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TAX EXEMPTION AS A BUSINESS INCENTIVE IN NORTH DAKOTA

Introduction

Chapter 40-57.1 of the North Dakota Century Code,¹ hereinafter referred to as the New Industries Exemption Act, authorizes a municipality's governing body to negotiate with a potential new business for the purpose of granting either a partial or complete ad valorem property tax exemption for a five year period. Before the exemption is granted, however, the governing body must apply to the State Board of Equalization and obtain its approval.² The Board holds hearings on every application submitted, and the applicants (representatives of the municipality and the prospective business) usually appear to present their case and to answer any questions aimed at determining whether an exemption in a particular case will fulfill the purposes of the statute. An adverse decision by the Board upon the first application is by no means decisive since some companies have submitted, through the representatives of a local community, up to three applications before the exemption was granted.³

A state income tax exemption may, in some cases, likewise be

1. N.D. CENT. CODE § 40-57.1-01 (Supp. 1969). "[T]o . . . encourage activities in the public interest and for the welfare of the state of North Dakota . . . by assisting in the establishment of additional industrial plants and promotion of economic activities"

"[A]n unfair advantage shall not be given to new enterprises which is to the substantial detriment of existing enterprises."

N.D. CENT. CODE § 40-57.1-02 (Supp. 1969).

"[T]he term 'project' shall mean any real property and improvements on real property or the buildings thereon and . . . any combination of two or more such enterprises, engaged or to be engaged in:

1. [M]anufacturing
2. Storing, warehousing, distributing, or selling any products
3. Any other industry or business not prohibited by the constitution or laws of the state of North Dakota."

N.D. CENT. CODE § 40-57.1-03 (Supp. 1969). "Municipalities are hereby authorized . . . to grant, after negotiation with a potential project operator, partial or complete exemption from ad valorem taxation on all tangible property used in or necessary to the operation of a project for a period of five years from the date of commencement of project operations The municipality shall, before granting any such exemption, make application to the state board of equalization for approval, and the board shall, if it finds that such exemption will not result in unfair tax reduction competition between political subdivisions of this state, determine whether the granting of the exemption is in the best interest of the people of North Dakota, and if it so determines shall give its approval"

2. North Dakota Business and Industrial Development Department, Did You Know? —North Dakota offers special tax exemptions to new industry.

3. Letter from Joseph R. Maichel, Special Assistant Attorney General for the Office of the North Dakota State Tax Commissioner, Nov. 9, 1970, to this office.

granted to a new business⁴ under the act, and it appears that an income tax exemption can only be approved, according to the Attorney General, if the property tax exemption has first been applied for and approved.⁵ "[T]he city or county may also apply to the State Board for a five year exemption from state income tax for the new industry if application for an ad valorem tax exemption is made."⁶ (Emphasis Added)

This note is undertaken to examine the necessity and desirability of the New Industries Exemption Act as an inducement for business to enter North Dakota. To achieve this purpose, the attitudes of businessmen and scholars towards such legislation as an inducement to businessmen in choosing to locate within a particular state are set forth. Some of the particular problems and questions arising from the New Industries Exemption Act will be considered, and some of the confusion inherent in the Act hopefully will be eliminated. Finally, an alternative approach to the problem of making a state attractive to businessmen will be offered, whereby, the author believes, the true measure of inducement—the state's business image—can be improved.

It appears that immediately after World War II state legislatures developed the "drive-industry-out" theory;⁷ namely, that if industries were not given tax incentives, they would shun the state in favor of more sympathetic areas. In fact, the theory so preoccupied the Indiana Tax Commission in 1952 that it induced them to conclude: "It is of the utmost importance to maintain Indiana's tax position as compared to competing industrial states, and any adjustments in rate or structure must give this position first consideration."⁸ However, this theory has suffered a loss of supporters due to the findings that it has little factual basis to justify the fears of Indiana's state legislators.

Costs and Benefits

Before considering the actual effect of such tax concessions upon businessmen, one must consider the actual costs and benefits of tax concessions from the state's point of view.

The benefit to the state is the present value of the increase

4. N.D. CENT. CODE § 40-57.1-04 (Supp. 1969). "The net income of any project granted an exemption from ad valorem taxation may be exempt from state income tax for a like period. . . ." The same procedure concerning the State Board of Equalization in § 40-57.1-03 is followed.

5. *Supra*, n. 3. The Board of Equalization has apparently been more reluctant to allow the income exemption than the property exemption. As of November 9, 1970 the Board had allowed the property tax exemption to fifteen applicants, and the income tax exemption to nine applicants. Letter, *supra*, note 3.

6. *Supra*, n. 2.

7. Due, *Studies of State-Local Tax Influences on Location of Industry*, 14 NAT'L TAX J. 163 (1961).

8. *Id.* at 172.

in state income due to investments undertaken in the state because of the incentive program measured by the increase in employment and the influx of new employees, and returns upon the investment in the state.⁹ The costs include the following:

1. The present value (over five years) of the decrease in state income due to diversion of funds used to finance this program from funds used to finance other investments.

2. The present value of the decrease in state income resulting because some of those financing the incentive program would have, as a result, lower incomes. (Taxpayers paying higher taxes to offset exemptions).¹⁰

3. Immediate loss of governmental services due to increase in state income,¹¹ combined with an influx of new workers thereby increasing the demand for such services.

4. Ecological dangers. The dangers of pollution by large factories in a state relatively free of that plight ought to be a prime concern of state legislators.

Whether the benefits of the New Industries Exemption Act actually outweigh its costs in North Dakota is impossible to calculate at this point because of its relative youth. However, findings in Louisiana based upon similar legislation tend to show that in that state it is doubtful whether the benefits actually outweighed the costs.¹²

Necessity: The Attitudes of Businessmen

The attitudes of businessmen have been reflected in two types of surveys undertaken to determine the effect of such legislation

9. Brandt, *The North Dakota Viewpoint*, Committee on Industry and Business (1969), p. 1, on file at the State Capitol Building, Bismarck, North Dakota.

10. *Id.*

11. Due, *supra*, n. 7 at 167; "Summary of Master's Thesis entitled 'Tax Environment and The Development of Manufacturing in North Dakota' by Lyle R. Fogel," Legislative Research Committee, Sept. 1967, at 11, on file at State Capitol Building, Bismarck, North Dakota.

12. A cost-benefit analysis of Louisiana's exemption statute will serve as an illustration. Brandt and Herman, *The Effect of Plant Location Factors on Business Investment Decisions*, Committee on Industry and Business, p. 3, on file at State Capitol Building, Bismarck, North Dakota.

Computation of tax revenue lost:

\$51 million (P.V. of exemption over period of exemption for all firms).

\$5 million (P.V. of exemptions of firms that would not have located in Louisiana but for exemption).

\$46 million*

*This figure represents the first cost mentioned above. Type one costs exceeded benefits in Louisiana. In other words, if some other form of financing had been utilized, more jobs would have been created with state funds than with those created under the tax exemption program.

However, the P.V. of increase in state income due to investments may have been greater than revenue lost. Brandt, *supra*, n. 9.

It is doubtful that the increase in state income due to increased investments was significant since it was estimated that only \$25 million in investment was agined due to the exemption.

from a businessman's viewpoint.¹³ In one type, questionnaires were submitted to firms asking them to list the most important factor or factors which induced them to locate in their present location. No suggestion of tax incentives was introduced to bias the sample of such surveys. Contrasted to this type of survey are questionnaires which specifically asked firms whether such tax incentives were important.

Surveys of the former type ranked tax incentives very low in importance when compared to other factors, and the results of three such surveys disclosed the following: A Southern study ranked financial inducements last among sixteen location factors. A favorable tax structure was next to last among reasons given by new or expanded firms for the choice of their present location.¹⁴ A North Carolina Survey disclosed that special inducements or industrial development incentives ranked tenth out of fourteen factors.¹⁵ In Michigan, management representing only two percent of the plants in that state felt that "concessions and inducements" were one of the main reasons for their location.¹⁶

However, surveys of the latter type tended to show that businessmen thought such incentives important. The same Michigan survey mentioned above brought different results, when businessmen were asked this specific question: Is financial assistance to industry by states or localities through the provision of initial tax incentives effective? Management, representing plants with 57% of the total employment in the survey, stated such inducements were effective.¹⁷ The Michigan survey is representative of such direct question studies, although it indicated a stronger pro-tax concession attitude of businessmen than most other surveys of this type. John F. Due reveals several reasons why businessmen stress the tax factor, and why these surveys are biased favorably towards tax concessions.¹⁸ Many businessmen have an anti-tax attitude thereby conditioning them to elevate the tax factor. In addition, businessmen believe that their answers may influence the findings of the survey which will stimulate lower taxes.

"Firms will frequently announce the suspension of building plans pending legislative action. Such announcements must be recognized for what they almost always are: purely strategic moves designed to influence the outcome of legislative action."¹⁹

13. Brandt and Herman, *The Effect of Plant Location Factors on Business Investment Decisions*, Committee on Industry and Business, on file at Capitol Building, Bismarck, North Dakota.

14. *Id.* at 1-2.

15. *Id.* at 3.

16. *Id.* at 5.

17. *Id.* at 7.

18. Due, *supra*, n. 7, at 166.

19. Due, *supra*, n. 7, at 166.

The following statement of Holly Sugar Company in 1968 may have been persuasion of this type: ". . . 'Having been frustrated thus far into 1967 efforts to use municipal industrial revenue bond financing and with very little prospect that this means of financing can be used in the future, Holly is now looking at alternative means of financing the projected Red River Valley Factory. The availability or unavailability of the valuable five year property tax exemption, whatever the means of financing used, could be a powerful inducement to proceed with new plant projects in North Dakota.'"²⁰ Holly never did locate in this state.

It also appears that firms which pay high taxes are particularly willing to co-operate, and thus bias the sample.²¹ One can assume that surveys of the latter type, representing the bias and expectations of businessmen were probably the catalysts of the "drive-industry-out" theory. Due notes that when compared to other factors, tax incentives are not very important, and this is the advantage of surveys which ask firms to list factors that will influence their location decision.²²

The following table adds to the case against the "drive-industry-out" theory which states tax incentives are necessary to draw businesses into a state. Minnesota will serve as an illustration from the table below. Although that state had the highest state corporate income tax rate (7.3%), it ranked above the average index of change in the United States in value added to total investment per state by manufacturing firms. To facilitate comprehension, the national average was indexed at 100, and the table below shows Minnesota to have obtained a higher relative increase in manufacturing investment than the national average since its change is indexed at 104.

TABLE I²³

INDEX OF CHANGE IN VALUE ADDED BY MANUFACTURE, BY STATE, 1954-58

(U. S. Average 100)

Percentages Indicate 1958 State Corporate Income Tax Rates

High Business Tax States	Index	Low State Taxes (No Corporate Income Taxes)
Industrial-Belt States		
Pennsylvania (6%)	97	Ohio 92
Michigan*	83	Illinois 93
Wisconsin (2-7%)	99	Indiana 96

20. Report of the North Dakota Legislative Research Committee, 1969, at 87.

21. Due, *supra*, n. 7, at 166.

22. Due, *supra*, n. 7, at 165, 167.

23. Due, *supra*, n. 7, at 170.

Industrial-Belt States (Continued)

Iowa (2%)	107
Minnesota (7.3%)	104
Kentucky (5%)	119

Southern States

Maryland (5%)	108
Virginia (5%)	108
North Carolina (6%)	116
South Carolina (5%)	111
Georgia (4%)	110
Alabama (3%)	110
Mississippi (2-6%)	113
Tennessee (3.75%)	108
Louisiana (4%)	100
Arkansas (1-5%)	106

*Value added and capital stock franchise taxes.

Source: U. S. Department of Commerce, Area Development Bulletin, Feb.-March 1960.

Desirability: Attitudes of Scholars

"But clearly the figures indicate that relatively low tax rates in themselves cannot protect a state from declining relative growth, when other factors are unfavorable, whereas high tax rates and bad reputations taxwise do not appear to have very significant effects in the opposite direction."²⁴ The attitudes of businessmen reflected above have led scholars to the conclusion that businessmen regard tax incentives as a relatively minor cost factor or at least of secondary importance.²⁵

However, several other factors have influenced scholars to shun the "drive-industry-out" theory. For example, taxes are of very minor consequence when compared to other costs, and on the average it appears that tax cost differentials are approximately 1/10th of the tax cost differentials in other costs such as transportation or labor.²⁶ This is portrayed by the surveys²⁷ above which listed the availability of labor, convenience to markets, availability of buildings or other property, transportation, lower labor costs, and the availability of raw materials as much more important factors in choosing a location. Due adds that any significance which businessmen place upon the

24. Due, *supra*, n. 7, at 171-172.

25. Due, *supra*, n. 7, at 171; Fred P. Brandt, *supra*, n. 9, at 5; Brandt and Herman, *supra*, n. 13, at 15-16; *In Defense of the Property Tax*, The Wall Street Journal, Feb. 3, 1971, at 10, col. 1.

26. "Summary of Master's Thesis," *supra*, n. 11, at 10; 'Tax Environment and the Development of Manufacturing in North Dakota,' by Lyle R. Fogel, Legislative Research Committee, Sept. 1967, at 10, on file at State Capitol Building, Bismarck, North Dakota.

27. Brandt, *supra*, n. 13.

tax element is further reduced by approximately 52% since the Internal Revenue Service allows all state business taxes to be deducted in calculating federal income tax liability.²⁸ Also, high taxes can be overemphasized, especially when as in many cases, the extra burden can be shifted to consumers.

In addition it is questionable whether the New Industries Exemption Act is desirable if it stimulates neighboring states to retaliate with identical tax incentives.²⁹ This would negate any effect such legislation may have had upon business choice. This is especially true since business does not seem to consider tax incentives as effecting a choice of a region, but only the choice of a location with a particular region. Fortunately, as of this time, North Dakota's sister states, Iowa, Minnesota, Montana, Nebraska, South Dakota, and Wyoming, have not retaliated in this manner. The effect of such retaliation would be compounded if governmental services are sacrificed by such measures: "Adequate taxation if matched by 'value received' in the form of public services may constitute less of a threat to sound industrial development than 'tax bargains' offered along with second rate public services and inadequate governmental revenues."³⁰ Due agrees that there is such a danger, adding that low-tax, poor-service areas may be very unattractive to employees.³¹

It is interesting to note that the North Dakota Legislature attempted to provide for such governmental service deficiencies in legislation of a similar type in lifting a mandatory requirement that all leaseholds of new businesses which were obtained from the state or any of its subdivisions be exempt from a personal property tax for a period of five years.³² "The firm might also decide that continuation of essential governmental services, such as fire and police protection, would not be possible if the tax revenue generated by assessment of the firm's property was not available."³³ This is a recognition that such tax inducements may well be self-defeating.

Probably the biggest danger of an exaggeration of the influence of taxation upon location is the imposition of a major obstacle to reform of tax structures, thereby neglecting the needs of the community.³⁴ It has been noted, "[t]hat all too frequently property tax exemptions have been used by localities as gimmicks to attract new industry, with resulting injustice to the taxpayers already there. The assessment process, moreover, has often been subverted by outright bribery."³⁵

28. Due, *supra*, n. 7, at 167.

29. "Summary of Master's Thesis," *supra*, n. 11, at 12.

30. "Summary of Master's Thesis," *supra*, n. 11, at 12.

31. Due, *supra*, n. 7.

32. N.D. CENT. CODE § 40-50-17 (1960, Supp. 1969).

33. N. Dak. Atty. Gen. Opinion, July 1, 1969.

34. Due, *supra*, n. 7, at 172.

35. *In Defense of the Property Tax*, The Wall Street Journal, Feb. 3, 1971, at 10, col. 1.

Particular Problems with the New Industries Exemption Act

Before considering the actual effect of state taxes upon the business image of a state, or before any alternative approaches can be suggested, some confusion arising from the New Industries Exemption Act should be alleviated, since the exemption does exist in North Dakota.

A frequent problem encountered by attorneys in North Dakota is whether the new exemption extends to land. One would assume an affirmative answer since the language of the Act is very broad, extending exemptions to "... all tangible property used in or necessary to the operation of a project . . .",³⁶ a project being "... any real property, buildings and improvements on real property or buildings thereon. . . ."³⁷

Nevertheless, the Attorney General³⁸ stated that land was not exempt under the New Industries Exemption Act because the North Dakota Constitution³⁹ did not expressly give the North Dakota Legislators authority to grant an exemption upon land. It is generally recognized that where the power to grant exemptions is constitutionally defined and limited the legislature is not permitted to extend or broaden their power beyond that authorized by the Constitution, and such a power is strictly interpreted to exclude expansion of the power by merely re-labeling the property so that it will come within the class of property which the legislature is permitted to exempt.⁴⁰

The North Dakota Supreme Court following this line of reasoning stated: "That the legislature did not intend the counties to cancel taxes upon lands owned by private individuals is a proposition that should need no demonstration. There must be some basis approved by the Constitution . . . for exempting property from taxation."⁴¹ Therefore to avoid constitutionally jeopardizing the New Industries Exemption Act, the Attorney General narrowed the apparent meaning of its language to exclude land.⁴²

36. N.D. CENT. CODE § 40-57.1-03 (Supp. 1969).

37. N.D. CENT. CODE § 40-57.1-02 (Supp. 1969).

38. N. Dak. Atty. Gen. Opinion, July 29, 1969; *see also* N. Dak. Atty. Gen. Opinion, Aug. 18, 1969.

39. N.D. CONST. § 176.

"Taxes shall be uniform upon the same class of property. . . . The legislature may by law exempt any or all classes of personal property from taxation and within the meaning of this section, fixtures, buildings and improvements of every character, whatsoever, upon land shall be deemed personal property. . . ."

40. 84 C.J.S. *Taxation*, § 220 (1954).

41. *Westland v. Stalneck*, 76 N.D. 291, 295, 35 N.W.2d 567, 570 (1948).

42. The problems with the New Industries exemption have arisen, chiefly due to a confusion with the leasehold exemption. N.D. CENT. CODE § 40-57-17 (Supp. 1969). "... Upon application by the project lessee to the governing body of the municipality and approval, the leasehold and all other personal property used by the lessee in connection with the project and located on the premises of the leasehold shall be exempt from personal property taxation for a period of five years from the granting of the leasehold. . ." Similar to § 40-47.1-04, this section

Confusion arises, also, when an attorney considers the effect of the personal property tax repeal provision⁴³ upon the property classified as personal for the purposes of the New Industries Exemption Act. Under this provision all personal property is exempt from taxation after 1970. The problem arises, as the Attorney General notes, from the broad language of the Act. "... [A]ll fixtures and buildings would be classified as personal property and so exempted. . . . [I]t seems possible that the word 'improvement' could be construed as including things additional to fixtures and buildings. Thus . . . , such things considered to be improvements under varying statutes [are] canals, planting of vineyards, sewers, wells, levees, grading, paving, sprinkling of streets, etc."⁴⁴ Does all the property labeled as personal property under the Act continue to be exempted after the five year period under the personal property repeal provision since it is defined as personal property? The answer offered by the Attorney General is that property deemed personal under the New Industries Exemption Act which is defined according to general laws as real property would not be exempt.⁴⁵ "Once the five year period of exemption has expired, fixtures, buildings, and improvements that are actually real property would no longer be entitled to be classed as personal property and thus exempt . . . ,

provides for an income tax exemption. Exemptions upon leaseholds granted to new businesses upon buildings and land leased from the city have been granted since 1955, although the exemption allowed was broadened somewhat in 1969. It is natural to assume, due to the broad language of the New Industries Exemption Act that, as is the case with the leasehold exemption, land would likewise be exempted. This confusing distinction between the two exemptions is answered by the Attorney General in the context of N.D. CONST. § 176: "The property . . . of . . . municipal corporations . . . shall be exempt from taxation." He notes in N. Dak. Atty. Gen. Opinion, August 1, 1969, that, "... if we consider that the Legislature did not have the authority to classify the leasehold as personal property, we must consider the real property as owned by the city, thus exempt from taxation." See also, *Neslutt v. Ford*, 434 P.2d 934 (Okla. 1968).

43. N.D. CENT. CODE § 57-02-08 (25) (Supp. 1969). "All personal property not required by section 179 of the Constitution of North Dakota to be assessed by the State Board of Equalization shall become exempt from assessment and taxation in the year 1970 and such property shall not be assessed or taxed for that year or any year thereafter. . . ." This provision makes § 40-57-17 meaningless for all purposes except the state income tax exemption.

44. N. Dak. Atty. Gen. Opinion, July 29, 1969.

45. Again a distinction arises between the New Industries Exemption Act and the leasehold exemption provision in that all property classified under the latter provision as personal property will continue after the five year period to be exempt from all property taxes because of the personal property tax repeal. No separation of real property from personal property in the general sense is made after the five year period of the leasehold exemption ends. The Attorney General reasons that, "The leasehold is apparently classified as *personal property* for the entire time such lease is in existence [therefore] it is our opinion that the leasehold . . . will continue to be exempt from all property taxes. . . ." N. Dak. Atty. Gen. Opinion, Aug. 1, 1969. *In accord* N. Dak. Atty. Gen. Opinion, April 10, 1910. Only land would be excluded from the continued exemption. It would appear that the Attorney General uses different theories to answer different questions. Is the leasehold municipal property or is it personal property? It would seem that if the leasehold is to be exempt under the personal property tax repeal provisions, it is necessary to classify leaseholds as personal property. Therefore, it would seem certain that land could not be deemed to be constitutionally within the exempted status. Therefore, a theory would not exist to explain the different treatment accorded land under the two exemptions. If it is municipal property, it seems that municipalities have been taxing themselves whenever the leasehold exemption did not apply after the five year period. I suppose this theoretical dilemma could be explained by stating that the land is municipal property, and the remainder of the leasehold is personal property.

but would actually be considered as real property and thus subject to real property taxation."⁴⁶

Another question frequently asked by attorneys concerning the new exemption is whether it extends to expansions of a business *at its present location* (emphasis added).⁴⁷ Interpretation of the Act has brought a negative answer. Although the legislative committee considering the bill utilized the term "expansion" and "expand" in their committee report, such terms are not found in the Act. The Attorney General states, in addition, that the title of the Act concerns "new industries," that the term "new enterprises" is utilized in the Act's first section, and that "[u]tter confusion could result if the term expansion was used in its broad general sense. . . . [H]ow much expansion must there be before the 'expanded business' could qualify under the act. . . ? [W]ould a one inch expansion of a physical plant be enough . . . ? [W]ould it mean expansion of one additional employee. . . ? [W]ould expansions . . . have to be in excess of \$1.00 . . . ?" In sheer exasperation he concludes that, "the committee had in mind a situation where a business was located in a certain place in the State of North Dakota and expanded by creating branch offices, business or enterprises in *other localities* (emphasis added)."⁴⁸

Assuming this interpretation to be correct, and assuming that tax incentives are an inducement to businessmen to build in a particular location, it can be strongly criticized. There is no reason why North Dakota businessmen cannot be offered the same inducement as is granted to out-of-staters. Expansions at the present location can fulfill the same purposes of the Act; the same standards of a material addition to the business consistent with prescribed benefits to the state could be applied to such expansions as is applied to extensions to a new location. Certainly, if businesses can be induced to come into the state and build a new factory by such an incentive, expansions of existing facilities can likewise be induced or at least accelerated, especially when many businesses would be inclined to

46. N. Dak. Atty. Gen. Opinion, July 29, 1969.

47. Again, a distinction arises between the Act and the leasehold exemption which allows expansions of business at their present location to come within the exemption, although an existing leasehold could not be terminated merely to renew or obtain an expired tax exemption. N. Dak. Atty. Gen. Opinion, July 18, 1969. See also N. Dak. Atty. Gen. Opinion, March 2, 1967. The reason it must be construed in light of N.D. CENT. CODE § 40-57-18 (1960). "Construction . . . the project may be acquired, purchased, constructed, reconstructed, improved, bettered, and extended, and bonds may be issued for such purposes . . ." (emphasis added). An illustration of how expansions came under § 47-57-17 is as follows:

Needham Packing Co. leased from the City of West Fargo under § 40-57-17 (1960) a "project" which was exempt for five years. In 1968 the old lease was cancelled, and after extensive remodeling of the old plant, a new lease was issued. The new leasehold was thus exempt since the act applied equally to the "reconstruction, improvement, betterment, or extension of any project." N. Dak. Atty. Gen. Opinion, July 1, 1969.

48. N. Dak. Atty. Gen. Opinion, April 10, 1970.

expand rather than relocate.⁴⁹ The author places more faith in the Board of Equalization's subjective judgment than does the Attorney General as to whether an expansion would materially benefit North Dakota.

The Attorney General's opinions, however, have merit insofar as a mere change in the form or organizational structure should not provide a basis for the exemption; nor should dissolution of an old corporation and creation of a new corporation, any more than a merger, come within the purview of the exemption.⁵⁰

It is clear that the Act is not limited to property owned by the operator of a project. The owner of property upon which facilities were constructed may lease the premises to an industry coming into the state, and still apply for the exemption. The Act states that exemptions are allowed for property "used in or necessary to the operation of a project,"⁵¹ with no reference to ownership.⁵²

A final problem specifically applicable to the New Industries Exemption Act concerns the New Business and Corporation Privilege Tax.⁵³ Although the latter tax is not specifically exempt under the Act, it does come within the exemption when it is considered as an "additional tax" to the state income tax from the corporate point of view, as interpreted by the Attorney General.⁵⁴

Taxes and a State's Business Image

Up to this point the weaknesses of legislation such as the New Industries Exemption Act have been highlighted and it appears that such legislation is neither necessary nor desirable. Also, specific problems pertaining to the Act have been noted. Before alternative legislation can be suggested, however, the factors that induce businessmen to locate in a particular state should be noted, and if taxes do play a role in the businessman's decision, the nature of the effect should be examined. Only then can one consider how the resources and intellect of North Dakota can best be utilized to meet the problem of making North Dakota an attractive state businesswise.

Although the local tax climate was ranked eleventh of fourteen locative factors in the North Carolina survey mentioned above, many authors feel that taxation is a major index of the general business

49. This criticism is given weight when one considers one of the major factors in choosing a location is the owner's residence. Brandt and Herman, *The Effect of Plant Location Factors on Business Investment Decisions*, Committee on Industry and Business, p. 3, on file at State Capitol Building, Bismarck, North Dakota.

50. N. Dak. Atty. Gen. Opinion, April 10, 1970.

51. N.D. CENT. CODE § 40-57.1-03 (Supp. 1969).

52. N. Dak. Atty. Gen. Opinion, April 10, 1970.

53. N.D. CENT. CODE § 57-38-66 (Supp. 1969). "East . . . corporation, (subject to some qualifications) . . . in addition to any other taxes . . . shall pay a separate and additional tax for the privilege of doing business in this state, of one percent of its taxable income. . . ."

54. N. Dak. Atty. Gen. Opinion, June 29, 1969.

climate of a state, and that this latter factor is very important, indeed. As such, the tax picture of a state may reflect the philosophy of a state towards business. It must be noted, however, that several other factors add or detract from a state's business image.

The effect of taxation upon the business image is determined by three factors:

(1) Magnitude. It has been pointed out however, that there is no correlation between high tax levels and industrial development.

(2) Type of Tax. While businesses probably frown upon business privilege taxes based upon income,⁵⁵ and personal property taxes,⁵⁶ many business groups rely upon sales taxes as reflecting a pro-business attitude.

(3) Precise structure of the tax. There appears to be resentment among businessmen against double taxation due to interstate allocation formulae,⁵⁷ and the imposition of every type of tax possible.

The attitude of scholars on business viewpoint is best summed up as follows:

The role which taxation plays in the general business climate is in part obviously a function not of actual tax differences, as noted, but a somewhat irrational reaction on the part of business groups. Largely because of high Federal taxes, the average businessman is inclined to have strong anti-tax emotional bias, and to be quick to emphasize tax elements relative to others.⁵⁸

How can this "irrational reaction" be overcome by North Dakota? Before this question can be considered a brief review of the former tax position of North Dakota and the developments since 1964 is necessary.⁶⁰ In that year North Dakota had the highest ratio of a six state group (Iowa, Montana, Nebraska, South Dakota and Wyoming) of total revenue collected to total taxable valuation of assessed real property.⁶¹

Furthermore, the total tax load upon an average hypothetical firm was nearly twice that of Montana, Nebraska, Wyoming and Iowa, and substantially higher than South Dakota, although property taxes are higher in South Dakota. However, North Dakota was the

55. Due, *supra*, n. 7, at 168.

56. "Summary of Master's Thesis," *supra*, n. 11, at 11, 12.

57. Due, *supra*, n. 7, at 168.

58. "Summary of Master's Thesis," *supra*, n. 11, at 11, 12.

59. Due, *supra*, n. 7, at 169.

60. "Summary of Master's Thesis," *supra*, n. 11.

61. "Summary of Master's Thesis," *supra*, n. 11, at 7.

only state to have a general property tax (real and personal), sales tax, and corporate income tax.⁶²

The foregoing led Lyle R. Fogel to conclude:

Claims that the tax system of North Dakota will deter prospective businessmen, seem not to be based upon fact. The effective rates which are, for the most part within reasonable limits, are seldom the determinants of new business starts. The 'image' which may be the product of misinterpretation, however, can sometimes be as strong a deterrent to the entrepreneur as a confirmed confiscatory tax. . . . The major feature of the state's tax structure which provides justification for . . . [this belief that tax loads are high] . . . is the presence of both general sales and corporate income taxation. . . .⁶³

North Dakota has changed its tax situation radically since then, abolishing the personal property tax,⁶⁴ adding the business privilege tax,⁶⁵ and extending exemptions to businesses to cover corporate income,⁶⁶ and some types of real property⁶⁷ and the business privilege tax.⁶⁸ It is interesting that the legislators thought it wise to add still another tax for the privilege of doing business in the state when trying in the New Industries Exemption Act to improve the state's image tax-wise. The repeal of the personal property tax was probably wise in view of the attitude of businessmen towards such a tax as expressed above. However, in view of the criticisms of the tax concessions mentioned, the desirability of legislation of that type is at least questionable. A review of corporate attitudes towards particular types of taxes is probably the best approach if tax concessions are to be granted. It may be more advantageous to continue to tax property locally and statewide, and exempt the corporate income tax, or repeal the business privilege tax. For the present, North Dakota no longer depends upon as many categories as in the past, and this has no doubt strengthened its tax image, but one must estimate the costs of such programs to the state and its people. It is the consensus of authority that the benefits of a tax exemption program such as the New Industries Exemption Act will, in the long run, not match its costs.

62. "Summary of Master's Thesis," *supra*, n. 11, at 9. For the purposes of this note, the tax structures of the five states within the comparative group have not changed radically. However, Nebraska has since added a sales tax. NEB. REV. STAT. § 77-2701 (Supp. 1996).

63. "Summary of Master's Thesis," *supra*, n. 26, at 11.

64. N.D. CENT. CODE § 57-02-08 (25) (Supp. 1969).

65. N.D. CENT. CODE § 57-38-66 (Supp. 1969).

66. N.D. CENT. CODE § 40-57.1-04 (Supp. 1969).

67. N.D. CENT. CODE § 40-57.1-03 (Supp. 1969).

68. N. Dak. Atty. Gen. Opinion, June 29, 1970.

Conclusion

In conclusion, this author agrees with Harold W. Bangert's approach to the problem of making North Dakota attractive to businessmen. The state should develop its own resources, recognizing an excellence in North Dakota, and by this means attract business, not by being apologetic. Mr. Bangert is surprised that North Dakota should feel demeaned by reference to other states.⁶⁹

Food, Mr. Bangert states, is North Dakota's real wealth, with mining representing a possible substantial basis for revenue. In light of this, North Dakota has an abundance of raw materials, and since the latter represents an important locative inducement, this factor should be stressed in attracting factories for intra-state processing of agricultural products and other natural resources.⁷⁰ Following this advice, the offsets of labor costs, availability of labor, and the high levels of public service that North Dakota may have to offer should be publicized. Furthermore, the fact that tax-cost differentials are of small consequence should be emphasized, especially if taxes are higher than taxes in neighboring states. Also, a clear picture of the equity of the tax structure in North Dakota should be established.

In addition, since the availability of buildings or sites is a strong locative inducement, increased activity on the part of the state and local government, and other public interest groups, should be initiated to inform businessmen of available buildings and sites. As such, instead of lowering tax revenue, the current tax revenue could be channeled towards improvement of the state's weaknesses. For example, the revenue could be used for better transportation facilities, markets, educational facilities, or work-training programs.⁷¹

If the New Industries Exemption Act is deemed necessary and desirable by the State Legislature, the legislation, as interpreted by the Attorney General, is too broad, in light of Mr. Bangert's approach to the problem. The Attorney General interprets the Act as follows:

. . . Section 40-57.1-03 refers to 'project operator' or to 'projects.' Nowhere in the Act do we find any limitation as to the type of project which may qualify for the tax exemp-

69. Statement of Harold W. Bangert to the Legislative Research Committee on Senate Concurrent Resolution KK, ug. 7, 1967, on file at State Capitol Building, Bismarck, N. Dak.

Mr. Bangert may be a little biased in his appraisal of North Dakota's financial and social position. He feels that North Dakota is not dependent on outsiders funds to build and develop its economy. He states that the Senate is preoccupied with per capita income, but it is not a good indicator; real income in North Dakota is among the highest in the nation; " . . . The mediocre person, of necessity, leaves North Dakota, searching for submergence in the anonymity of urban life."

70. *Infra*, n. 74.

71. Brandt, *supra*, n. 18, at 12.

tion. . . . It would include profit as well as non-profit corporations and co-operative corporations as well as corporations.⁷²

It is the author's opinion that the purposes of the statute, and the guidelines formulated (set forth below) to assist the Board of Equalization in determining approval of the exemption could be followed much more closely if the statute was drawn in narrower terms as to which industries are eligible for the exemption. The guidelines, in part, are as follows:

1. Generally, new industry or business should create new jobs in this state; . . .

. . .

4. The impact of new industry or business on the community in which it locates should not result in undue financial burden on . . . property owners by reason of the exemption. . .

. . .

6. The potential new industry or business should be of a kind whose continued operation in the state will be in the best interests of the people of North Dakota.⁷³

In view of the natural resources of this state, exemption policies should be drawn to favor agricultural and other natural resource processing plants. Such plants, in view of the above guidelines, are of about equal benefit to all members of the community, serve the best interests of the community in providing a statewide integrated system of producing goods, and would probably be the highest employment level industry that would be attracted to North Dakota. The statute should be drawn along policy lines exploiting the strengths of the state—a broadly interpreted statute bears the danger of developing an across-the-board exemption grant to all new industries. Such industries would be more apt to continue their existence in North Dakota, especially in view of the fact that agriculture is a comparatively long-lasting source of raw materials.

Finally, an exemplary bill based upon the above guidelines is appropriate. Apparently, this conceptual approach to the problem of attracting new industries to the state has attracted some followers in the North Dakota Legislature. The proponents of a bill recently introduced seemed to concur with the conclusions reached above in attempting to solve the problems inherent in improving a state's business image while at the same time not sacrificing the needs of its citizens. This is exemplified from the following excerpts in the Grand Forks Herald of February 10, 1971.⁷⁴ "A bill which would allow counties and farmers to combine their economic muscle to

72. *Supra*, n. 2.

73. N. Dak. Atty. Gen. Opinion, Aug. 1, 1969.

74. Grand Forks Herald, Feb. 10, 1971 at 1, Col. 2.

attract new agricultural industry to North Dakota was heard by the Senate Industry, Business and Labor Committee, (Feb. 10, 1971)."

"... [R]ural development financing authority would be used as a vehicle to issue bonds to construct processing plants for lease to firms with worldwide marketing resources."

"It is specifically designed for the sugar beet growers of the Red River Valley, but proponents of the bill pointed out that it is applicable for any type of agricultural processing plant, including sunflower seeds, potatoes, and malting barley." (Emphasis added)

The article pointed out the economical advantage to businessmen of processing goods at or near their source rather than shipping them hundreds of miles away. It appears that such a bill would not only relieve the burden placed upon the state government of attracting businesses while still generating tax revenue to provide essential community services, but it would also highlight the primary strength of North Dakota's raw material in the form of food.

The statute should be narrowed for a second reason due to the broadness inherent in the Attorney General's opinion. At the present time the statute covers all types of businesses. The danger of such broad language is pointed out by Vincent A. Schmidt, Milwaukee Tax Commissioner:

... The easy route is to grant the exemption and avoid judicial review and its resulting pressure and controversy at the expense of the taxpayer in the respective community. . . .

Any tax exemption, in fairness to the public, should eliminate organizations of fraternal, business or professional people who devote their service to a classified group. Exemption in these situations is granted on the basis of some public good which the organization or unit sponsors. There are benevolent and worthy aspects in many human activities in life in varying degrees, by every corporation, individual or organization. The percentage of determination of public benefit should not rest with assessment administration. This can be remedied by clear, concise statutory language in our exemption laws.⁷⁵

Thus, such a broad statute could cater to interests benefiting relatively small groups, which would cause community taxpayers to shoulder an undue tax burden.⁷⁶ For example, an exemption was granted to a nursing home in North Dakota. The undue burden upon local taxpayers arises due to the fact that such institutions benefit a larger area than the municipality, in providing services to the aged, and as such, the community taxpayers are forced to share

75. Schmidt, *Limitation of Property Tax Exemptions*, PROCEEDINGS OF THE NATIONAL TAX ASSOCIATION 236-237 (1968).

76. *Id.* at 236.

disproportionately the indirect subsidy to such services. A bill as that set forth above would focus narrowly on those types of industries worthy of exemption from property or income taxes.

Since the "drive-industry-out" theory is no longer thought to carry any weight, the conclusion is inescapable that exemptions are not the answer to attracting business. Instead of timidly granting meaningless concessions, North Dakota should boldly present its strengths and implement these strengths in making the state more inviting. The latter approach, in the light of the attitudes of both businessmen and scholars, and the alternatives available, is by far the more enlightened viewpoint.

JAY PETTERSON

