



NORTH DAKOTA OFFICE OF STATE TAX COMMISSIONER GUIDELINE - RENAISSANCE ZONE TAX INCENTIVES

RYAN RAUSCHENBERGER,
TAX COMMISSIONER

JANUARY 2016



THIS GUIDELINE
DESCRIBES THE INCOME
TAX INCENTIVES
AVAILABLE UNDER NORTH
DAKOTA'S RENAISSANCE
ZONE PROGRAM

28223

North Dakota Renaissance Zone Program

Under the North Dakota Renaissance Zone Program, a North Dakota city may apply to the state for designation of part of the city as a renaissance zone. Property and income tax incentives are available to taxpayers for making qualified investments in a zone. The North Dakota Commerce Department's Division of Community Services grants zone status and provides general administration of the zones. The North Dakota Office of State Tax Commissioner generally administers the income tax incentives. The property tax incentives are administered at the city level.

Legislative changes

The 2015 North Dakota Legislature made the following changes to the law governing the renaissance zone program:

- **Size of a renaissance zone**—For a city with a population up to 5,000, the maximum allowable size of a zone was increased from 23 to 34 blocks. For a city with a population greater than 5,000, which is allowed an additional block for each additional 5,000 in population, the maximum allowable size of a zone was increased from 38 to 49 blocks. For purposes of establishing a city's population, the most recent federal census estimate published since the last federal decennial census may be used.
- **Renaissance fund organization investment tax credit**—The maximum amount of tax credits allowed to all taxpayers in all tax years for investments made in renaissance fund organizations was increased from \$8.5 million to \$10.5 million.

For more information about these changes, contact the North Dakota Commerce Department's Division of Community Services—for contact information, see the right hand side of this page.

Contents

Legislative changes.....	This page
Where to get help and forms.....	This page
Part 1: General information	3
Part 2: Single-family residence tax credit.....	5
Part 3: Business or investment income exemption	6
Part 4: Business purchase or expansion tax credit	9
Part 5: Historic property preservation or renovation tax credit	10
Part 6: Nonparticipating property owner tax credit	10
Part 7: Renaissance fund organization investment tax credit	10
Appendix: Zone apportionment factor.....	12

Need help?

Office of State Tax Commissioner

For more information and assistance on the income tax incentives, contact the Office of State Tax Commissioner as follows:

Website

www.nd.gov/tax

E-mail

Individuals, estates, trusts, partnerships, and S corporations:

individualtax@nd.gov

C corporations: corptax@nd.gov

Call

General	701.328.2770
Property tax	701.328.3127
Individual income tax	701.328.1247
Estate, trust, partnership, and S corporation income tax	701.328.1258
C corporation income tax	701.328.1249
Speech or hearing impaired—Relay North Dakota	1.800.366.6888

Write

ND Office of State Tax Commissioner
600 E. Boulevard Ave., Dept. 127
Bismarck, ND 58505-0599

Division of Community Services (Commerce Department)

For more information and assistance on the creation and administration of a zone, the application and approval of zone projects, and the program in general, contact the North Dakota Commerce Department's Division of Community Services as follows:

Website

www.communityservices.nd.gov

E-mail

commerce@nd.gov

Call

General	701.328.5300
Speech or hearing impaired—Relay North Dakota	1.800.366.6888

Write

ND Commerce Department
Division of Community Services
PO Box 2057
Bismarck, ND 58502-2057

Part 1

General information

This document provides a description of the income tax incentives available under the North Dakota Renaissance Zone Program (“Program”) as well as guidance on claiming them. While the Program also provides for property tax incentives, only a brief description of them is provided in this document—see **Property tax incentives** for more information. The statutory provisions governing the Program are contained in North Dakota Century Code ch. 40-63.

Division of Community Services

The North Dakota Commerce Department’s Division of Community Services is responsible for the administration of the Program’s provisions covering the creation and administration of a zone, including the setup of a renaissance fund organization, and the review and final approval of zone projects. You may contact that office as follows:

Website

www.communityservices.nd.gov

Write

ND Commerce Department
Division of Community Services
PO Box 2057
Bismarck, ND 58502-2057

Call

701.328.5300

Office of State Tax Commissioner

The North Dakota Office of State Tax Commissioner is responsible for the Program’s provisions covering the income tax incentives. You may contact that office as follows:

Website

www.nd.gov/tax

Write

ND Office of State Tax Commissioner
600 E. Boulevard Ave., Dept. 127
Bismarck, ND 58505-0599

Call

General	701.328.2770
Property tax	701.328.3127
Individual income tax	701.328.1247
Estate, trust, partnership, or S corporation income taxes	701.328.1258
Corporation income tax	701.328.1249

Definitions

Unless stated otherwise, the following definitions apply throughout this document:

Leasehold improvement—means an improvement made by a lessee to expand or improve the efficacy of leased space in a building, which increases the building’s current true and full value by an amount equal to or more than the minimum amount specified in the zone’s development plan.

Local zone authority—means the governing body of the city in which the zone is located, or the entity designated by the city to promote, develop, and manage the zone.

Public utility infrastructure—means the power lines, gas lines, and other property making up the infrastructure of a regulated public utility. It does not include any property, such as water and sewer lines, streets, etc., subject to special assessment by the city.

Passthrough entity—means a partnership, S corporation, or limited liability company (treated like a partnership or S corporation) that passes its income, gains, deductions, losses, and credits through to its owners for federal income tax purposes.

Program—means the Renaissance Zone Act under North Dakota Century Code ch. 40-63.

Taxpayer—means an individual, estate, trust, partnership, C corporation, S corporation, limited liability company, or any other entity that is required to file a North Dakota income tax return under N.D.C.C. ch. 57-38.

Zone—means a state-approved renaissance zone created under the Program.

Zone project—means a qualifying transaction in an established zone that is approved by both the local zone authority and the North Dakota Commerce Department’s Division of Community Services. The qualifying transaction or transactions differ for each tax incentive under the Program.

Zone project property—means the property or portion of property that is the subject of a zone project.

Income tax incentives

The income tax incentives available under the Program are as follows:

- Single-family residence individual income tax credit—see **Part 2** on page 5.
- Business or investment income exemption—see **Part 3** on page 6.
- Business purchase or expansion individual income tax credit—see **Part 4** on page 9.
- Historic property preservation or renovation income tax credit—see **Part 5** on page 10.
- Nonparticipating property owner income tax credit—see **Part 6** on page 10.
- Renaissance fund organization investment income tax credit—see **Part 7** on page 10.

Property tax incentives

The property tax incentives under the Program are provided for under N.D.C.C. § 40-63-05. They are mentioned in this guideline for informational purposes only. The property tax incentives provided under the Program are as follows:

- A municipality may grant a partial or complete exemption from property tax for up to five years to an individual who purchases or rehabilitates a single-family residence in a zone that is the individual's legal residence.
- A municipality may grant a partial or complete exemption from property tax for up to five years to a taxpayer who purchases or rehabilitates real property in a zone that is used for business or investment purposes.
- The North Dakota State Board of Equalization may grant a partial or complete exemption from property tax for up to five years for the rehabilitation of public utility infrastructure property.

Zone project property may be exempted from property taxes only one time over the life of the zone. If the property is transferred to a qualified purchaser, the remaining portion of the exemption period originally granted for the property transfers to the qualified purchaser.

For more information on the property tax incentives, contact the applicable city's property tax officials or, in the case of the public utility infrastructure property exemption, the North Dakota State Board of Equalization.

How to qualify for a tax incentive

Except for the tax credit for investing in a renaissance fund organization, eligibility for any of the income tax incentives is dependent on having a qualifying zone project.

Zone project

A zone project is a transaction in a zone that is approved by both the local zone authority and the North Dakota Commerce Department's Division of Community Services. A taxpayer must apply to the local zone authority for approval of a proposed transaction as a zone project.

For more information on how to apply for a zone project, contact the local zone authority for the zone in which the project will be located prior to entering the transaction.

Zone project approval letter

Upon final approval of a zone project, the North Dakota Commerce Department's Division of Community Services will issue a final zone project approval letter to the local zone authority, a copy of which is also provided to the taxpayer. Among other things, the letter will include the following:

- Project number assigned to the project by the local zone authority.
- Description of the income tax incentive(s) allowed for the project.
- The starting date of the 5-year exemption or credit period, if applicable.

Prior to the issuance of the final zone project approval letter, the Division of Community Services may issue a preliminary letter. The purpose of the preliminary letter is to allow the taxpayer to proceed with the eligible transaction or begin the rehabilitation work. The final zone project approval letter is issued only after the Division of Community Services determines that the project has satisfied the criteria for eligibility.

Passthrough entity. In the case of a passthrough entity, the copy of the zone project approval letter must be attached to the passthrough entity's North Dakota income tax return. The owners of the passthrough entity do not attach a copy of the zone project approval letter to their returns.

How to claim an income tax incentive

The income tax incentives are claimed by completing and attaching Schedule RZ to the North Dakota income tax return. Information from the final zone project approval letter will be needed to complete Schedule RZ. A copy of the final zone project approval letter must be attached

to Schedule RZ. If a taxpayer did not receive a copy of the letter or misplaces it, the taxpayer must contact the local zone authority to obtain one.

Priority of exemptions/credits

A taxpayer may qualify for more than one income tax incentive under the Program. If a taxpayer qualifies for both an income exemption and an income tax credit, the income exemption must be applied first to determine North Dakota taxable income, and the tax credit must be applied second to reduce the North Dakota tax liability.

Multiple income exemptions

If a taxpayer qualifies for both an income exemption under the Program and the new or expanding business income exemption under N.D.C.C. ch. 40-57.1, the taxpayer may choose which of the two exemptions to apply first.

The income remaining after applying the first exemption must be multiplied by a fraction to determine the amount of income that may be exempted under the second exemption. In general, the fraction is composed of the following:

- **Numerator**—The numerator is the average value of owned and rented property used in the activity or project for which the exemption applied *second* was granted.
- **Denominator**—The denominator is the average value of the total owned and rented property in North Dakota less the average value of the owned and rented property used in the activity or project for which the exemption applied *first* was granted.

Average value of property. The average value of owned property is determined by adding the original cost of the property on the first and last days of the tax year and dividing the result by two. The average value of rented property is determined by multiplying the annual gross rents by eight.

Multiple tax credits

If a taxpayer qualifies for more than one income tax credit under the Program or other North Dakota law provision, the credits must be applied in the order specified under North Dakota Administrative Code § 81-03-01.1-08. Under this rule, tax credits with no carryback or carryforward provision must be applied first. Tax credits with a carryback provision are applied next, and tax credits with a carryforward provision are applied last. In the case of an individual, the credit for income tax paid to another state must be applied first in all cases.

Passthrough entity

Except as provided below under **Exception for certain S corporations**, if the taxpayer is a passthrough entity, the amount of an income exemption or tax credit under the Program must be determined at the passthrough entity level and passed through to the owners according to their respective interests in the entity. The total amount of the income exemption or tax credit must be reported on Schedule K of either Form 58 (partnership return) or Form 60 (S corporation return). Each owner's share of the income exemption or credit must be reported on the North Dakota Schedule K-1 given to each owner.

Exception for certain S corporations. If an S corporation elects to be taxed as a C corporation under N.D.C.C. § 57-38-01.35, the income exemption under the Act is claimed as a deduction on the corporation's North Dakota income tax return (Form 40) **and** is passed through to its shareholders according to their respective interests in the corporation. **The income tax credits under the Act, however, are claimed only by the corporation and may not be passed through to the shareholders.** In this case, because the corporation files Form 40, it will not issue a North Dakota Schedule K-1 to the shareholders. Instead, on or before

the due date, or extended due date, of Form 40, the corporation must provide each of its shareholders with a notice containing the following:

- **The heading:** Renaissance Zone Shareholder Notice.
- **The statement:** This notice contains information that is important to the preparation of your North Dakota income tax return. For instructions on how to report this information on your North Dakota income tax return, obtain Schedule RZ from the North Dakota Office of State Tax Commissioner. Attach a copy of this notice to your North Dakota income tax return.
- Name, address, and federal employer identification number (FEIN) of the corporation.
- Tax year of the corporation to which the income exemption relates.
- Name and social security number (or FEIN) of the shareholder.
- Shareholder's share of the income exemption.

Passthrough entity owner

If you own an interest in a passthrough entity that qualifies for an income tax incentive under the Program, the passthrough entity generally must provide you with a North Dakota Schedule K-1 or, if applicable, a Renaissance Zone Shareholder Notice showing your share of the income exemption or tax credit. An exception applies in the case of certain S corporations—see **Passthrough entity** on this page for more information.

To claim your share of the income exemption or tax credit on your North Dakota tax return, you must complete North Dakota Schedule RZ and attach it along with a copy of the North Dakota Schedule K-1 or Renaissance Zone Shareholder Notice, whichever applies.

Part 2

Single-family residence tax credit

N.D.C.C. § 40-63-04(1)

An income tax credit is available to an individual (on Form ND-1) for purchasing or making a qualified rehabilitation to a single-family residence that is owned and used as the primary place of residence by the individual. To qualify, the purchase or rehabilitation must be approved as a zone project.

A **purchase** means the acquisition of an existing single-family residence or the construction of a new single-family residence.

A **qualified rehabilitation** means the repair or remodeling of a single-family residence at a cost equal to or more than 20 percent of the residence's current true and full value for property tax purposes. *Note: A zone may establish additional qualification conditions.*

A **single-family residence** means a single-family detached home, townhouse, single unit in a duplex, or a condominium.

An individual's **primary place of residence** means the physical place of abode that is the individual's legal residence. An individual's legal residence is the individual's true, fixed and permanent home. It is the place to which the individual intends to return whenever absent from it. While an individual may have more than one physical place of abode, only one of them may be the individual's legal residence. Legal residence is based on each individual's facts and circumstances as well as the individual's intent.

Amount of tax credit

The tax credit is equal to \$10,000 per year over a five-year credit period. If the allowable credit for any tax year exceeds the individual's tax liability for that year, the excess of the credit over the tax liability is not refundable and may not be used to offset the individual's tax liability for any other tax year. For this purpose, "tax liability" means the tax calculated for the tax year less:

- The credit for income tax paid to another state.
- Any other income tax credits allowed under the Program or other North Dakota law provision that the individual chooses to use before applying the single-family residence tax credit. See **Priority of exemptions/credits** on page 4 for more information on the order in which to claim multiple tax credits.

Five-year credit period

The credit is allowed in each year of a five-year credit period. The five-year credit period is a period of sixty consecutive months, consisting of five 12-month periods. The \$10,000 credit corresponds to each of the five 12-month periods. The 60-month credit period begins as follows:

Purchase—If the residence is purchased, the 60-month credit period begins on the first day of the month in which the residence is first occupied by the individual.

Qualified rehabilitation—If an individual makes a qualified rehabilitation to a residence already owned and occupied by the individual, the 60-month credit period begins on the first day of the month in which the rehabilitation work is completed, as determined by the local zone authority.

Once the 60-month credit period begins to run with respect to a single-family residence, it runs uninterrupted through the end of the period. The credit is allowed over the entire 60-month credit period even if the zone itself expires before the end of the credit period.

Reconciling 60-month exemption period with taxpayer's tax year

If the beginning of the 60-month credit period does not correspond with the beginning of an individual's tax year, or if an individual is not eligible for the credit for the individual's entire tax year, the amount of the \$10,000 credit available for a particular tax year is limited. This will occur in the following situations:

- The individual purchases the residence during the tax year and first occupies it in a month other than the first month of the tax year.
- The individual sells or otherwise disposes of the residence during the tax year.
- The individual establishes another residence as the primary place of residence during the tax year.
- The 60-month credit period ends during the tax year, and the sixtieth month is not the last month of the tax year.

If any of the above situations apply, the portion of the \$10,000 credit allowed for the tax year is determined by multiplying \$833.33 (\$10,000 divided by 12) by the number of months the individual is eligible for the credit during the tax year.

One time eligibility

A single-family residence is eligible for this tax credit only one time over the life of the zone.

Transfer of residence

The tax credit and its five-year credit period attach to the single-family residence. If title to the residence is transferred to another person before the end of the five-year credit period, the individual transferring the residence is ineligible for the credit starting on the first day of the month in which title passes. If title to the residence is transferred to another qualifying individual before the end of the five-year credit period, the individual acquiring the residence is eligible for the

credit for the unexpired portion of the five-year credit period beginning on the first day of the month in which title passes.

Change in primary place of residence

If an individual ceases to use the residence as the primary place of residence during the five-year credit period, the individual is ineligible for the tax credit starting on the first day of the month in which the primary place of residence changed.

Part 3

Business or investment income exemption

N.D.C.C. § 40-63-04(2)

A business or investment income exemption is available to a taxpayer for income tax purposes for any of the following types of transactions:

- **Purchase**—The taxpayer purchases or constructs residential or commercial real property in a zone for business or investment purposes. This includes the construction of new residential or commercial real property.
- **Purchase with major improvements**—This is the same as a purchase transaction except that major improvement to the property is necessary before the taxpayer can begin any income-producing activity.
- **Lease**—The taxpayer leases residential or commercial real property in a zone for business use only. A lease qualifies if:
 - ▶ The taxpayer moves an existing business into, or establishes a new business in, the leased space.

- ▶ The taxpayer's business is already located in the zone and the lease is for additional space to accommodate an expansion of the business.

- ▶ The taxpayer is renewing or continuing a lease for the same space already occupied by the taxpayer's business, provided the building in which the leased space is located is a rehabilitation zone project.

- **Leasehold improvement**—The taxpayer makes alterations to leased residential or commercial real property used for business or investment purposes to improve its usefulness, provided the alterations are expected to increase the building's current true and full value for property tax purposes by the amount specified in the zone's development plan. *Note: A zone may establish additional qualification conditions.*
- **Qualified rehabilitation**—The taxpayer repairs or remodels residential or commercial real property in a zone for business or investment purposes, provided the cost equals or exceeds 50 percent of the current true and full value of the property for property tax purposes. *Note: A zone may establish additional qualification conditions.*
- **Public utility infrastructure rehabilitation**—The taxpayer is a regulated public utility that makes changes to relocate or upgrade power lines, gas lines, and other infrastructure property for the purpose of accommodating the zone projects of other taxpayers and the zone's objectives.

This income exemption may be claimed by the following taxpayers:

- An individual (on Form ND-1).
- An estate or trust (on Form 38).
- A corporation (on Form 40).

If the taxpayer is a passthrough entity, see **Passthrough entity** on page 5.

Optional credit election. If certain conditions are met, an individual (Form ND-1) filer who qualifies for the business income exemption may elect to claim an income tax credit in lieu of the business income exemption. See **Part 4** on page 9 for more information.

Business or investment use

The exemption amount (*explained later under Amount of income exemption*) is dependent on whether the zone project property is used for business or investment purposes. Zone project property is considered used for business purposes if it is used in an occupation, trade, profession, or commercial or mercantile enterprise. Zone project property is considered used for investment purposes if it is not part of or used in any business owned by the taxpayer. Depending on the facts and circumstances, this distinction may not always be clear. If in doubt as to whether zone project property is used for business or investment purposes, the local zone authority or taxpayer is advised to make a written request for an opinion from the Office of State Tax Commissioner prior to entering the purchase, lease, or rehabilitation transaction.

Five-year exemption period

The exemption is allowed in each year of a five-year exemption period. The five-year exemption period is a period of sixty consecutive months. The 60-month exemption period begins as follows:

- **Purchase**—If the zone project consists of a purchase, the 60-month exemption period begins on the first day of the month in which the taxpayer takes title to the property. Under a contract for deed, title is considered to have passed for this purpose when the contract is executed.
- **Purchase with major improvements**—If the zone project consists of a purchase with major improvements, the 60-month exemption period begins on the first day of the

month in which the improvement work is completed, as determined by the local zone authority.

- **Lease**—If the zone project consists of a lease, the 60-month exemption period begins on the first day of the month in which the taxpayer enters the contract.
- **Leasehold improvement**—If the zone project consists of a leasehold improvement, the 60-month exemption period begins on the first day of the month in which the improvement work is completed, as determined by the local zone authority.
- **Qualified rehabilitation**—If the zone project consists of a qualified rehabilitation, the 60-month exemption period begins on the first day of the month in which the rehabilitation work is completed, as determined by the local zone authority.
- **Public utility infrastructure rehabilitation**—If the zone project consists of a public utility infrastructure rehabilitation, the 60-month exemption period begins on the first day of the month in which the work is completed, as determined by the local zone authority.

Once the five-year exemption period begins to run, it runs uninterrupted through the end of the period. The exemption is allowed over the entire 60-month exemption period even if the zone itself expires before the end of the exemption period.

Amount of income exemption

Only the portion of the taxpayer's North Dakota business or investment income that is attributable to the zone project property is eligible for exemption. The amount exempted is dependent on whether the zone project property is used for business or investment purposes and is subject to the limitations explained under **Limitations on exemption** later in this **Part 3**.

Business use property. If the zone project property is used in a business, the amount of the exemption is determined in the following steps:

1. **Income attributable to zone project property.** The amount of business income attributable to the zone project property is determined by multiplying the taxpayer's North Dakota net income derived from the business by a zone apportionment factor. If the zone project includes all of the taxpayer's business real property in North Dakota, the zone apportionment factor is 100 percent. If the zone project does not include all of the taxpayer's business real property in North Dakota, the factor will be less than 100 percent. The zone apportionment factor is explained in the appendix on page 12 of this guideline.
2. **Exemption eligibility period.** The taxpayer is eligible for the exemption for the entire tax year *unless* one of the following apply:
 - The taxpayer becomes eligible for the exemption in a month other than the first month of the tax year.
 - The taxpayer sells the zone project property, terminates the lease on the zone project property, or permanently withdraws the zone project property from business use during the tax year.
 - The 60-month exemption period ends during the tax year, and the sixtieth month is a month other than the last month of the tax year.

If any of the above apply, the portion of the business income attributable to the zone project property that may be exempted is determined as follows:

- a. Divide the business income attributable to the zone project property (calculated in step 1) by the number of months in the tax year.
- b. Multiply the result in item a by the number of months the taxpayer is eligible for the exemption during the tax year.

Investment use property. If the zone project property is used for investment purposes, the amount of the exemption equals the taxpayer's actual net income derived from the zone project property during the portion of the tax year the taxpayer is eligible for the exemption. For this purpose, investment income means net rental income and the taxable portion of a gain from the sale or exchange of the property. In the case of an installment sale, the taxpayer may exempt the taxable portion of the gain included in North Dakota taxable income over the life of the installment contract. However, interest income derived from the installment sale contract is not eligible for the exemption. The exemption is allowed only to the extent that the investment income is included in North Dakota taxable income.

Limitations on exemption

For zone projects approved on or after August 1, 2013, the five-year business or investment income exemption is subject to the following limitations:

Expansion project limitation—If a zone project primarily consists of a physical expansion of an existing building, the amount of the exemption for a tax year is limited to an amount equal to the income eligible for the exemption multiplied by an expansion ratio. The expansion ratio is equal to the square footage added by the expansion project divided by the total square footage of the building after the expansion. For this purpose, an "expansion" means adding physical square footage to an existing building to increase the amount of usable space within the building. Generally, the type of qualifying transaction which may involve an expansion is a purchase with major improvements or a qualified rehabilitation. If expansion of an existing building is only incidental to the larger project, the zone project will not be considered an expansion for purposes of this limitation.

Taxpayer limitation—No more than \$500,000 of eligible income may be exempted in a tax year. This limitation applies to the total eligible income that a taxpayer derives from all business and investment interests held during the tax year.

One-time eligibility

Zone project property is eligible for this exemption only one time over the life of the zone.

Change from qualifying business or investment use

If, during the five-year exemption period, the taxpayer changes the use of the zone project property from business or investment use to personal use, the taxpayer is ineligible for the exemption starting with the first day of the month in which the change occurs.

Transfer of zone project property during exemption period

The income exemption and its five-year exemption period attach to the zone project property. If the property is transferred to another taxpayer before the end of the property's five-year exemption period, the exemption and its unused exemption period transfer with the property. The taxpayer who transfers the property is ineligible for the exemption starting with the first day of the month of disposition. If the property is transferred to another qualifying taxpayer, the taxpayer acquiring the property is eligible for the exemption for the unexpired portion of the exemption's five-year exemption period.

Part 4

Business purchase or expansion tax credit

N.D.C.C. § 40-63-04(3)

An individual who qualifies for the business income exemption under N.D.C.C. § 40-63-04(2)—see **Part 3**—may elect to take an income tax credit in lieu of the income exemption if the following conditions are met:

- The zone project consists of a purchase, lease, or improvement of real property used in a business owned and operated as a sole proprietorship by the individual.
- The underlying purpose of the zone project is to purchase, expand, or make leasehold improvements to the business.
- The zone project is located in a renaissance zone city with a population of no more than 2,500.
- The zone project's cost is over \$75,000.
- The individual elects to claim the business purchase or expansion credit in lieu of the business income exemption.

Making the election

The election is made by completing the appropriate parts of Schedule RZ and attaching it to the individual's North Dakota income tax return (Form ND-1). To be valid, the return must be filed on or before its due date or extended due date. The election is irrevocable.

Amount of tax credit

The tax credit is equal to \$2,000 per year over a five-year credit period. If the credit exceeds the individual's tax liability for a tax year, the excess of the credit over the tax liability is not refundable and may

not be used to offset the individual's tax liability for any other tax year. For this purpose, "tax liability" means the tax calculated for the tax year less:

- The credit for income tax paid to another state.
- Any other income tax credits allowed under the Program or other North Dakota law provision that the individual chooses to use before applying the business purchase or expansion tax credit. See **Priority of exemptions/credits** on page 4 for more information on the order in which to claim multiple tax credits.

Five-year credit period

The credit is allowed in each year of a five-year credit period. The five-year credit period is a period of sixty consecutive months, consisting of five 12-month periods. The \$2,000 credit corresponds to each of the five 12-month periods. With respect to a particular zone project property, the 60-month exemption period begins as follows:

- **Purchase**—If the zone project consists of a purchase of a business, the 60-month credit period begins on the first day of the month in which the taxpayer enters the contract.
- **Purchase with major improvements**—If the zone project consists of a purchase of a business, but major improvements to the property are necessary before any income-producing activity can take place, the 60-month exemption period begins on the first day of the month in which the improvement work is completed, as determined by the local zone authority.
- **Expansion**—If the zone project consists of an expansion of an existing business already owned by an individual, the 60-month credit period begins on the first day of the month in which the expansion work is completed, as determined by the local zone authority.

- **Leasehold improvement**—If the zone project consists of a leasehold improvement, the 60-month exemption period begins on the first day of the month in which the improvement work is completed, as determined by the local zone authority.

Once the 60-month period begins to run with respect to the zone project property, it runs uninterrupted through the end of the period. The credit is allowed over the entire 60-month credit period even if the zone itself expires before the end of the credit period.

Reconciling 60-month credit period with taxpayer's tax year.

If the beginning of the 60-month credit period does not correspond with the beginning of an individual's tax year, or if an individual is not eligible for the credit for the individual's entire tax year, the amount of the \$2,000 credit available for a particular tax year is limited. This will occur in the following situations:

- The individual purchases the business, or completes the improvement or expansion of the business, in a month other than the first month of the individual's tax year.
- The individual sells or otherwise disposes of the business during the tax year.
- The individual discontinues using the zone project property for business purposes during the tax year.
- The 60-month credit period ends during the tax year, and the sixtieth month is not the last month of the tax year.

If any of the above apply, the portion of the \$2,000 credit allowed for the tax year is determined by multiplying \$166.67 (\$2,000 divided by 12) by the number of months the individual is eligible for the credit during the tax year.

One tax eligibility

Zone project property is eligible for this credit only one time over the life of the zone.

Transfer of zone project property

The tax credit and its five-year credit period attach to the zone project property. If title to the zone project property is transferred to another person before the end of the five-year credit period, the individual transferring the property is ineligible for the credit starting on the first day of the month in which title passes. If the zone project property is sold to another qualifying individual before the end of the five-year credit period, the individual acquiring the zone project property is eligible for the credit for the unexpired portion of the five-year credit period.

This tax credit may be claimed by the following taxpayers:

- An individual (on Form ND-1).
- An estate or trust (on Form 38).
- A corporation (on Form 40).

Passthrough entity. If the taxpayer is a passthrough entity, see **Passthrough Entity** on page 5.

Amount of credit

The credit equals 25 percent of the amount invested in the project, up to a maximum credit of \$250,000 per project. The first tax year for which the credit is allowed is the tax year in which the preservation or renovation work is completed, as determined by the local zone authority. If the credit exceeds the taxpayer's tax liability for the tax year in which the credit is first allowed, the unused credit may be carried forward for up to five tax years.

The tax credit may be claimed by the following taxpayers:

- An individual (on Form ND-1).
- An estate or trust (on Form 38).
- A corporation (on Form 40).

Passthrough entity. If the taxpayer is a passthrough entity, see **Passthrough Entity** on page 5.

Amount of credit

The tax credit equals the amount of the eligible costs approved by the local zone authority. The first tax year in which the credit is allowed is the nonparticipating property owner's tax year in which the related zone project is completed. If the credit exceeds the taxpayer's tax liability for the tax year in which the credit is allowed, the unused credit may be carried forward for up to five tax years.

Part 5

Historic property preservation or renovation tax credit

N.D.C.C. § 40-63-06

An income tax credit is allowed for making an investment in the preservation or renovation of zone project property consisting of historic property.

Historic property—means property that the North Dakota Historic Society certifies to be:

- Listed, or eligible for listing, on the National Historic Register of Historic Places.
- A contributing structure within a National Register Historic District or a certified state or local historic district.

Part 6

Nonparticipating property owner credit

N.D.C.C. § 40-63-04(4)

An income tax credit is allowed to 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. The affected property may be located within or without the zone.

To qualify, a nonparticipating property owner must apply to the local zone authority, which will review and approve the amount of the costs incurred by the property owner that are eligible for the tax credit.

Part 7

Renaissance fund organization investment tax credit

N.D.C.C. § 40-63-07

An income tax credit is allowed for making an investment in a renaissance fund organization established by a zone.

A **renaissance fund organization** is an entity established by a local zone authority for the purpose of raising funds for financing zone projects or non-zone projects located in approved zones. This may include equity investments, loans, guarantees, commitments for financing, or any combination of these. A city may establish a renaissance fund organization by either creating and managing its own

fund or contracting with an outside entity to create and manage the city's fund. For more information about renaissance fund organizations, contact the North Dakota Commerce Department's Division of Community Services—see page 2 for contact information.

The tax credit may be claimed by the following taxpayers:

- An individual (on Form ND-1).
- An estate or trust (on Form 38).
- A corporation (on Form 40).

Passthrough entity. If the taxpayer is a passthrough entity, see **Passthrough Entity** on page 5.

Amount of credit

The credit equals 50 percent of the amount invested in a renaissance fund organization during the tax year. The first tax year in which the credit is allowed is the tax year in which the investment is made. If the credit exceeds the taxpayer's tax liability for the tax year in which the investment is first allowed, the unused credit may be carried forward for up to five tax years.

Redemption of investment by original investor

If a taxpayer who *originally* made an investment in a renaissance fund organization redeems part or all of it within ten years of the date of investment, the

credit with respect to the redeemed portion of the investment is disallowed and must be repaid to the state by the taxpayer. A payment equal to the amount of the credit claimed for all tax years with respect to the redeemed portion of the investment must be made with the North Dakota tax return filed for the tax year in which the redemption occurs. A timely repayment of the credit is not subject to any penalty or interest charges.

Maximum tax credits

On a statewide basis, the maximum amount of tax credits allowed for investments made by all taxpayers in all tax years is limited to \$10.5 million. This statewide maximum is allocated to three categories of cities based on population, as determined by the North Dakota Commerce Department's Division of Community Services. For purposes of determining which taxpayers are allowed the credit when the city or statewide maximum amount is reached, the credits will be allowed to taxpayers based on the chronological order of their investments, as evidenced by the investment reporting forms required to be filed by the renaissance fund organizations—see **Investment reporting form** below.

Investment reporting form

When a taxpayer makes an investment in a renaissance fund organization, the

organization must complete a North Dakota Renaissance Fund Organization Investment Reporting Form and file it with the Office of State Tax Commissioner. The form must be filed within thirty days of the date on which the organization receives payment for the investment. This form also must be completed and filed by the organization to report a redemption of an investment. The organization must provide a copy of the completed form to the taxpayer.

Passthrough of renaissance fund organization's tax exemption

A renaissance fund organization is exempt from North Dakota income tax. However, a renaissance fund organization is not exempted from any requirement to file an income tax return. If a renaissance fund organization is an employer, the exemption also does not apply to any income tax withholding requirement under N.D.C.C. ch. 57-38.

If a renaissance fund organization is a passthrough entity, the exemption is passed through to the entity's owners. At the owner level, the exemption operates to exempt any income passed through to the owner by the entity.

Appendix: Zone apportionment factor

This appendix explains how to determine the zone apportionment factor ("zone factor") for purposes of the business income exemption in Part 3 of this guideline.

Zone factor in general

The zone factor is a fraction composed of the following:

- **Denominator**—The denominator consists of all North Dakota property owned and used in the taxpayer's business.
- **Numerator**—The numerator consists of zone project property.

Property includable in zone factor.

"Property" includes all North Dakota real and tangible personal property, whether owned or rented, that is used in the regular course of the taxpayer's business during the tax period.

"Real and tangible personal property" includes land, buildings, machinery, stocks of goods, equipment, and other property. It excludes coin and currency.

"Used in the regular course of the trade or business" means the property is actually used, available for use, or capable of being used in the regular course of the business during the tax period. Property held as reserves or standby facilities, or property held as a reserve source of materials, is included in the zone factor. Except for inventoriable goods in process, property under construction during the tax period is excluded from the zone factor until it is actually used in the regular course of the business. In the case of an improvement to an existing business that is approved as a zone project, personal property that is purchased for purposes of the improvement and becomes an integral part of the business real property is excluded from the zone factor until completion of the improvement project. If property under construction is actually used in the regular course of the business, it must be included in the zone factor to the extent of the value attributable to its use. Property used in the regular course of the business must remain in the zone factor until its permanent withdrawal is established by an identifiable event, such as its sale or the lapse of an extended period of time (normally five years) during which the property is held for sale.

Consistency in reporting. If there is a departure from, or modification to, the manner of valuing property, or the manner of including or excluding property, in the zone factor used in returns for prior tax periods, the nature and extent of the departure or modification must be disclosed in the return for the current tax period.

Denominator of zone factor

The denominator of the zone factor depends on the scope of business activity as follows:

- **100% North Dakota activity**—If the business conducts 100% of its activity in North Dakota, the denominator consists of the average value of all North Dakota property.
- **Multistate activity**—If the business conducts its activity both within and without North Dakota, the denominator is equal to the numerator of the property factor calculated under N.D.C.C. § 57-38.1-10.

Numerator of zone factor

The numerator of the zone factor includes the average value of the property, whether owned or rented, that is used at the business's zone project property location. Property in transit and mobile or movable property is included in the numerator in the following cases:

- The property is in transit between separate physical locations of the same business and the property's destination is a zone project property location.
- The property is in transit between a buyer and seller and, based on the taxpayer's regular accounting practices, is included in the denominator of the zone factor, and the property's final destination is a zone project property location.
- The value of mobile or movable property, such as construction equipment, trucks, or leased electronic equipment, is assigned to a zone project property location. This includes an automobile assigned to a traveling employee who is assigned to a zone project property location.

Exception for certain rented property. If the zone project consists of the rental of space in a building for business use, and the taxpayer had previously qualified for a zone project for renting space in the same building for use in the same business, do not include in the numerator the space rented for the previous zone project or any owned or rented property located in that space.

Valuation of property

After determining what property is included in the zone factor, the value used in the zone factor calculation is determined in the following two steps:

Step 1—Determine value of property. The value of property depends on whether it is owned or rented.

• Owned property

In general, owned property must be valued at its original cost. "Original cost" is generally deemed to be the basis of the property for federal income tax purposes (before any federal adjustments are made to it) at the time of acquisition. The original cost must be adjusted by subsequent capital additions or improvements to the property, and by any partial disposition of the property through sale, exchange, abandonment, or other means.

Inventory of stock of goods must be valued using the valuation method used for federal income tax purposes.

Property acquired by gift or inheritance must be valued at its basis for depreciation purposes for federal income tax purposes.

Note: Leasehold improvements are considered property owned by the lessee regardless of whether the lessee is entitled to remove the improvements or the improvements revert to the lessor when the lease expires. Value at original cost.

• Rented property

Rented property must be valued at eight times its net annual rental rate. "Net annual rental rate" for any item of rented property equals the annual rental rate paid less the aggregate annual subrental rates received from subtenants, subject to the following:

1. Subrents are not deducted if they constitute income earned in the regular course of the taxpayer's trade or business.
2. If the subrents produce a negative or clearly inaccurate value for any item of property, another method that properly reflects the value of rented property may be required by the tax commissioner or requested by the taxpayer. For this purpose, the resulting value must not be less than an amount which bears the same ratio to the annual rental rate paid for the property as the fair market value of that portion of the property used by the taxpayer bears to the total fair market value of the rented property.

"Annual rental rate" means the amount paid as rent for property for a twelve month period. If property is rented for a term of less than twelve rental months, the annual rental rate equals the rent paid for the actual rental term during the tax period. If property is rented for a term of twelve or more months and the current tax period covers a period of less than twelve months because of a reorganization or change of accounting period, etc., the rent paid for the short tax period must be annualized.

"Rent" means the actual sum of money or other consideration payable, directly or indirectly, by the taxpayer or for the taxpayer's benefit for the use of the property, including the following:

- a. Any amount payable for the use of real or tangible personal property, or any part thereof, whether designated as a fixed sum of money or as a percentage of sales, profits, or otherwise.
- b. Any amount payable as additional rent or in lieu of rent, such as interest, taxes, insurance, repairs, or any other

items which are required to be paid by the terms of the lease or other arrangement. This does not include an amount paid as a service charge, such as for utilities or janitorial services. If a payment includes both rent and other unsegregated charges, the amount of rent must be determined by considering the relative values of the rent and the other items.

Rent does not include incidental day-to-day expenses, such as hotel accommodations or daily automobile rentals.

If the use of the net annual rental rate method produces a negative or clearly inaccurate value, or where property is used by the taxpayer at no charge or rented at a nominal rate, the net annual rental rate for the property must be determined on the basis of a reasonable market rental rate for the property.

• Leasehold improvements

Leasehold improvements are considered property owned by the lessee regardless of whether the lessee is entitled to remove the improvements or the improvements revert to the lessor when the lease expires. The leasehold improvements are valued at original cost.

Step 2—Calculate the average value of property. After determining the value of property includable in the zone factor, the value assigned to each item of property must be averaged.

• Owned property

In general, the value of each item of owned property must be averaged by adding the property's values at the beginning and ending of the tax period and dividing the result by two.

The tax commissioner may require or allow averaging on a monthly basis if deemed necessary to properly reflect the average value of the property for the tax period. This method will generally be applied in the following cases:

- a. There are substantial fluctuations in the values of the property during the tax period.

- b. The property is acquired after the beginning of the tax period.
- c. The property is disposed of before the end of the tax period.

Example: The property values per month are as follows:

January	\$ 2,000
February	2,000
March	3,000
April	3,500
May	4,500
June	10,000
July	15,000
August	17,000
September	23,000
October	25,000
November	13,000
December	2,000
Total	<u>\$ 120,000</u>

The average value of the property for the tax period is \$10,000 (\$120,000 divided by 12).

• Rented property

Averaging with respect to rented property is automatically achieved by use of the net annual rental rate method that must be used to value rented property. See **Rented property** under **Valuation of property** above.

Alternative method

If the zone apportionment factor method does not fairly represent the extent of the business activity attributable to the zone project property, the taxpayer may petition for (or the tax commissioner may require) another reasonable method to be applied to all or any part of the business. Other methods may include the following:

- Separate accounting.
- Any other method that results in an equitable allocation and apportionment of the taxpayer's income derived from the business.

This procedure may be invoked only in cases involving unusual fact situations that, because of their unique and nonrecurring nature, produce incongruous results.