North Dakota Office of State Tax Commissioner

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Income Tax Update

News and developments for tax practitioners

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Some payroll service providers must file and pay state withholding taxes by electronic means

The 2003 North Dakota Legislature enacted legislation to require a payroll service provider to use electronic means to file and pay North Dakota income tax withholding taxes. For this purpose, a "payroll service provider" means a third-party person who:

Inside this issue:

- Files North Dakota income tax withholding returns on behalf of an employer;
- Pays the North Dakota income tax withheld on behalf of an employer; and
- Uses electronic means to both file and pay the federal withholding taxes on behalf of the employer.

For purposes of this requirement, North Dakota income tax withholding returns includes Form 306 (North Dakota Income Tax Withholding Return) and the year-end filing of the state copy of Form W-2.

A third-party is subject to this new requirement ***only if*** the third-party both files ***and*** pays the federal and state withholding taxes for an employer. For example, if a tax preparer prepares (and even files) the federal and state withholding returns for a client, but the tax preparer does not also pay any tax due on behalf of the client, the tax preparer is not subject to this new requirement.

For complete details on this new requirement, including the procedures that the payroll service provider must follow, go to the North Dakota Office of State Tax Commissioner's Web site at **ndtaxdepartment.com** and click on **Individual Withholding**. In the drop-down menu, click on **Publications**.

This law change takes effect August 1, 2003, and the new requirement will first apply to the tax period ending September 30, 2003 (3rd quarter of 2003). If a payroll service provider is unable to comply with the new requirement, an extension may be requested. *House Bill 1108 (Sessions Laws 2003, ch. 533), amending North Dakota Century Code § 57-38-60.*

Effect of Federal Jobs and Growth Tax Relief Reconciliation Act of 2003

On May 28, 2003, President Bush signed into law the Jobs and Growth Tax Relief Reconciliation Act of 2003 (P.L. 108-27). North Dakota's income and financial institution tax laws automatically recognize any change in the Act that affects the calculation of federal

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taxable income, the starting point in the calculation of North Dakota taxable income. This includes the increased standard deduction for married taxpayers filing jointly, the 50 percent additional first-year depreciation, and the increase in the Section 179 expense deduction. An adjustment for these items is not required when preparing the North Dakota income and financial institution tax returns.

The changes made by the Act to the child tax credit, the federal income tax brackets and rates, the alternative minimum tax exemption amounts, the capital gains tax rates, and the calculation of the tax on dividends do not affect North Dakota income tax law and will not affect the calculation of the North Dakota individual income tax.

New and expanding business income exemption now allowed on Form ND-1

North Dakota Century Code ch. 40-57.1 provides for a five-year income tax exemption that may be granted to a qualified new or expanding business. For individuals, this exemption has been allowed only on the optional method of filing on Form ND-2 (or the former long-form method on Form 37 prior to 2001). This significantly reduced the benefit of the exemption for individuals. Senate Bill 2099, enacted by the 2003 North Dakota Legislature, makes this exemption available to individuals who use the main method of filing on Form ND-1 starting with the 2003 tax year. This change will now make the exemption more appealing to sole proprietorships and to passthrough entities having individuals as owners. A new line will be added to the subtractions section on page 1 of the Form ND-1 to accommodate this exemption. *Senate Bill 2099 (Session Laws 2003, ch. 529), amending subsection 2 of North Dakota Century Code § 57-38-30.3.*

"In addition, compensation received for attending annual training, basic military training, professional military education, or active guard and reserve tours for which the member volunteered is not eligible for the deduction."

New deduction for National Guard and Reserve members called to federal active duty outside North Dakota

The 2003 North Dakota Legislature created a new deduction for National Guard and U.S. armed forces reserve members who are called to active duty in the U.S. armed forces. The deduction is equal to the amount of taxable compensation received for active duty service performed outside North Dakota. Compensation that is excluded from gross income under federal income tax law for service in a combat zone is not eligible for the deduction. In addition, compensation received for attending annual training, basic military training, professional military education, or active guard and reserve tours for which the member volunteered is not eligible for the deduction. The new deduction, which takes effect starting with the 2003 tax year, is allowed on both Form ND-1 and Form ND-2. A new line will be added to the subtractions section on page 1 of the Form ND-1 to accommodate this exemption. If Form ND-2 is used, the deduction must be entered on the "Other" line of Schedule 2. *Senate Bill 2367 (Session Laws 2003, ch. 526), creating a new subdivision to subsection 1 of N.D.C.C. § 57-38-01.2 and to subsection 2 of N.D.C.C. § 57-38-30.3.*

2003 legislative rundown

Following is a summary of the legislation affecting North Dakota's income and financial institution taxes. If a bill contained changes affecting areas of the law not related to income and financial institution taxes, the summary only covers the income and financial institution tax matters.

For the text, legislative history, and other information on any of the bills listed, go to the North Dakota Legislative Council's Web site at state.nd.us/lr

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HB 1019 - Seed capital investment tax credit

This is the North Dakota Commerce Department's appropriations bill. Included in it were the following changes to the seed capital investment tax credit provisions:

- The credit rate was increased from 30 percent to 45 percent.
- The limit on the total investments made in a tax year that are eligible for the credit was increased from $50,000 to $250,000.
- The limit on the amount of the total allowable credit that a taxpayer may claim in any tax year was decreased from 50 percent to 30 percent.
- The $250,000 limit on the amount of credits allowed for investments made in any one qualified seed capital business during a calendar period was repealed.

The bill includes a statement of intent that the seed capital investment tax credit provisions are to be the primary focus for encouraging the availability of seed capital or early stage financing for the 2003-05 biennium.

Note: *This credit is allowed on both Form ND-1 (Main Method) and Form ND-2 (Optional Method) for individuals, and on Form 38 (Methods 1 and 2) for estates and trusts.*

Statutory changes: Amended N.D.C.C. § 57-38.5-03.
Effective date: Taxable years beginning after December 31, 2002.

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HB 1108 - Electronic filing by payroll service providers

The income tax withholding law was changed to require a payroll service provider to use electronic data interchange or other electronic media prescribed by the tax commissioner to file an employer's withholding returns (Form 306) and remit the withheld taxes. This includes the annual transmittal form (Form 307) and the state's copy of Form W-2. For this purpose, a "payroll service provider" is a person who, for federal tax purposes, electronically processes and transmits an employer's withholding returns and withheld taxes, including Form W-2. This requirement may be waived by the tax commissioner for good cause.

Note: *See the article on page 1, "Some payroll service providers must file and pay state withholding taxes by electronic means", for additional information.*

Statutory changes: Created a new subsection to N.D.C.C. § 57-38-60.
Effective date: August 1, 2003.

HB 1115 - Income tax confidentiality: Reporting to U.S. Census Bureau

The income tax confidentiality law was changed to add a new exception allowing the tax commissioner to disclose an individual's social security number and county of residence (as reported on the individual's income tax return) to the U.S. Census Bureau, provided the Bureau requests the information in writing. The Bureau may use the information only for determining migration methodologies in estimating the annual shifts in the state's population. Any person who receives information under this exception may not disclose it to anyone other than the taxpayer to whom it relates. If the information is presented in a form that does not directly or indirectly identify the taxpayer to whom it relates, the information may be disclosed.

Statutory changes: Created a new subsection to N.D.C.C. § 57-38-57.
Effective date: March 26, 2003.

"... if a National Guard member is called or ordered to state active duty by the governor for 30 or more consecutive days, the protections provided by the federal Soldiers and Sailors Civil Relief Act of 1940 will be recognized for state purposes."

HB 1151 - State civil relief protections for National Guard

State military law was changed to provide that, if a National Guard member is called or ordered to state active duty by the governor for 30 or more consecutive days, the protections provided by the federal Soldiers and Sailors Civil Relief Act of 1940 will be recognized for state purposes. Among the protections provided under the federal Act, the following affect the administration of North Dakota income tax law as it applies to the collection of unpaid income tax:

- If the ability to pay North Dakota income tax is significantly impaired because of the active duty service, the collection of the tax must be deferred for a period not exceeding six months after the termination of the active duty service. This applies whether the tax becomes due prior to or during the period of active duty service.
- No penalty or interest accrues on the tax due during the deferral period.
- The time period for collection of the deferred tax is suspended for the period of active duty service plus nine months beginning with the day following the active duty service.

Statutory changes: Created a new section to N.D.C.C. ch. 37-01.
Effective date: March 12, 2003.

HB 1183 - Beginning farmer income tax deductions

Individual income tax law was changed to make a technical change to the definition of a beginning farmer for purposes of the beginning farmer income tax deductions. With respect to the education requirement in the definition, the name "state board for vocational and technical education" was changed to "state board for career and technical education."

Note: *The beginning farmer income tax deductions are allowed only on Form ND-2 (Optional Method) for individuals and Form 38 (Method 2) for estates and trusts.*

Statutory changes: Amended N.D.C.C. §§ 57-38-01.2(1)(m) and 57-38-67(2)(d).
Effective date: August 1, 2003.

HB 1207 - Port authorities

North Dakota law was changed to allow a political subdivision of the state to create a port authority. A port authority is a public entity set up to operate a port facility for the handling of equipment, passengers, and freight, and has the authority to promote, stimulate, develop, and advance the general welfare, commerce, economic development, and prosperity of its jurisdiction. Any property in North Dakota acquired by a port authority, and any income derived from the ownership, operation, or control of the property, is exempt from state taxation to the same extent as other property used for public purposes. Bonds issued by a port authority together with interest on and income from the bonds are also exempt from all taxes.

Statutory changes: Created N.D.C.C. ch. 11-36.
Effective date: August 1, 2003.

"North Dakota law was changed to allow a political subdivision of the state to create a port authority."

HB 1243 - Income tax confidentiality: Reporting to the North Dakota Lottery

This is North Dakota's lottery bill. It includes a provision that adds a new exception to the income tax confidentiality law allowing the tax commissioner to disclose to the director of the North Dakota Lottery whether or not a retailer is in compliance with North Dakota income tax law. The purpose of the exception is to facilitate the administration of the qualification criteria that a retailer must satisfy to be selected as a lottery retailer. One part of the criteria requires that a retailer who is a sole proprietorship must be current in the payment of all taxes, interest, and penalties owed to the state, excluding items under formal dispute or appeal. The director of the North Dakota Lottery must keep the disclosed information confidential.

Statutory changes: Created N.D.C.C. ch. 53-12 and created a new subsection to N.D.C.C. § 57-38-57.
Effective date: April 4, 2003.

HB 1309 - Corporate biodiesel production income tax credit

The corporation income tax law was changed to provide a new tax credit equal to 10 percent of the direct costs incurred after December 31, 2002, to adapt or add equipment to retrofit an existing facility, or to adapt a new facility in North Dakota, to produce or blend diesel fuel containing at least 2 percent biodiesel fuel by volume. The credit is allowed in each of 5 tax years. The first tax year in which the credit may be claimed is the tax year in which the facility begins producing or blending biodiesel fuel. Eligible costs incurred before the tax year in which production or blending begins are taken into account in calculating the credit. The unused portion of a tax year's credit may be carried forward for five tax years. The cumulative credit allowed to a taxpayer for all tax years is $250,000.

Statutory changes: Created a new section to N.D.C.C. ch. 57-38.
Effective date: Taxable years beginning after December 31, 2002.

HB 1426 - Commerce authorities

North Dakota law was changed to allow a political subdivision of the state to create a commerce authority. A commerce authority is a public entity set up to promote, stimulate, develop, and advance the general welfare, commerce, economic development, and prosperity of its jurisdiction. Any property in North Dakota acquired by a commerce authority, and any income derived from the ownership, operation, or control of the property, is exempt from state taxation to the same extent as other property used for public purposes.

Bonds issued by a commerce authority together with interest on and income from the bonds are also exempt from all taxes.

Statutory changes: Created N.D.C.C. ch. 11-37.
Effective date: Taxable years beginning after December 31, 2002.

HB 1457 - Renaissance zone size

The renaissance zone law was changed to provide an exception to the 20-block limit on the size of a renaissance zone. If a city has a population greater than 5,000, the 20-block limit may be increased up to 35 blocks at the rate of one block for each additional 5,000 in population. In addition, the provision allowing a one-time adjustment of an established zone's boundary to replace a nonproductive portion with another equal and contiguous area was changed to allow more than one adjustment at any time during the zone's life.

Statutory changes: Amended N.D.C.C. §§ 40-63-03(1)(c), 40-63-03(7), and 40-63-03(9).
Effective date: August 1, 2003.

"Effective for a North Dakota net operating loss incurred in a taxable year beginning after December 31, 2002, a corporation may not carry the loss back to a previous tax year."

HB 1471 - Corporation income tax changes

Effective for a North Dakota net operating loss incurred in a taxable year beginning after December 31, 2002, a corporation may not carry the loss back to a previous tax year. A related provision allowing a corporation to file a claim for refund or credit of an overpayment resulting from a North Dakota net operating loss carryback is ineffective for the same losses. *Note: These changes do not affect the carryback of capital losses, so capital losses may still be carried back as provided under these provisions prior to the 2003 changes.*

Effective for taxable years beginning after December 31, 2003, the following changes were made to the corporation income tax law:

- The federal income tax is no longer allowed as a deduction in calculating North Dakota taxable income.
- In conjunction with the repeal of the federal income tax deduction, the tax rates were changed as shown in the table below.

If North Dakota taxable income is: Over	But not over	The tax is:
$ 0	$ 3,000	2.60% of North Dakota taxable income
3,000	8,000	$78.00 + 4.10% of the amount over $3,000
8,000	20,000	$283.00 + 5.60% of the amount over $8,000
20,000	30,000	$955.00 + 6.40% of the amount over $20,000
30,000		$1,595.00 + 7.00% of the amount over $30,000

- If an eligible corporation elects to use the water's edge method to apportion its income, the corporation is subject to an additional 3.5 percent surtax on their North Dakota taxable income.

Effective for taxable years beginning after December 31, 2003, financial institution tax law was changed to insert new language to maintain the federal income tax deduction for financial institution tax purposes and to revise cross-references to statutory adjustments in the income tax law. These changes were necessary because of the statutory adjustments, including the federal income tax deduction, are allowed under the financial institution tax law (in N.D.C.C. § 57-35.3-02) by reference to the corporation income tax law (in N.D.C.C. § 57-38-01.3).

Statutory changes: Amended N.D.C.C. §§ 57-35.3-02(1)(a) and 57-35.3-02(2)(a); created new subdivision i of N.D.C.C. § 57-35.3(2); amended N.D.C.C. §§ 57-38-01.3(1), 57-38-01.3(3), 57-38-30, and 57-38-40(3); and created a new subsection to N.D.C.C. § 57-38.4-02.
Effective date: See above summary of bill.

SB 2015 - Amnesty program

This is the Office of Management and Budget's appropriations bill. Included in it was a provision that requires the tax commissioner to conduct a one-time amnesty program for all state tax types beginning before December 31, 2003.

Statutory changes: Will not be placed in the ND Century Code; see instead S.L. 2003, ch. 36, Section 49.
Effective date: May 2, 2003.

Note: *The criteria, timeline, and other details of the Tax Amnesty program are not finalized at the time of writing this article. More information will be provided in the near future.*

"The criteria, timeline, and other details of the Tax Amnesty program are not finalized at the time of writing this article."

SB 2091 - Obsolete corporation income tax provisions

Corporation income tax law was changed to repeal two obsolete sections covering the allocation of income and to make corresponding technical revisions to several other sections of the law.

Statutory changes: Repealed N.D.C.C. §§ 57-38-12 and 57-38-13; and amended N.D.C.C. §§ 57-38-11, 57-38-14, and 57-38-30.
Effective date: August 1, 2003.

SB 2098 - Tax credit for income tax paid to another state

The individual income tax law was changed to provide that a full- or part-year resident of North Dakota who claims the tax credit for income tax paid to another state must provide written proof of the payment only if the tax commissioner requires it to be provided.

Note: *The law as amended by this bill differs from prior law. Under prior law, written proof of the payment was statutorily mandated as a condition of claiming the credit. In other words, it was not up to the discretion of the tax commissioner. Long-standing administrative policy has called for a copy of the other state's income tax return to be attached to the North Dakota individual income tax return to satisfy the requirement for written proof. This policy will not change under the new law, except that the tax commissioner will no longer require an electronic return originator (ERO) to submit a paper copy of the other state's return in the case where a Schedule ND-1CR is electronically filed.*

Statutory changes: Amended N.D.C.C. §§ 57-38-04(2)(a) and 57-38-04(6)(c); and created a new subdivision to subsection 5 of N.D.C.C. § 57-38-30.3.
Effective date: Taxable years beginning after December 31, 2002.

SB 2099 - Income and financial institution tax changes

This bill made the following changes to the income and financial institution tax laws:

- The income tax law in general was changed to authorize the rounding of amounts entered on all returns, forms, statements, and other documents that are officially prescribed by the tax commissioner. This includes the amounts shown in the tables published in the individual income tax booklets and in the tables published for income tax withholding purposes. For purposes of rounding a number containing cents, if the number contains cents equal to $0.01 through $0.49, the cents must be disregarded, and if a number contains cents equal to $0.50 through $0.99, increase the number to the next whole dollar amount. This change is effective August 1, 2003.

- Effective for taxable years beginning after December 31, 2002, the individual income tax law was changed to provide that the new and expanding business income exemption under N.D.C.C. ch. 40-57.1-04 may be deducted in calculating North Dakota taxable income under the main method of filing for individuals on Form ND-1.

Note: *See the article on page 2, "New and expanding business income exemption now allowed on Form ND-1", for additional information.*

- Retroactively effective for taxable years beginning after December 31, 1999, the North Dakota domestic dividend exclusion is repealed for income and financial institution tax purposes.

"The income tax law in general was changed to authorize the rounding of amounts entered on all returns, forms, statements, and other documents that are officially prescribed by the tax commissioner."

Statutory changes: Created a new section to N.D.C.C. ch. 57-38; created a new subdivision to subsection 2 of N.D.C.C. § 57-38-30.3; and repealed N.D.C.C. §§ 57-35.3-02(2)(b), 57-38-01.2(1)(i), and 57-38-01.3(1)(g).
Effective date: See above summary of bill.

SB 2100 - Time period for assessment

The income tax law was changed to provide that the two-year period following the filing of an amended return in which the tax commissioner may audit and assess tax due (even though all other time periods for audit and assessment have expired) also applies if:

- The amended return shows a change in taxable income or income tax liability that exceeds 25% of the amount stated in the original return as filed; and,
- The amended return is filed within six years after the due date of the original return (without extension) or within six years after the original return was filed, whichever period expires last.

Statutory changes: Amended N.D.C.C. § 57-38-38(9).
Effective date: Amended returns filed after December 31, 2002.

SB 2101 - Three-year income averaging for farmers

The individual income tax law covering the three-year farm income averaging method was changed to codify the following administrative policies established in 2001:

- A farmer must elect to use the federal three-year income averaging method for calculating the federal income tax for the year to be eligible to use the state three-year income averaging method.
- If Form 37 or Form ND-2 was used for a base period, the individual must use the provisions of law applicable to that form when recalculating the tax for the base period.
- Elected farm income must be reduced by the portion of a net long-term capital gain exclusion claimed for the year, but only to the extent that it is attributable to a net long-term capital gain included in elected farm income.

Statutory changes: Amended subsections a and b of subsection 11 of N.D.C.C. § 57-38-30.3.
Effective date: August 1, 2003.

SB 2159 - Technical change to main method of filing for individuals

The individual income tax law was changed to make a technical change to the provisions covering the main method of filing for individuals (on Form ND-1) to remove a provision that was inadvertently included in the law in 2001.

Statutory changes: Amended N.D.C.C. § 57-38-30.3.
Effective date: August 1, 2003.

SB 2259 - Renaissance fund organization

The renaissance zone law covering the renaissance fund organization (RFO) was changed to:

- Allow an RFO to use its funds to invest anywhere within the boundaries of any city in North Dakota that has a designated renaissance zone. In other words, an RFO does not have to restrict its investment activity to qualified projects within a renaissance zone.
- Provide that an RFO that receives investments for which the additional $2.5 million in tax credits are allowed may use no more than 50% of the investments to make investments in an area located outside a renaissance zone but within the boundaries of the city where the zone is located. For the this purpose, "additional $2.5 million in tax credits" means the amount of tax credits that become available upon exhaustion of the $2.5 million in tax credits originally allowed by law when the renaissance zone law was enacted.
- Remove the rule that precluded an RFO from accepting new investments if, during the immediately preceding four years, the RFO did not use at least 50% of its funds for qualified purposes.
- Removed the rule that precluded investments in an RFO from qualifying for any of the additional $2.5 million tax credits (available if the original $2.5 million credits are used) if the RFO did not use at least 65% of its funds for qualified purposes or the RFO was created after the original $2.5 million in credits was used.

"In other words, an RFO does not have to restrict its investment activity to qualified projects within a renaissance zone."

SB 2367 - Active duty military pay exclusion

The individual income tax law was changed to provide for a new deduction from federal taxable income for National Guard and U.S. armed forces reserve members who are called to active duty in the U.S. armed forces. The deduction is equal to the compensation received for federal active duty service performed outside North Dakota, but only to the extent the compensation is included in federal taxable income. Compensation received for attending annual training, basic military training, professional military education, or active guard and reserve tours for which the member volunteered is not eligible for the deduction. The deduction is allowed on both the main method of filing (on Form ND-1) and the optional method of filing (on Form ND-2).

Note: *See the article on page 2, "New deduction for National Guard and Reserve members called to federal active duty outside North Dakota", for additional information.*

Statutory changes: Created a new subdivision to subsection 1 of N.D.C.C. § 57-38-01.2 and to subsection 2 of N.D.C.C. § 57-38-30.3
Effective date: Taxable years beginning after December 31, 2002.

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