schedule 2 (Long Method), were changed to add an instruction covering a new adjustment for certain S corporation shareholders (*see article on page 3*).

Schedule 7

Schedule 7, which implements the federal income tax liability recomputation provisions under North Dakota Administrative Code § 81-03-02.2-03, was revamped top to bottom to incorporate references to Federal Form 1041 and Schedule 1 of Form 38. These changes make the schedule easier to complete by a fiduciary for a nonresident estate or trust that is subject to the recomputation rule.

Flood relief update

In the *Practitioners' Newsletter* dated July 3, 1997, practitioners were provided with a summary of the tax relief measures granted by Tax Commissioner Rick Clayburgh. A news release dated August 14, 1997 announced additional relief granted by Commissioner Clayburgh which was not included in the previous newsletter.

The additional relief consists of the waiver of interest for the period starting after May 30, 1997 and ending August 15, 1997. This relief applies to North Dakota income tax returns of individuals in certain counties who were granted an extension to August 15, 1997 to file their federal income tax returns. Individuals in the following North Dakota counties are eligible for this additional relief: Cass, Grand Forks, Pembina, Richland, Traill and Walsh. This interest waiver applies only if the income tax return was filed on or before August 15, 1997.

Out-of-state corporation income tax nexus

A U.S.-based corporation that is domiciled in a state other than North Dakota must file a North Dakota income tax return if it has activity within North Dakota that is not protected by Public Law 86-272 (15 U.S.C. § 381). Likewise, a Canadian-based corporation having activity within North Dakota that is not protected by Public Law 86-272 must also file a North Dakota income tax return.

If a Canadian-based corporation is otherwise required to file a North Dakota income tax return, but is not required to file a U.S. income tax return under the U.S. Internal Revenue Code, North Dakota Century Code § 57-38-32 requires the corporation to prepare a U.S. income tax return on a pro forma basis to determine a starting point for the computation of the North Dakota income tax.

North Dakota has administratively adopted the *Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States under Public Law 86-272*. See this statement for guidance in determining if the activities of a corporation exceed the mere solicitation of sales which are protected under Public Law 86-272.