ECONOMIC DEVELOPMENT TAX INCENTIVE STUDY - COAL SEVERANCE AND CONVERSION TAX EXEMPTIONS

Pursuant to North Dakota Century Code Section 54-35-26, created by Senate Bill No. 2057 (2015), a variety of economic development tax incentives must be reviewed by a Legislative Management interim committee every 6 years. The purpose of the review is to ensure economic development tax incentives are serving their intended purposes in a cost-effective and equitable manner. This memorandum is provided to assist in the review of coal severance and conversion exemptions and provides an explanation of the exemptions, the perceived goals of the Legislative Assembly in creating or altering the exemptions, and the data and testimony that will be required to conduct an effective analysis of the exemptions.

EXPLANATION OF COAL SEVERANCE AND CONVERSION TAX EXEMPTIONS

Coal Severance Tax

The coal severance tax is imposed on the act of removing coal from the earth pursuant to Chapter 57-61. The tax is in lieu of both the sales and use taxes on coal and the property tax on minerals in the earth. The coal severance tax applies to all coal severed for sale or industrial purposes, except coal used for heating buildings in the state, coal used by the state or any political subdivision of the state, and coal used in agricultural processing facilities in the state or adjacent states. The tax is applied at a rate of 37.5 cents per ton. An additional 2 cents per ton tax is levied for the lignite research fund. A 50 percent reduction of the 37.5 cent tax is allowed for coal burned in a cogeneration facility designed to use renewable resources to generate 10 percent or more of its energy output. A county may grant a partial or complete exemption from the county's 70 percent portion of the 37.5 cent tax for coal that is shipped out of state.

Coal Conversion Privilege Tax

The coal conversion tax is imposed in lieu of property taxes on the operator of each coal conversion facility pursuant to Chapter 57-60. The land on which the facility is located remains subject to property taxes. The privilege tax on coal conversion facilities is applied based on the type of coal conversion facility as follows:

- **Electrical generating plants** - Electrical generating plants are subject to two separate levies. One levy is a .65 mill times 60 percent of installed capacity times the number of hours in the taxable period, and the other levy is .25 mill per kilowatt-hour of electricity produced for sale. Installed capacity means the number of kilowatts a power unit can produce as displayed on the nameplate assigned to the turbine of the power unit.
- Other coal conversion plants:

  Coal gasification plants - A coal gasification plant is subject to a monthly tax of 13.5 cents per thousand cubic feet of synthetic natural gas produced for sale, or 2 percent of gross receipts, whichever is greater.

  Plants converting coal to products other than gas - These plants are taxed at a rate of 2 percent of gross receipts.

  Coal beneficiation plants - The tax rate for a coal beneficiation plant is 20 cents per ton of beneficiated coal produced for sale, or 1.25 percent of gross receipts, whichever is greater.

Various types of plants and production receive a full or partial exemption from coal conversion tax. Beneficiated coal produced in excess of 80 percent of a plant's design capacity or produced for use within a coal conversion facility is exempt from tax. A new or repowered coal-burning electrical generation plant is exempt from the general fund portion of both levies for 5 years. The county may grant an exemption for up to 5 years from the county's 15 percent share of the levy on installed capacity. All new coal conversion plants other than electrical generating plants are exempt from the general fund's 85 percent share of the tax for 5 years. The county may grant a partial or complete exemption from the county's 15 percent share for up to 5 years. A coal conversion facility that achieves a 20 percent capture of carbon dioxide emissions during a taxable period receives a 20 percent reduction in the general fund share of the tax, and an additional reduction of 1 percent for every additional 2 percentage points of carbon dioxide emissions captured, up to a 50 percent reduction for 80 percent or more capture. The reduction is available for 10 years from the date of the first capture or from the date the facility is eligible to receive the credit. A conversion facility that met the carbon dioxide capture requirements before January 1, 2017, is not eligible for the reduction.

PERCEIVED GOALS OF THE LEGISLATIVE ASSEMBLY IN CREATING OR ALTERING COAL SEVERANCE AND CONVERSION TAX EXEMPTIONS

Coal Severance Tax

The exemption provided in Section 57-61-01.1, for coal used to heat buildings in the state and coal used by the state or any political subdivision of the state, was enacted by Senate Bill No. 2239 (1981). The perceived goal of the Legislative Assembly in creating the exemption was to encourage the use of coal by the state and political subdivisions and the use of coal for heating purposes to decrease the state's dependence on other energy sources. It was estimated the exemption would reduce coal severance tax revenues by $435,000 during the 1981-83 biennium. The only change to the exemption following its enactment was by Senate Bill No. 2229 (1989), which removed redundant and unnecessary language.

The exemption provided in Section 57-61-01.4, for coal used in agricultural processing facilities in the state or adjacent states, was enacted by House Bill No. 1470 (1985). The exemption, as originally enacted, included an exemption for coal used in sugar beet refining plants. The perceived goal of the Legislative Assembly in creating the exemption was to make lignite coal more competitive with coal from Montana and Wyoming for use in agricultural processing facilities and sugar beet refining plants. Supporters of the exemption noted the loss of coal contracts was having a negative impact on employment in coal-producing areas of the state. It was estimated the exemption would reduce coal severance tax revenues by $208,000 during the 1985-87 biennium.

The exemption for coal used in agricultural processing facilities was amended two times following its enactment. Senate Bill No. 2035 (2009) expanded the exemption to include coal purchased for improvement through beneficiation which is then used in an agricultural commodity processing facility or a facility owned by the state or a political subdivision. Senate Bill No. 2036 (2015) removed the July 1, 2015, sunset date placed on the expanded provisions enacted by Senate Bill No. 2035 (2009).

The 50 percent coal severance tax reduction provided in Section 57-61-01.3, for coal burned in a cogeneration facility designed to use renewable resources to generate 10 percent or more of its energy output, was enacted by Senate Bill No. 2449 (1985). The perceived goal of the Legislative Assembly in providing the tax reduction was to grow the export market for North Dakota coal. It was estimated the tax reduction would reduce coal severance tax revenues by $2.97 million during the 1985-87 biennium. The tax reduction has not been amended since its enactment.

Section 57-61-01.7, which allows a county to grant a partial or complete exemption from the county's 70 percent portion of the severance tax for coal that is shipped out of state, was enacted by House Bill No. 1362 (1993). The exemption, as originally enacted, allowed a county to grant a partial or complete exemption from the county's 35 percent portion of the severance tax for coal that is shipped out of state. The perceived goal of the Legislative Assembly in creating the exemption was to prevent the potential closure of a local mine by reducing the tax on coal the mine shipped out of state. The fiscal impact of the exemption could not be determined during the 1993 legislative session. The exemption was amended two times following its enactment. Senate Bill No. 2299 (2001) reflected changes to the county's portion of the tax, from 35 to 70 percent, for purposes of identifying the amount of tax the county could exempt. Senate Bill No. 2377 (2015) added commercial leonardite to the exemption, which for purposes of taxation is treated in the same manner as coal.

Coal Conversion Privilege Tax

The exemption provided in Section 57-60-02, for beneficiated coal produced in excess of 80 percent of a plant's design capacity or produced for use within a coal conversion facility, was enacted by House Bill No. 1613 (1989). The exemption, as originally enacted, only applied to beneficiated coal produced in excess of 80 percent of the plant's design capacity. The perceived goal of the Legislative Assembly in providing the exemption was to incentivize developers to consider beneficiation projects to help maintain existing coal jobs and create future jobs. The exemption was viewed as providing environmental as well as economic benefits. The fiscal impact of the exemption could not be determined during the 1989 legislative session. The only change to the exemption following its enactment was by Senate Bill No. 2036 (2015), which expanded the exemption to beneficiated coal produced for use within a coal conversion facility.

The 5-year exemption provided in Section 57-60-02 for the general fund's 85 percent share of tax for new coal conversion plants other than electrical generating plants was enacted by House Bill No. 1574 (1985). The exemption, as originally enacted, exempted 65 percent of the tax imposed on the plant for 5 years with the county retaining the ability to grant a full or partial exemption on the remainder of the tax for the same time period. The perceived goal of the Legislative Assembly in providing the exemption was to encourage the construction of new coal conversion plants. The fiscal impact of the exemption could not be determined during the 1985 legislative session. The exemption was amended two times following its enactment. Senate Bill No. 2099 (1987) changed the start of the 5-year time period from the date of first production to the date of the first taxable production. Senate Bill No. 2299 (2001) reflected changes to the county's portion of the tax, reduced from 35 to 15 percent, for purposes of identifying the amount of tax the county could exempt.

The 5-year exemption provided in Section 57-60-02 for a new or repowered coal-burning electrical generation plant was enacted by House Bill No. 1606 (1991). The exemption, as originally enacted, exempted 65 percent of the tax imposed on new electrical generating plants for 5 years with the county retaining the ability to grant a full or partial exemption on the remainder of tax for the same time period. The perceived goal of the Legislative Assembly in providing the exemption was to promote economic development by providing the same tax incentive to electrical generation plants as was provided to coal conversion facilities. It was noted each 400 megawatt plant creates 1,000 direct and indirect jobs and $72 million in business activity. It was estimated the exemption would have no fiscal impact during the 1991-93 biennium because the forecast did not include the building of a power plant. The exemption was amended three times following its enactment. Senate Bill No. 2299 (2001) reflected changes to the county's portion of the tax, reduced from 35 to 15 percent, for purposes of identifying the amount of tax the county could exempt. House Bill No. 1268 (2005) expanded the 5-year exemption to plants that completed repowering after June 30, 1991. Senate Bill No. 2036 (2009) changed references to "electrical generating plants" to "electrical energy generating units."

The reduction provided in Section 57-60-02.1, for a coal conversion facility that captures carbon dioxide emissions, was enacted by Senate Bill No. 2221 (2009). The perceived goal of the Legislative Assembly in providing the tax reduction was to encourage the capture and reduction of carbon dioxide emissions. The facility that anticipated qualifying for the tax reduction indicated the incentive would reduce coal conversion tax revenues by $7.42 million during the 2009-11 biennium. The only change to the tax reduction following its enactment was by Senate Bill No. 2133 (2017), which disqualified coal conversion facilities that met carbon dioxide capture requirements before January 1, 2017, from qualifying for the tax reduction.

DATA AND TESTIMONY REQUIRED TO CONDUCT AN EFFECTIVE ANALYSIS OF COAL SEVERANCE AND CONVERSION TAX EXEMPTIONS

Data pertaining to the following items will need to be collected to effectively analyze the exemptions:

1. The number of claimants;
2. The fiscal impact of the exemptions;
3. Employment opportunities, business growth, or diversity in the state's economy resulting from the availability of the exemptions;
4. Negative impacts created as a result of the exemptions; and
5. Benefits that flow to out-of-state concerns resulting from the exemptions.

Testimony will need to be solicited from the following parties to effectively analyze the exemptions:

1. The Department of Commerce;
2. The Tax Department;
3. The North Dakota Economic Development Foundation; and
4. Coal and energy industry representatives.