

ECONOMIC DEVELOPMENT TAX INCENTIVE STUDY - ELECTRICAL GENERATING FACILITIES SALES TAX EXEMPTION

Pursuant to North Dakota Century Code Section 54-35-26, created by 2015 Senate Bill No. 2057, a variety of economic development tax incentives are to be reviewed by a Legislative Management interim committee over the ensuing six-year period. The study is aimed at ensuring that economic development tax incentives are serving their intended purposes in a cost-effective and equitable manner. This memorandum has been provided to assist in the review of the electrical generating facilities sales tax exemption and provides an explanation of the incentive, the perceived goals of the Legislative Assembly in creating or altering the incentive, and the data and testimony that will be required to conduct an effective analysis of the incentive.

EXPLANATION OF THE ELECTRICAL GENERATING FACILITIES SALES TAX EXEMPTION

Sections 57-39.2-04.2 and 57-40.2-04.2 provide for a sales and use tax exemption for purchases of production equipment, building materials, and other tangible personal property used to add environmental upgrades or to construct or expand certain electrical generating facilities. The exemption is available for purchases used to upgrade, construct, or expand a wind-powered electrical generating facility if the facility will be completed before January 1, 2017, and has at least one single electrical energy generation unit with a nameplate capacity of 100 kilowatts or more. The exemption is also available for purchases used to upgrade, construct, or expand a coal-powered electrical generating facility if the facility converts coal from its natural or beneficiated form into electrical power and has at least one single electrical generation unit with a capacity of 50,000 kilowatts or more. For facilities powered by sources other than coal or wind, the exemption is available for purchases used to upgrade, construct, or expand an electrical generation facility if the facility produces electricity for resale or for consumption in a business activity and has at least one single electrical generation unit with a capacity of 100 kilowatts or more.

A facility operator may receive the sales tax exemption at the time of purchase if the operator applies for and receives a certificate from the Tax Commissioner verifying the materials the operator intends to purchase qualify for the exemption. If a certificate of exemption is not received prior to the operator making a purchase, the operator may apply to the Tax Commissioner for a refund of the applicable amount of tax paid. If a contractor purchases or installs the tangible personal property or equipment, the facility operator may apply for a refund of the amount of sales or use tax paid by the contractor on qualifying items.

PERCEIVED GOALS OF THE LEGISLATIVE ASSEMBLY IN CREATING OR ALTERING THE ELECTRICAL GENERATING FACILITIES SALES TAX EXEMPTION

Sections 57-39.2-04.2 and 57-40.2-04.2 were created through the passage of 1991 House Bill No. 1606. At that time, Sections 57-39.2-04.2 and 57-40.2-04.2 provided for a sales and use tax exemption for purchases of production equipment and other tangible personal property used in the construction of a coal-powered electrical generating facility. In 2001 the exemption was expanded to apply to purchases made by operators of a second type of power plant, wind-powered electrical generating facilities, through the passage of House Bill No. 1221. The bill defined a qualifying wind-powered electrical generating facility as a facility having at least one single electrical energy generation unit, with a nameplate capacity of 100 kilowatts or more, on which construction would be completed before January 1, 2011. Upon a review of the legislative history relating to House Bill No. 1221, the perceived goal of the Legislative Assembly providing this exemption was to encourage economic development through the construction of new electrical generating facilities. In estimating the fiscal impact of this exemption, it was determined that each wind tower could qualify for a sales tax exemption of approximately \$30,000. This figure was reached under the assumption that the materials subject to the exemption would cost roughly \$600,000 per tower.

In 2005 the sales tax exemption was expanded for a second time through the passage of House Bill Nos. 1498 and 1268. House Bill No. 1498 allowed for the exemption to apply to machinery and equipment used to reduce emissions, increase efficiency, or enhance reliability at a new or existing oil refinery or gas processing plant. House Bill No. 1268 expanded the sales tax exemption to production equipment and materials purchased by a power plant operator for purposes of environmental upgrades or repowering. The bill defined the term "environmental upgrade" as an investment of more than \$25 million, or \$100,000 per megawatt of installed nameplate capacity, in machinery, equipment, or facilities by an existing power plant for purposes of reducing emissions or increasing efficiency. The term "repowering" was defined as an investment of at least \$200 million, or \$1 million per megawatt of installed nameplate capacity, by an existing power plant that modifies or replaces its existing process of converting coal into electric power.

In 2007 the definition of a "power plant" was broadened through the passage of Senate Bill No. 2298 to include not only coal-powered and wind-powered electrical generating facilities, but to include any other types of electrical generating facilities as well. The bill also reduced the capacity required for a power plant to receive the sales tax exemption and allowed the exemption to be claimed upfront by a contractor, rather than requiring the contractor to first pay the tax and then have the operator apply for a refund. It was estimated that the provisions of Senate Bill No. 2298 would result in a \$2.4 million reduction in general fund revenues during the 2007-09 biennium. This estimate was based on the four qualifying plants under construction in the state at that time. Also passed in 2007 was House Bill No. 1365, which served to expand the sales tax exemption to power plants using any type of coal, rather than only lignite coal. The bill also replaced the requirement that power plants begin construction after June 30, 1991, with the requirement that materials qualifying for the exemption be delivered to the power plant on or after January 1, 2007.

In 2009 the exemption was further amended through the passage of Senate Bill Nos. 2035 and 2032. Senate Bill No. 2035 extended the sales and use tax exemption for power plant equipment to include equipment used for an electrical generating plant that converts beneficiated coal into electrical power. Senate Bill No. 2032 extended the deadline from 2011 to 2015 for the sales and use tax exemption for materials used in the construction or expansion of a wind-powered facility. This deadline was extended for a second time during the 2013 legislative session through the passage of House Bill No. 1382. The bill extended the expiration date of the sales tax exemption for materials used in the construction of a wind-powered electrical generating facility from December 31, 2014, to December 31, 2016. The expiration date related to the sales and use tax exemption for purchases made by electrical generating plants converting beneficiated coal into electric power was removed in 2015 through the passage of Senate Bill No. 2036. The sales tax exemption for purchases made by operators of these types of electrical generating facilities was otherwise scheduled to expire on July 1, 2017.

Information provided to the Political Subdivision Taxation Committee by the Department of Commerce on July 29, 2015, indicates the amount of the sales tax exemption realized by all claimants during the 2013-15 biennium cannot be disclosed due to confidentiality restrictions as fewer than five claimants utilized the exemption in each tax year.

DATA AND TESTIMONY REQUIRED TO CONDUCT AN EFFECTIVE ANALYSIS OF THE ELECTRICAL GENERATING FACILITIES SALES TAX EXEMPTION

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

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

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

1. The Department of Commerce;
2. The Tax Department;
3. The North Dakota Economic Development Foundation; and
4. Representatives of the generation and lignite industries.