



Income Tax Update

News and developments for tax practitioners

A publication of the Tax Administration Division

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Income tax rates are cut for individuals, estates, trusts, and corporations

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Starting with the 2009 tax year, the income tax rates for individuals, estates, and trusts are reduced. The remaining North Dakota estimated income tax payments for the 2009 tax year may be adjusted based on the reduced tax rates. Also, the North Dakota income tax withholding tables for employers have been revised for the 2009 calendar year and are now available on the Office of State Tax Commissioner’s website at www.nd.gov/tax. Use of the revised withholding tables for the remainder of the 2009 calendar year is optional. Following are the new tax rates and corresponding taxable income brackets for individuals, estates, and trusts for the 2009 tax year:

2009 Taxable Income

Bracket	Rate	Single		Married, Joint		Head of Household	
		\$	\$	\$	\$	\$	\$
1	1.84%	0	33,950	0	56,750	0	45,500
2	3.44%	33,950	82,250	56,750	137,050	45,500	117,450
3	3.81%	82,250	171,550	137,050	208,850	117,450	190,200
4	4.42%	171,550	372,950	208,850	372,950	190,200	372,950
5	4.86%	Over	372,950	Over	372,950	Over	372,950

Bracket	Rate	Married, Separate		Estate or Trust	
		\$	\$	\$	\$
1	1.84%	0	28,375	0	2,300
2	3.44%	28,375	68,525	2,300	5,350
3	3.81%	68,525	104,425	5,350	8,200
4	4.42%	104,425	186,475	8,200	11,150
5	4.86%	Over	186,475	Over	11,150

Starting with the 2009 tax year, the number of taxable income brackets and tax rates for corporations are reduced. The remaining North Dakota estimated income tax payments for the 2009 tax year may be adjusted based on these reductions. Following are the new tax rates and corresponding taxable income brackets for corporations for tax years beginning after December 31, 2008:

Bracket	Rate	2009 Taxable Income	
1	2.10%	\$ 0	\$ 25,000
2	5.25%	25,000	50,000
3	6.40%	Over	50,000

Senate Bill 2199; effective for taxable years beginning after December 31, 2008.



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Form ND-2, the optional method of filing for individuals, is repealed

For 28 years, North Dakota was unique among the states with two separate income tax systems for individuals. That has changed. Starting with the 2009 tax year, North Dakota returns to one system of taxation for individuals with the repeal of the optional method of filing found on Form ND-2. To most, Form ND-2 has been better known as the “long form,” a term coined in 1981 when the legislature created a second “short form” system of taxation for individuals. Since 1981, less than 2 percent of all filers have used Form ND-2 because of its higher tax rates. The deductions and tax credits that were available to individuals only if they filed Form ND-2 were also repealed; however, if any deduction or tax credit was also allowed to a corporation or other entity, the law provision governing the deduction or tax credit was amended to make it inapplicable for an individual. These changes also apply to estates and trusts, which are subject to the same income tax provisions applicable to individuals.

In addition to the repeal of Form ND-2, the law governing Form ND-1 was changed to require the tax commissioner to prescribe a new “optional simplified method” of filing for an individual. This new “EZ” method will be a true short form in that it will be the same as the Form ND-1 except that there will be no additions, subtractions, or tax credits on it. The same tax rates will apply to both the Form ND-1 and the new “EZ” form.

Starting with the 2009 tax year, all individuals will file either Form ND-1 or the new “EZ” form, and estates and trusts will file Form 38 (as modified to remove Schedule 2, the optional method).

House Bill 1324; effective for taxable years beginning after December 31, 2008. 

A one-time credit is allowed to taxpayers ineligible for the property tax relief credit in 2007 and 2008

A new nonrefundable income tax credit is available to certain taxpayers who were ineligible for the property tax relief income tax credit under the 2-year program enacted by the 2007 North Dakota Legislature. The new credit is allowed only for the 2009 tax year (with an unused credit carryover provision—see below).

Eligible property—The new credit is allowed for real property located in North Dakota that is classified by the county as agricultural or commercial for property tax purposes. This includes a mobile home that is classified as commercial property for mobile home tax purposes. ***Property for which an income tax credit was allowed on the 2007 or 2008 North Dakota income tax return under the 2-year program enacted by the 2007 North Dakota Legislature IS NOT eligible for this new credit. This includes property for which a credit could have been claimed on the 2007 or 2008 return but was not allowed because of the limitations under the 2-year program.***

Eligible property taxes—The new credit is based on the following property taxes:

- **2006 property tax**—This includes (1) the 2006 real estate tax due on January 1, 2007, and (2) the 2007 mobile home tax due on January 10, 2007.
- **2007 property tax**—This includes (1) the 2007 real estate tax due on January 1, 2008, and (2) the 2008 mobile home tax due on January 10, 2008.

The amount on which the credit is based is the “consolidated tax,” which is the amount of the total real estate tax (or mobile home tax) before any discount is subtracted and before any special assessments are added, as shown on the real estate and mobile home tax statements issued by the county.

Eligible taxpayer—The new credit is allowed to a resident or nonresident individual, estate, or trust. To qualify, the individual, estate, or trust must have owned the eligible property on the due date of the eligible property taxes. An individual, estate, or trust is also eligible for the credit on its share of

... the law governing Form ND-1 was changed to require the tax commissioner to prescribe a new “optional simplified method” of filing for an individual.

eligible property taxes paid by a partnership, S corporation, or limited liability company (treated like a passthrough entity) on eligible property that the entity owned on the due date of the eligible property taxes—see “Passthrough entity” below for more details.

Amount of credit—The new credit equals the *sum* of the following two credits:

- **Credit on 2006 property tax**—This credit equals 10% of the 2006 property tax on eligible property (including any 2006 property tax from a passthrough entity), up to a maximum credit of \$1,000.
- **Credit on 2007 property tax**— This credit equals 10% of the 2007 property tax on eligible property (including any 2007 property tax from a passthrough entity), up to a maximum credit of \$1,000.

Unused credit—If an individual, estate, or trust is unable to use all of the new credit, the unused credit may be carried forward for up to 4 tax years. There is no option to receive a property tax relief certificate for the unused portion of the credit.

Passthrough entity—If eligible property is held by a partnership, S corporation, or limited liability company that files North Dakota Form 58 (partnership return) or North Dakota Form 60 (S corporation return), the owners—limited to individuals, estates, or trusts—include their respective shares of the eligible property taxes paid by the entity in calculating the credit on their 2009 North Dakota income tax returns. If an owner is another partnership, S corporation, or limited liability company, that owner’s share of eligible property taxes passes through in a similar manner to its owners. *If a passthrough entity is subject to the North Dakota financial institution tax (on Form 35), neither the entity nor its owners are eligible for the credit.*

An estate or trust may either (1) calculate the credit on its eligible property taxes and apply it to its own tax liability or (2) pass part or all of its eligible property taxes through to its beneficiaries. If passed through, a beneficiary includes the passed through property taxes in the calculation of the credit on the beneficiary’s 2009 North Dakota income tax return.

Eligible property taxes paid by an estate, trust, partnership, or S corporation on eligible property will be a required information item on the 2009 North Dakota Form 38, 58, or 60. The eligible property taxes passed through to beneficiaries, partners, or shareholders will not be reported to them on Schedule K-1. Instead, using the same passthrough entity procedure prescribed by the tax commissioner for purposes of the 2007 and 2008 income tax returns, the entity will separately provide the eligible property tax information to its eligible members.

House Bill 1448; effective for the 2009 taxable year only. 

2009 legislative rundown

Following is a summary of legislation affecting income and financial institution taxes passed by the 2009 North Dakota Legislature. This summary only covers the portions of a bill relating to income and financial institution taxes. For the bill text, summary of bill actions, and other legislative information, go to the North Dakota Legislative Council’s website at www.legis.nd.gov. **Note:** *Unless stated otherwise, all changes apply to taxable years beginning after December 31, 2008.*

House Bill 1086 – Technical changes

A number of technical changes were made to the income and financial institution tax laws. The more notable changes are summarized below. See the bill for all of the changes.

- The law governing the research expense income tax credit was changed to provide that the annual \$2 million credit ceiling only applies to a taxpayer who earned or claimed the credit in a tax year beginning before January 1, 2007, and not to every taxpayer as the current law incorrectly reads. Also, for credits earned after December 31, 2008, a claim for refund based on a credit carryback must be filed within three years of the due date, or extended due date, of the return filed for the tax year in which the credit was earned.

There is no option to receive a property tax relief certificate for the unused portion of the credit.

- For amended returns filed after June 30, 2009, the income tax law providing for when interest accrues on a refund attributable to a net operating loss or capital loss carryback was changed to include a credit carryback.

House Bill 1088 – New exceptions to confidentiality law

The law prohibiting the disclosure of state income tax information by the Office of State Tax Commissioner was changed to add the following new exceptions to the prohibition:

- A court may issue an order or subpoena directing the tax commissioner to disclose information to a local, state, or federal law enforcement official conducting a criminal investigation if:
 1. There is probable cause to believe that a specific criminal act has been committed and that the information constitutes evidence of a criminal offense or may be relevant to a matter relating to the commission of the criminal offense;
 2. The information is sought exclusively for use in a criminal investigation or proceeding concerning such act; and
 3. The information cannot reasonably be obtained under the circumstances from another source.
- Before obtaining a court order, a local, state, or federal law enforcement official may request information from the tax commissioner as to whether a taxpayer, who is the subject of a criminal investigation and for which the information is or may be relevant to the commission of a criminal offense, has complied with the law, in which case the tax commissioner is limited to stating that the taxpayer has or has not complied with the law.
- Except as required during court proceedings, information disclosed to a local, state, or federal law enforcement official remains confidential during an active criminal investigation, after the investigation, after prosecution concludes, or until the time period for appeals has expired, whichever is later in time.

House Bill 1199 – Expansion of income tax refund offset program

The North Dakota Insurance Department was added to the list of claimant agencies whose debts may be offset using an individual debtor's North Dakota income tax refund.

House Bill 1209 – New income tax credit for owning a long-term care “partnership plan” insurance policy

A new nonrefundable income tax credit is available to a North Dakota resident individual or spouse who is insured by a long-term care “partnership plan” insurance policy. The credit equals the premiums paid during the tax year, up to a maximum credit of \$250. In the case of married individuals who file a joint return, where each spouse is covered by an eligible policy, the \$250 credit limit applies to each spouse (for a total maximum credit of \$500). A “partnership plan” policy is distinguished from other types of long-term care insurance policies by a special notice that an insurer is required to give to the policyholder as part of the policy. ***There are long-term care insurance policies that are not “partnership plan” policies and therefore not eligible for this new credit. This includes policies for which the long-term care insurance income tax credit may have been claimed on Form ND-2 prior to 2009.***

House Bill 1256 – New deduction for “qualified dividends”

A new deduction from income is available to an individual, estate, or trust that receives qualified dividends. The deduction equals 30 percent of the qualified dividends received during the tax year that are taxable in North Dakota. “Qualified dividends” means dividends as defined under Internal Revenue Code § 1(h) as of December 31, 2008, which are dividends received from a domestic corporation or qualified foreign corporation that are eligible to be taxed at the lower net long-term capital gain tax rates for federal income tax purposes. Qualified dividends do not include dividends treated as investment income for purposes of the investment expense deduction for federal income tax purposes.

A court may issue an order or subpoena directing the tax commissioner to disclose information to a local, state, or federal law enforcement official . . .

House Bill 1277 – Geothermal energy device income tax credit allowed to Form ND-1 filers

For tax years up through 2008, the income tax credit for installing a biomass, geothermal, solar, or wind energy device in North Dakota was not allowed to an individual who used Form ND-1; the credit could be claimed only on Form ND-2. For tax years beginning after December 31, 2008, the law was changed to allow this tax credit to be claimed on Form ND-1, **but only for installing a geothermal energy device**. To qualify, the geothermal energy device must be installed after December 31, 2008. This change also applies to an estate or trust that calculates its income tax using Schedule 1 of Form 38. (Also see *Senate Bill 2033 for changes made to the energy device income tax credit provisions in general.*)

House Bill 1392 – New deduction for an interest-charge DISC corporation

A new deduction is available to a corporation that is an interest-charge domestic international sales corporation (IC-DISC) under Internal Revenue Code (IRC) § 992, provided it is owned by one or more individuals or passthrough entities and is without economic substance, which means it elects to use intercompany pricing rules under IRC § 994. The deduction equals the amount of actual or deemed distributions by the IC-DISC to its owners. The purpose of this deduction is to treat this type of IC-DISC in the same manner as for federal income tax purposes, where the IC-DISC's income is exempted from corporation income tax and taxed to the shareholder.

House Bill 1428 – Renaissance zone program changes

The law governing the North Dakota renaissance zone tax incentive program was changed to provide that a city may apply to the North Dakota Commerce Department, Division of Community Services, to make two new changes to its renaissance zone: One, request the removal of a completed block within its renaissance zone and replace it with a new block. Two, request that the duration of its zone (which is initially limited to 15 years) be extended in increments of up to 5 years. In addition to these changes, the ceiling on the total credits allowed for investments made in renaissance fund organizations for all years is increased by \$2.5 million, putting the ceiling at \$7.5 million. (Also see *Senate Bill 2060 for other changes made to the renaissance zone program.*)

House Bill 1489 – New income tax credit for soybean or canola crushing facility costs

The law governing the existing corporation income tax credit for the cost to retrofit or construct a facility to produce or blend biodiesel fuel was expanded to include a facility that crushes soybeans or canola. Direct costs incurred after December 31, 2008, are eligible for the credit relating to a soybean or canola crushing facility, and the credit is first allowed in the tax year in which the crushing operation begins. Eligible costs incurred after December 31, 2008, but before the tax year in which the crushing operation begins may be used to calculate the credit.

Senate Bill 2033 – Energy device income tax credit changes

The law governing the existing income tax credit for installing a biomass, geothermal, solar, or wind energy device was changed as follows:

- The sunset date of this law was extended from January 1, 2011, to January 1, 2015. *Note: The credit is not available for devices installed on or after this date.*
- The unused credit carryover period was extended from 5 to 10 tax years for devices installed after September 30, 2008; however, for a wind device only that is installed after September 30, 2008, and before January 1, 2012, the unused credit carryover period was extended to 20 years.
- The provisions providing for the transfer of the credit to another taxpayer who purchases the power generated by the device through a power purchase agreement, or who constructs or expands an electricity transmission line in North Dakota, were repealed.

. . . the law was changed to allow [the geothermal energy device credit] to be claimed on Form ND-1 . . .

Leasehold improvements and rehabilitation of public utility infrastructure were added to the list of eligible zone projects for purposes of the business income exemption.

Senate Bill 2060 – Renaissance zone program changes

The law governing the North Dakota renaissance zone tax incentive program was changed as follows:

- The provision allowing a city to set up a 3-block area that is not contiguous with the zone was changed to remove the restriction that the distance between the zone and the 3-block area may not exceed one half mile.
- Leasehold improvements and rehabilitation of public utility infrastructure were added to the list of eligible zone projects for purposes of the business income exemption. Also, leasehold improvements were added as an eligible zone project for purposes of the tax credit that may be elected in lieu of the business income exemption.
- A new tax credit was added for a property owner not participating in a zone project who is required to make changes in utility services or building structure solely because of changes directly resulting from another taxpayer's zone project. Subject to approval by the local zone authority, the credit is equal to the necessary costs incurred to make the required changes. The credit must be claimed in the tax year in which the related zone project is completed. An unused credit may be carried forward for up to 5 tax years.
- The property tax exemption provisions were expanded to provide that the state board of equalization may grant a partial or complete exemption from ad valorem taxation of public utility infrastructure rehabilitated as a zone project.

(Also see House Bill 1428 for other changes made to the renaissance zone program.)

Senate Bill 2089 – New addition adjustment for corporations

A new addition adjustment must be made by a corporation that holds an interest in a captive real estate investment trust (captive REIT). The adjustment equals the amount of the dividends-paid deduction claimed on the captive REIT's federal income tax return. The purpose of the adjustment is to prevent the same dividend income from being excluded twice from North Dakota taxable income—first, when the state recognizes the captive REIT's federal taxable income (reduced by the dividends-paid deduction) and, second, when the corporate parent is allowed to exclude as an intercompany elimination the dividends it received from the captive REIT when computing its combined income for its North Dakota income tax return. A "captive REIT" is an entity that meets the following conditions:

- It is a real estate investment trust as defined under Internal Revenue Code (IRC) § 856;
- Its shares or beneficial interests are not regularly traded on an established securities market; and
- Over 50% of the voting power or value of its shares or beneficial interests are owned or controlled—directly, indirectly, or constructively—by a single entity that is treated as an association taxable as a corporation under federal income tax law and is not a tax-exempt entity under IRC § 501. For this purpose, an association taxable as a corporation does not include a non-captive REIT, a qualified REIT subsidiary of a non-captive REIT, a listed Australian property trust, or a qualified foreign entity.

Senate Bill 2269 – Changes to angel fund investment tax credit

The law governing the angel fund investment tax credit was changed to provide a definition of what constitutes a qualifying angel fund, and to require its certification by the North Dakota Commerce Department. To be certified, an entity must satisfy all of the following conditions:

- It must be a for-profit partnership (all types), corporation, limited liability company, trust, or estate that is headquartered in North Dakota and is in compliance with North Dakota's securities laws.
- It must have at least six accredited investors, as defined by Securities and Exchange Commission Regulation D, Rule 501, of which no one investor owns more than 25% of the angel fund's capitalized investment assets. The investor members, or a designated board that includes investor members, must manage the angel fund and make decisions as a group.
- Except where any one investor member owns 50% or more of the ownership interests in an enterprise, investor members may be involved in the enterprises in which the angel fund invests.

- It must have a minimum of \$500,000 in commitments from its accredited investors, subject to call for investment over an unspecified number of years for building a portfolio of investments in enterprises. Its investment portfolio must contain at least 3 early-stage and mid-stage private, nonpublicly traded enterprises with strong growth potential.


In addition, a lifetime maximum of \$5 million in credits was set for all investments made in a single angel fund.

Senate Bill 2388 – New income tax credit for employers of employees called to active duty in the U.S. armed forces

A new nonrefundable income tax credit is available to an employer of an employee in the National Guard or a reserve component of the U.S. armed forces who is mobilized for federal active duty under Title 10 of the U.S. Code. To qualify, the employee must be a North Dakota resident. The credit is equal to 25% of the lesser of (1) the amount of compensation the employer continues to pay during the period of mobilization or (2) the “reduction in compensation” (*see below*). The credit is limited to \$1,000 for each eligible employee. An unused credit may be carried forward for up to 5 tax years. If an employer is a partnership, S corporation, or limited liability company that files Form 58 (partnership return) or Form 60 (S corporation return), the credit is calculated at the entity level, and the resulting credit is passed through to the entity’s owners in proportion to their respective interests.

The “reduction in compensation” is the excess of (1) the amount of compensation the employer would have paid had there been no mobilization over (2) the total military compensation paid because of the mobilization. In determining the amount of compensation the employer would have paid, the employer’s portion of any voluntary or matching contributions paid, or that would have been paid, into a defined contribution plan may be included. In determining the reduction in compensation, the civilian and military compensation must be compared for the same time period. If the military compensation is equal to or more than the civilian compensation, the “reduction in compensation” is zero, and no credit is allowed.

Senate Bill 2405 – Exception to § 199 addition adjustment for certain cooperatives

For tax years ending after April 30, 2009, an exception is provided to the addition adjustment that a corporation must make for the Internal Revenue Code (IRC) § 199 domestic production activity deduction. The exception applies only to a corporation that is a cooperative that elects to pass its domestic production activity deduction through to its patrons under IRC § 199(d)(3). The reason for this exception is to prevent the overstatement of North Dakota taxable income. Federal taxable income, as reduced by the IRC § 199 deduction, is the starting point for calculating North Dakota taxable income. However, in the case of a cooperative that passes its IRC § 199 deduction through to its patrons, the IRS procedure for completing Form 1120-C calls for the cooperative to enter the IRC § 199 deduction on the line provided for it on the return (which reduces federal taxable income) and then use the same amount to reduce the dividends paid to patrons reported on the return (which increases federal taxable income), effectively resulting in no change to federal taxable income. 

A new nonrefundable income tax credit is available to an employer of an employee . . . mobilized for federal active duty . . .



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