

November 2005

## ELECTRIC INDUSTRY COMPETITION COMMITTEE STUDY OF TAXATION - HISTORY

The participants in the electric utility industry in North Dakota may be grouped in four categories:

1. Rural electric cooperatives - Nonprofit, member-owned corporations engaged in the electric utility business. Rural electric cooperatives may be further divided into distribution cooperatives, of which there are 19 operating in North Dakota, and generation and transmission cooperatives, of which there are seven operating in North Dakota.
2. Investor-owned utilities - For-profit corporations owned by their shareholders. Three investor-owned utilities do business in North Dakota.
3. Municipal utilities and municipal power agencies - Political subdivisions engaged in distribution of electricity to residents of a city or group of cities. A municipal utility provides services to one city. In North Dakota there are 12 municipal utilities. A municipal power agency is composed of two or more municipal utilities functioning jointly to take advantage of economies of scale. In North Dakota there is one municipal power agency functioning on behalf of six member municipal utilities.
4. Power marketers - Entities engaged in purchase and resale of electricity through transmission and distribution infrastructure owned by electric utilities. In North Dakota one power marketer is doing business.

### TAX TYPES IMPOSED ON THE ELECTRIC INDUSTRY

In addition to differences in types of taxes that apply to electric utilities depending upon how they conduct business, different forms of taxation apply to each part of the process of generating and delivering electricity. Separate forms of taxation apply to severance of coal from the earth, generation of electricity or production of other products from coal, generation of electricity from wind, transmission of electricity through large-capacity transmission lines, and distribution of electricity to consumers.

#### Coal Severance Tax

The coal severance tax was initially imposed in North Dakota in 1975 and has been the subject of numerous rate changes and other adjustments. A substantial change in severance and conversion tax policy was made by passage of Senate Bill No. 2299

(2001). The legislation was intended to assist the North Dakota lignite industry to maintain its competitive position in the market by shifting some tax burden from severance to generation of electricity. The legislation reduced the general coal severance tax rate from 75 cents per ton to 37.5 cents per ton and increased the rate of coal conversion taxes to offset revenue losses to the state and affected political subdivisions. The revenue from the general severance tax is allocated 30 percent to a constitutionally established coal development trust fund and 70 percent to the coal-producing counties based upon coal production in each county. Severance tax revenues received by a county are further allocated 30 percent among cities, 30 percent among school districts, and 40 percent to the county.

In addition to the general severance tax rate, a separate two cents per ton tax is imposed upon severance of coal. The entire revenue from the two cents per ton tax is deposited in the lignite research fund.

#### Coal Conversion Tax

The coal conversion tax is imposed on the operator of a coal conversion facility, defined to include any coal-fired electric generating unit with a capacity of 10,000 kilowatts or more and any coal gasification facility. The tax is in lieu of property taxes on the facility, but the land on which the facility is located remains subject to local property taxes. The coal conversion tax for an electric generating facility is imposed at a rate of .65 mill times 60 percent of the installed capacity of the facility times the number of hours in the taxable period and an additional tax of .25 mill per kilowatt-hour of electricity produced for sale. For coal gasification plants, the tax is imposed at the greater of 4.1 percent of gross receipts or 13.5 cents per 1,000 cubic feet of synthetic natural gas produced for sale.

Coal conversion tax revenues are allocated 15 percent to the producing county and 85 percent to the state general fund, except the separate tax of .25 mill per kilowatt-hour produced for sale and, through 2009, the first \$41,666.67 each month from coal gasification plant tax revenues must be deposited in the state general fund. Coal conversion tax revenues received by a county are allocated 30 percent among cities, 30 percent among school districts, and 40 percent to the county general fund.

#### Property Taxes

Under Article X, Section 4, of the Constitution of North Dakota, property used to furnish or distribute electricity is subject to central assessment by the State Board of Equalization as prescribed by law. Under Article X, Section 5, of the Constitution of North Dakota, the Legislative Assembly may exempt any personal property from taxation and may classify any property other than land as personal property.

Property of investor-owned utilities is subject to property taxes. All operative property is subject to assessment by the State Board of Equalization under North Dakota Century Code (NDCC) Chapter 57-06. Operative property is defined to include all property reasonably necessary for use by a public utility in operation and conduct of the business engaged in by the company. Property subject to assessment by the State Board of Equalization has its valuation assigned to the taxing district in which the property is located. Assessments of continuous lines of property, such as transmission and distribution lines, are allocated among counties based on the prorated portion of mileage of such lines in each county. The Tax Commissioner certifies to the county auditor of each county the total assessed valuation of centrally assessed property and the amount in each assessment district within the county. Local tax levies are then applied against the valuation in the same manner used for other property subject to local property taxes.

Property of a municipal utility or municipal power agency is exempt from property taxes under Article X, Section 5, of the Constitution of North Dakota.

Property, other than land, owned by a rural electric cooperative and used as operative property or part of a generating facility is exempt from property taxes and is instead subject to gross receipts taxes under NDCC Chapter 57-33, which applies to operative property of rural electric cooperatives, or Chapter 57-33.1, which applies to cooperative electrical generating plants. Taxes imposed under each of these chapters is in lieu of property taxes, except taxes on land (which may not be exempted under Article X, Section 5, of the Constitution of North Dakota). Land owned by a rural electric cooperative is subject to local assessment and payment of property taxes. In addition, Basin Electric Power Cooperative pays locally assessed property taxes on its headquarters land and buildings because the building is not a part of the cooperative's operative property or part of a generating facility.

### **Gross Receipts Taxes and Transmission Line Taxes**

A 2 percent tax on gross receipts is imposed on rural electric cooperative transmission and distribution cooperatives. A 2 percent gross receipts tax also applies to rural electric cooperative generation cooperatives, but only if a generation facility is not subject to coal conversion taxes under NDCC Chapter 57-60. An additional tax of \$225 per mile applies to rural

electric cooperative-owned transmission lines of 230 kilovolts or larger under Section 57-33.1-02.

Gross receipts taxes from transmission and distribution cooperatives are allocated among counties in proportion to the miles of line in each county. Tax revenues received by a county are allocated among taxing districts in proportion to the miles of line in each taxing district. Gross receipts taxes from a cooperative electrical generating plant during the first two years of operation go entirely to the county in which the facility is located. After the first two years of operation, taxes from an electrical generating plant are allocated so that the first \$50,000 goes to the county, the second \$50,000 is split evenly between the county and the state general fund, and all additional revenue is divided 25 percent to the county and 75 percent to the state general fund. Cooperative electrical generating plant gross receipts taxes received by the county are allocated 15 percent to cities, based on population; 40 percent to the county general fund; and 45 percent to school districts, based on average daily attendance. Transmission line taxes under NDCC Section 57-33.1-02 are allocated among counties in proportion to the miles of line in each county and are allocated entirely to the county general fund.

Gross receipts taxes do not apply directly to investor-owned utilities, municipal utilities, municipal power agencies, or power marketers but may be embedded in the cost of electricity purchased from a rural electric cooperative.

### **City Privilege Tax**

Under NDCC Section 57-33-04, a city is allowed to impose a privilege tax on the value of electric distribution facilities of a rural electric cooperative furnishing power to city consumers. The tax must be reduced by the amount of gross receipts tax allocated to the city.

### **Municipal Utility Revenues**

A municipal utility is limited by NDCC Section 40-33-12 to a maximum of 20 percent of its annual gross revenues which may be transferred by the municipal utility to the general fund of the city. It appears that Section 40-33-12 would allow a greater amount of gross revenues to be transferred if approved by electors of the city at a regular city election.

### **1997-98 INTERIM**

Since the beginning of the Electric Utilities Committee in 1997, the committee has studied electric utility taxation. During the 1997-98 interim, the committee studied electric utility taxation in other states. In addition, the committee authorized the formation of an electric industry taxation task force, made up of representatives of this state's investor-owned utilities, rural electric cooperatives, municipal

electric utilities, and power marketers, to determine common areas of agreement for changes in taxation.

Representatives of the state's rural electric cooperatives proposed a distribution tax per megawatt of \$1.43 to be levied in lieu of current property-based taxes. Under the proposal, a tax of \$1.43 per megawatt or \$.00143 per kilowatt-hour would have been levied on retail electricity distributed in North Dakota, whether by an investor-owned utility, a rural electric cooperative, or a municipal electric utility. The tax would be paid by the distribution utility. The distribution tax would be in lieu of current distribution taxes paid by the investor-owned utilities and the rural electric cooperatives. For the rural electric cooperatives, the proposal included the elimination of the 2 percent gross receipts tax and the city privilege tax. In addition, investor-owned utilities would be assessed the high-voltage transmission line tax and the land tax on the same basis as the rural telephone cooperatives and would pay a property tax or other tax on generating facilities.

Representatives of the state's investor-owned utilities proposed a flat rate consumption tax on all electric sales on a per kilowatt-hour or megawatt basis. Under the proposal, the all-existing taxes would be designated in lieu of the new consumption tax. The tax would capture the consumption of out-of-state power marketers.

### 1999-2000 INTERIM

During the 1999-2000 interim, the committee received proposals from representatives of the state's rural electric cooperatives and the state's investor-owned utilities and also developed its own proposals. The initial proposal submitted by the rural electric cooperatives taxed all transmissions facilities on a line-mile basis. Transmission lines:

1. Under 75 kilovolts would be taxed at a rate of \$100 per mile;
2. From 75 to 149 kilovolts at \$200 per mile;
3. From 150 to 224 kilovolts at \$300 per mile;
4. From 225 to 299 kilovolts at \$400 per mile; and
5. Of 300 kilovolts or more at \$500 per mile.

Concerning the distribution function, utilities would be charged a tax on the distribution of electricity using a two-part formula:

1. A flat tax of 62 cents per megawatt-hour of delivered power.
2. A tax of 1 percent of the revenue collected on the retail sale of kilowatt-hours of electricity.

This taxation proposal would replace gross receipts and transmission line taxes paid by rural electric cooperatives and property taxes paid by investor-owned utilities.

Proponents testified that the two-component distribution tax would balance opposing views on how distribution taxes should be allocated among consumer classes. One view holds that each

kilowatt-hour should be taxed the same for use of the distribution system. The other view holds that high-volume or offpeak energy users who receive volume discounts or price concessions to encourage usage should pay a lesser proportionate share of distribution taxes. The flat tax per kilowatt-hour generally benefits utilities that sell smaller amounts of energy at higher prices, whereas imposition of a tax based on percentage of retail sales benefits utilities that sell a high volume of energy at low prices.

Opponents testified that the proposal did not address state income taxes paid by this state's investor-owned utilities. Opponents testified that the percentage of retail sales component of the proposal added complexity to the taxation scheme, shifted the costs among consumers, and could produce negative results in terms of revenue erosion in a restructured market. Concerning taxation of the transmission component, opponents testified that the transmission proposal did not tax these assets at an appropriate level. They testified that the proposal shifted a disproportionate portion of the tax to the distribution component in favor of the transmission component.

The state's investor-owned utilities submitted a taxation proposal that taxed the generation, transmission, and distribution components by function. Concerning the generation component, the proposal taxed all generation plants in the state based on the current coal conversion formula.

Concerning the transmission component, the proposal taxed all transmission facilities on a line-mile basis. Transmission lines of:

1. 41.6 kilovolts would be taxed at a rate of \$200 per mile;
2. 57 kilovolts at \$300 per mile;
3. 69 kilovolts at \$500 per mile;
4. 115 kilovolts at \$600 per mile;
5. 230 kilovolts at \$800 per mile;
6. 345 kilovolts at \$1,000 per mile; and
7. 400 kilovolts at \$1,200 per mile.

Concerning the distribution component, utilities would be charged a distribution tax of:

1. \$1.5255 per megawatt-hour for residential and other classes of customers.
2. \$.9153 per megawatt-hour for commercial and industrial customers.

This component also included a power marketer tax of \$.4416 per megawatt-hour. The proposal replaces gross receipts and transmission line taxes paid by rural electric cooperatives, property taxes paid by investor-owned utilities, and state income taxes paid by investor-owned utilities.

The representatives from this state's rural electric cooperatives submitted a revised proposal. The proposal extended the coal conversion tax to all generation facilities of five megawatts or greater, regardless of fuel source. The proposal taxed all transmission facilities on a line-mile basis. Transmission lines:

1. Under 50 kilovolts would be taxed at a rate of \$75 per mile;
2. From 50 to 99 kilovolts at \$150 per mile;
3. From 100 to 199 kilovolts at \$300 per mile;
4. From 200 to 299 kilovolts at \$450 per mile;
5. From 300 to 399 kilovolts at \$600 per mile; and
6. Of 400 kilovolts or more at \$900 per mile.

Concerning the distribution component, utilities would be charged a tax on the distribution of electricity using a two-part formula:

1. A flat tax of 59 cents per megawatt-hour of delivered power.
2. A tax of .95 percent of revenue collected on the retail sale of kilowatt-hours of electricity.

This revised proposal increased transmission line taxes and reduced distribution taxes by 20 percent.

The committee considered, but did not recommend, a bill draft relating to the taxation of the distribution and transmission of electric power for retail sale in this state. The bill draft would have applied this state's coal conversion tax to the Heskett plant in Mandan; removed investor-owned utilities property from central assessment; removed the gross receipts tax for rural electric cooperatives; imposed transmission and distribution line taxes in lieu of property taxes, except that property taxes would still be imposed on land, office- or administrative-type buildings, and buildings and structures not used primarily and directly in the delivery of electricity through transmission and distribution lines; subjected peaking plants of less than 80 megawatts to local property tax assessment or exempted them as property used primarily in the delivery of electricity through lines; increased the transmission line tax; imposed a distribution tax; excluded municipal electric utilities from coverage under the bill draft; and allocated transmission and distribution tax revenue with the continuing appropriation to political subdivisions.

The transmission line tax would have been imposed on a line-mile basis. Transmission lines of:

1. Less than 57 kilovolts would be taxed at a rate of \$200 per mile for alternating current voltage;
2. 57 to 68 kilovolts at \$300 per mile for alternating current voltage;
3. 69 to 114 kilovolts at \$400 per mile for alternating current voltage;
4. 115 to 229 kilovolts at \$600 per mile for a nominal operating alternating current voltage;
5. 230 to 344 kilovolts at \$800 per mile for a nominal operating alternating current voltage;
6. 345 to 499 kilovolts at \$1,000 per mile for a nominal operating alternating current voltage;
7. Less than 400 kilovolts at \$1,200 per mile for direct current voltage;
8. 500 kilovolts or more at \$1,300 per mile for alternating current voltage; and

9. 400 kilovolts or more at \$1,500 per mile for direct current voltage.

Concerning distribution taxes, distribution companies would have been subject to a distribution tax of:

1. 75.83 cents per megawatt-hour for the retail sale of electricity to commercial or industrial consumers.
2. \$1.2638 per megawatt-hour for the retail sale of electricity of noncommercial or nonindustrial consumers.

Revenue from the taxation on the transmission lines would have been allocated to counties based on the miles of line in each county. Revenues received by a county would have been allocated among taxing districts based on the mileage of transmission lines and the rates of tax on those lines within each taxing district. Revenue from that portion of a transmission line located in more than one taxing district would have been allocated among those taxing districts in proportion to their respective current property tax mill rates that apply to the land on which the transmission line is located. Revenue from distribution company tax would have been allocated to the county in which the retail sale was made and allocated among taxing districts in proportion to the property tax levies in dollars.

Representatives of the state's investor-owned utilities testified that any tax legislation should be part of a comprehensive electric industry competition restructuring bill and should not be enacted before implementation of industry restructuring. Representatives of this state's rural electric cooperatives testified the bill draft would result in excess tax-shifting among utilities.

## 2001 LEGISLATION

Among the changes in Senate Bill No. 2299 (2001) was a change in the tax status of the Heskett generating station in Morton County, which was an issue that arose in earlier discussions of the Electric Industry Competition Committee. Under previous law the Heskett station was excluded from the definition of a coal conversion facility because the production capacity of its two generating units was less than the threshold for application of the coal conversion tax. The 2001 legislation reduced the threshold for inclusion as a coal conversion facility, changing the status of the Heskett station from payment of property taxes to payment of coal conversion taxes. A special provision was added to the coal conversion tax law to incorporate a "hold harmless" provision for Morton County and taxing districts in Morton County to ensure that the county and taxing districts would continue to receive at least as much coal conversion tax revenue as was received from the property taxes for the facility for taxable year 2001.

Passage of House Bill No. 1348 (2001) increased the rate of the transmission line tax to \$300 per mile for a transmission line of 230 kilovolts or larger initially

placed in service on or after October 1, 2002. However, House Bill No. 1348 also created an exemption from this tax for the first year after a new transmission line is placed in service and provided a 75 percent reduction for the second year, 50 percent reduction for the third year, and 25 percent reduction for the fourth year of operation of the transmission line. House Bill No. 1348 also established a distinction between a transmission line and a distribution line. A transmission line is one which operates at a voltage of 41.6 kilovolts or more, and a line operating at lower voltage is a distribution line.

Another significant change made by House Bill No. 1348 was that a new transmission line owned by an investor-owned utility is exempt from property taxes and subject to taxation in the same manner as taxes apply to transmission lines of rural electric cooperatives for lines placed in service on or after October 1, 2002. Such lines of investor-owned utilities are subject to a tax of \$300 per mile and are entitled to exemption for the first year of operation and a reduction of 75 percent for the second year, 50 percent for the third year, and 25 percent for the fourth year of operation of the transmission line.

### **2001-02 INTERIM**

During the 2001-02 interim, the committee began its review of the taxation of the electric utility industry in this state by reviewing a bill draft that had been considered by the 1999-2000 Interim Electric Industry Competition Committee but not recommended to the Legislative Council. After reviewing the proposal that had been developed by the 1999-2000 Electric Industry Competition Committee, the committee requested the electric industry taxation study working group to update the electric utilities statistics that were used to develop that proposal. Updated electric utilities statistics contained information on generation, coal conversion taxes paid by plant and year, transmission taxes, electricity sales by utility, electricity utility gross receipts taxes paid, electric utility city privilege taxes paid, public utility property taxes paid, electric utility real estate taxes paid, income taxes on electric operations paid, and payments in lieu of taxes paid by municipal power systems. After receiving this information, the committee invited representatives of the electric industry to submit proposals relating to the taxation of electric utilities to the committee.

The North Dakota Association of Rural Electric Cooperatives submitted a bill draft that would have restructured taxation of the electric industry by eliminating property taxes centrally assessed under current law for the state's investor-owned utilities, eliminating the gross receipts tax as currently assessed for the state's rural electric cooperatives, and replacing those taxes by a tax on the transmission and distribution of electricity. The bill draft would have imposed an annual transmission line-mile tax. Transmission lines of:

1. Less than 50 kilovolts would be taxed at a rate of \$75 per mile;
2. 50 to 99 kilovolts at \$150 per mile;
3. 100 to 199 kilovolts at \$300 per mile;
4. 200 to 299 kilovolts at \$450 per mile;
5. 300 to 399 kilovolts at \$600 per mile; and
6. 400 kilovolts or more at \$900 per mile.

A company engaged in distribution of electricity for retail sale to consumers in this state through distribution lines would have been subject to a distribution tax of:

1. 54 cents per megawatt-hour for the retail sale of the electricity delivered through a distribution line to a consumer.
2. .92 percent of the company's gross revenues from retail sales.

The revenue on transmission lines would have been allocated among counties based on the mileage of transmission lines and the rates of tax on those lines within each county. The bill draft contained two alternatives for distribution of the revenues from the distribution company tax. One alternative would have provided that revenue from the distribution company tax would be allocated to the county in which the retail sale to which the tax applied was made. The second alternative would have provided that revenue from the taxes paid by a distribution company would be allocated to each county in which the distribution company's distribution lines are located in the ratio in which the number of miles of its lines in each county bears to the total number of miles of lines of the distribution company in the state.

The committee revised the bill draft to provide that the distribution tax of 54 cents per megawatt-hour for the retail sale be distributed based on the mileage of transmission lines and that the .92 percent of the company's gross revenues from the retail sale be allocated to the county in which the retail sale was made. The main argument raised by opponents of the bill draft was that it did not address corporate income taxes paid by investor-owned utilities. In addition, the transmission line-mile tax transfers tax obligations away from electric cooperatives and shifts them to the state's investor-owned utilities.

### **2003-04 INTERIM**

During the 2003-04 interim, House Concurrent Resolution No. 3061 directed a study of the feasibility and desirability of enacting legislation to tax electric utility providers with a fair and uniform tax system. The resolution reflected the Legislative Assembly's concern that the system of taxation results in disparities in tax collections among the state and its political subdivisions and creates unfairness in tax burdens among electric utilities.

To facilitate the electric industry taxation study, the committee requested the Association of Rural Electric Cooperatives and investor-owned utilities reprise their electric industry taxation study working group to

compile updated taxation information for the committee's use. The electric industry taxation study working group compiled statistics on generation capacity, transmission line miles, electric sales, and taxes.

Concerning statistics relating to the generation of electricity, information compiled by the group shows the state's electric generation--nearly 4,000 megawatts of generation capacity--is fueled largely by coal. Hydropower from the Garrison Dam contributes almost 550 megawatts of generation capacity. There are 80 megawatts of small generation peaking plants and 67 megawatts of potential wind generation. While coal and hydropower generation remain largely unchanged over the past several years, nearly all of the wind generation has been added during the past two years. The wind generation includes two 900-kilowatt turbines, owned and operated by Minnkota Power Cooperative near Valley City and Petersburg; two 1.3-megawatt turbines south of Minot, owned and operated by Basin Electric Power Cooperative, and 62 megawatts of wind generation built in the Edgeley-Kulm area by FPL Energy under long-term purchase contracts to supply wind energy to Basin Electric Power Cooperative and Otter Tail Power Company. Total generation capacity in North Dakota is 4,658 megawatts.

North Dakota's electric utility industry has paid over \$73 million in coal conversion taxes over the past five years, with the amount of taxes increasing from approximately \$12 million in 1998 to nearly \$21 million in 2002. This increase in coal conversion revenue resulted from legislative changes adopted in 2001. The most significant change was an increase in the coal conversion tax formula and the corresponding decrease in the coal severance tax formula. In addition, the Legislative Assembly amended the coal conversion tax to make the tax applicable to smaller coal-based plants. Thus, the 86-megawatt Heskett plant in Mandan owned by Montana-Dakota Utilities Company is now subject to the coal conversion tax instead of the public utility property tax.

Concerning the transmission function, representatives of the electric industry reported that the state has over 12,500 miles of transmission lines, including over 5,000 miles owned by rural electric cooperatives, nearly 5,000 miles owned by investor-owned utilities, and more than 2,000 miles of lines owned by the Western Area Power Administration. There has been almost a 3 percent increase in total transmission line miles in the past two years. Rural electric cooperatives pay a \$225 per mile tax on high-voltage transmission lines of 230 kilovolts or more. Transmission lines of all sizes owned by investor-owned utilities are subject to centrally assessed ad valorem property taxes. Taxes on transmission lines from 41.6 kilovolts to less than 230 kilovolts owned by rural electric cooperatives are collected under the provisions of the gross receipts tax. Legislation enacted during the 58th Legislative Assembly (2003) grants both

investor-owned utilities and rural electric cooperatives a four-year declining property tax exemption for transmission lines rated at 230 kilovolts or larger placed in service after October 1, 2002. Following the four-year declining property tax exemption, the affected transmission line facilities will be taxed at \$300 per mile for both rural electric cooperatives and investor-owned utilities. In addition to the high-voltage transmission line tax, cooperatives pay gross receipts tax, in lieu of personal property tax, on electric facilities and on transmission lines smaller than 230 kilovolts. Cooperatives also pay real estate taxes on the unimproved value of their real estate. As a federal agency, the Western Area Power Administration lines are not subject to state taxation. Municipal utilities, which own approximately 10 miles of transmission line in the state, do not pay property taxes on these facilities. The state collects approximately \$411,000 in transmission line taxes annually.

Concerning retail sales of electricity, the electric industry taxation study working group reported that for the three-year period from 2000 to 2002, investor-owned utilities had approximately 54 percent of retail sales, cooperatives had approximately 43 percent, and municipal electric utilities accounted for 3 percent of total retail electricity sales in the state.

Rural electric cooperatives pay a gross receipts tax. The gross receipts tax is a tax in lieu of a personal property tax and is a 2 percent tax on all cooperative revenue, excluding the sale of capital assets and revenue attributable to electric generation plants subject to the coal conversion tax. The 58th Legislative Assembly added two additional exemptions. First, revenue from wholesale sales of electric energy to cooperatives subject to paying the gross receipts tax on retail sales on the energy is exempt. This exemption is expected to reduce future gross receipts tax payments by Central Power Electric Cooperative and Upper Missouri Generation and Transmission Electric Cooperative by slightly more than \$100,000 each per year. Second, revenue from the sale of wind energy from a North Dakota wind energy facility subject to centrally assessed property taxation is exempt from gross receipts taxation. This puts North Dakota wind energy sales on the same footing as sales from coal conversion facilities. Before enactment of the 2003 legislation to address duplicate gross receipts taxation, member cooperatives of Central Power Electric Cooperative and Upper Missouri Generation and Transmission Electric Cooperative executed contract amendments with their power suppliers to purchase most of their electricity directly from Basin Electric Power Cooperative and not through their intermediate transmission cooperative. This change was implemented in the last quarter of 1999 and accounts for the somewhat lower taxes paid by Central Power Electric Cooperative and Upper Missouri Generation and Transmission Electric Cooperative in 2000.

A city is authorized by law to impose a privilege tax on the value of rural electric cooperative-owned facilities within the city. When a city imposes a privilege tax, the amount of this tax is reduced by the amount of the gross receipts tax revenue the city receives. During 2002 only the city of New Town imposed this tax.

Investor-owned utilities pay a public utility property tax. This tax is based upon the value of the utility's entire electric system, including real estate, distribution, transmission, and generation that is not subject to the coal conversion tax. In 2001 the Legislative Assembly amended the law to make the coal conversion tax applicable to smaller-based load power plants, including the 86-megawatt Heskett plant owned by Montana-Dakota Utilities Company, which was previously included as part of Montana-Dakota Utilities Company's property subject to the utility property tax.

Concerning state income taxes, as nonprofit cooperative associations, rural electric cooperatives are generally exempt from federal and state income taxation under Section 501(c)(12) of the Internal Revenue Code. However, rural electric cooperatives are subject to income taxes on their electric operations when more than 15 percent of their revenues are derived from nonmember sources. In addition, should a rural electric cooperative engage in a nonelectric utility business, any income derived from the operation is most likely subject to state and federal income taxes as unrelated business income.

The electric industry taxation study working group reported that distribution and generation and transmission cooperatives paid an average of \$5,650,330 in gross receipts taxes for the years 1998 through 2002. The working group reported that the state's investor-owned utilities paid an average of \$6,134,623 in public utility property taxes for the years 1998 through 2002. The working group reported that the state's distribution cooperatives and generation and transmission cooperatives paid an average of \$670,994 in electric utility real estate taxes for the year 2000 and the year 2002. The working group reported that the state's investor-owned utilities paid an average of \$2,395,898 in North Dakota corporate income taxes on electric operations for the years 1998 through 2002. The working group reported that the state's municipal power systems paid an average of \$1,877,205 in lieu of taxes for the years 1998 through 2002.

The working group reported that North Dakota electric utilities paid an average of \$33,721,247 in taxes for the years 2000 through 2002. This includes \$16,464,937 in coal conversion taxes, \$6,190,235 in public utility property taxes, \$670,994 in real estate taxes, \$411,435 in transmission line taxes, \$5,531,268 in gross receipts taxes, \$2,932 in city privilege taxes, \$2,430,539 in income taxes, and \$2,018,908 in payments in lieu of taxes.

The committee considered a bill draft relating to the taxation of generation, transmission, and distribution of electric power. Representatives of the Association of Rural Electric Cooperatives testified that the proposal was based on three principles--taxes be revenue-neutral; taxes be fair and equitable; and taxes be easy and inexpensive to administer, collect, and distribute. The proposal would have eliminated the public utility property tax on investor-owned utilities, the 2 percent gross receipts and city privilege taxes on rural electric cooperatives, and the high-voltage transmission line tax on rural electric cooperatives. The proposal would have retained the coal conversion tax, wind tax incentives under NDCC Section 57-02-27.3, property taxes on land owned by electric utilities, and city franchise fees on electric utilities.

Concerning the generation function of producing electricity, the proposal would have left the current coal conversion tax in place, continued tax incentives for wind generation facilities, and made the conversion tax applicable to noncoal or wind generation plants of five megawatts or more.

Concerning the transmission function of electricity generation, the proposal would have taxed all transmission facilities on a line-mile basis based on an increasing tax based on transmission line voltage. The proposal would have taxed transmission facilities of:

1. Less than 50 kilovolts at \$75 per mile;
2. 50 to 99 kilovolts at \$150 per mile;
3. 100 to 199 kilovolts at \$300 per mile;
4. 200 to 299 kilovolts at \$450 per mile;
5. 300 to 399 kilovolts at \$600 per mile; and
6. 400 kilovolts and above at \$900 per mile.

Concerning the distribution fund of electricity production, the proposal would have implemented a two-part formula:

1. Flat tax of 52 cents per megawatt-hour of delivered power.
2. .88 percent of revenue collected on the retail sale of kilowatt-hours of electricity.

Although a political decision, proponents testified that in the interest of presenting a complete proposal it contained an allocation of tax revenues. Under the proposal, revenue from the transmission line tax would have been allocated to counties and taxing districts based on transmission line miles and rates of tax of each taxing district. Revenue from the megawatt-hour tax would have been allocated to the county in which the retail sale was made and allocated among taxing districts in proportion to their most recent property tax levies in dollars. Revenue from the tax on retail revenue would have been allocated according to the ratio of miles of distribution line in a county compared to the total number of miles of distribution lines the utility had in the state. Revenue would have been allocated among taxing districts in

proportion to their most recent property tax levies in dollars.

Proponents testified that the proposal was revenue-neutral with both the current and proposed tax systems raising approximately \$11.2 million on transmission and distribution property, was fair to utilities with benefits and burdens shared among rural electric cooperatives and investor-owned utilities and rural electric cooperatives and investor-owned utilities being taxed the same, and was easy to administer as the plan was understandable and easy to apply.

The proposal would have reduced taxes paid by distribution cooperatives by \$330,147, increased taxes paid by generation and transmission cooperatives by \$249,793, and increased taxes paid by investor-owned utilities by \$88,225. All distribution cooperatives except Cass County Electric Cooperative and Mor-Gran-Sou Electric Cooperative would have realized a decrease in tax burden. Under the proposal, taxes would have increased for Basin Electric Power Cooperative, Square Butte Electric Cooperative, and Great River Energy, while decreasing for Minnkota Power Cooperative, Central Power Cooperative, and Upper Missouri Generation and Transmission Electric Cooperative. Under the proposal, taxes would have decreased for Xcel Energy, Inc., and Otter Tail Power Company while Montana-Dakota Utilities Company would have realized an increase of \$243,485.

Proponents of the proposal testified there were several good reasons to support the plan. First, the in lieu taxes would have been uniform for all investor-owned utilities and rural electric cooperatives so the proposal met the test of fairness. Second, the proposal would have minimized tax shifting between rural electric cooperatives and investor-owned utilities. Although individual utilities might have paid more or less in taxes, overall the tax shift between investor-owned utilities and rural electric cooperatives would have been only 1.5 percent. Third, the tax formulas would have been easy to calculate and administer. Fourth, the in lieu taxes would have been predictable, which led to the final benefit which would have been that the proposal guaranteed that overall the plan would raise approximately the same amount of revenue for local taxing districts as the current taxation system of ad valorem and gross receipts taxes that would be replaced. In addition, if the electric industry grows, political subdivisions automatically would have seen increased tax revenues in future years.

In addition to the Association of Rural Electric Cooperatives, the proposal was supported by Cass County Electric Cooperative, Basin Electric Power Cooperative, Verendrye Electric Cooperative, Capital Electric Cooperative, Slope Electric Cooperative, and Dakota Valley Electric Cooperative.

Representatives of Montana-Dakota Utilities Company testified in opposition to the bill draft. They

testified property taxes should be taxes on the value of property, not an "in lieu of" system that is confusing and contains opportunity for mischief by shifting taxes from one property owner to another. They testified the proposal violated the concept of simplicity and easy understandability and that a tax on transmission lines, but not including substations, appeared to be an effort to achieve a predetermined effect, i.e., a minimalization of tax increases for the large-voltage transmission lines. They testified the proposal would have imposed an administrative burden on investor-owned combination utility companies, such as Montana-Dakota Utilities Company, because it would have subjected their property to two different tax systems--one for electric operations and one for natural gas operations.

The committee considered an amendment to the bill draft which would have limited the transmission line mile tax contained in the proposal to alternating current lines and imposed a separate tax on direct current lines. The tax on direct current lines would have provided that for transmission lines that operate at a nominal operating direct current voltage of less than 300 kilovolts, a tax of \$450 would be imposed for taxable year 2006, \$500 for taxable year 2007, \$550 for taxable year 2008, \$600 for taxable year 2009, and \$650 for taxable years after 2009 for each mile or fraction of a mile. The amendment also would have imposed a tax for transmission lines that operate at a nominal operating direct current voltage of 300 kilovolts or more of \$900 for taxable year 2006, \$950 for taxable year 2007, \$1,000 for taxable year 2008, \$1,050 for taxable year 2009, and \$1,100 for taxable years after 2009 for each mile or fraction of a mile. The amendment also would have deleted the requirement that revenue collected on the retail sale of kilowatt-hours of electricity be allocated according to the ratio that the miles of distribution line in a county bears to the total number of distribution lines the utility has in the state and would have required that all revenue be allocated to the county in which the retail sale was made and allocated among taxing districts in proportion to their most recent property tax levies in dollars.

This amendment was opposed by the Association of Rural Electric Cooperatives. Representatives of the association testified that the paramount reason for not setting higher tax rates for direct current transmission lines is that North Dakota has a strong economic interest in encouraging the export of its lignite and wind resources, and direct current transmission lines are one way to export the state's energy resources economically. If the state were to impose too great a tax burden on its high-voltage transmission lines, it would discourage further transmission investment at a time when the state should be doing everything possible to promote energy development for export and that a further increase of these taxes is not warranted, particularly in light of the competitive



challenges faced by lignite-fired generation. In addition, a representative of Slope Electric Cooperative testified that no matter where the end sale occurs, transmission lines and other infrastructure must be constructed to serve the load. Thus, the representative testified that it would be unfair to direct all of the revenue to taxing districts where the load is located rather than distributing some of the revenue more broadly throughout the service area of the cooperative.

The committee considered a bill draft that would have eliminated gross receipts taxes for rural electric cooperatives and would have subjected their property to centrally assessed ad valorem property taxes. Proponents of this proposal testified that rural electric cooperative property would be taxed in exactly the same manner in which investor-owned property is taxed. Proponents testified that the central assessment method is a well-developed system for determining value for investor-owned property and an appropriate methodology could be developed to extend this method to rural electric cooperative property, even if some of their original records were lost or unavailable.

A representative of Utility Shareholders of North Dakota testified that a switch in policy that would tax electric cooperatives on an ad valorem basis, the same as shareholder-owned utility companies are taxed, would be a positive move for all consumers, taxpayers, and competitors.

The committee requested that the state supervisor of assessments prepare an analysis of converting Verendrye Electric Cooperative to a centrally assessed property taxation system. The committee learned that it was not possible for Verendrye Electric Cooperative to provide a schedule showing an original cost of its property in each taxing district because cooperatives were not required to collect this information. However, that information is necessary to calculate the tax amount due each taxing district and to compare it with the tax amount each taxing district received from Verendrye Electric Cooperative's gross receipts tax. Because it was not possible to make these calculations, the state supervisor of assessments testified that it was not possible to estimate the tax shift among taxing districts which would occur if Verendrye Electric Cooperative paid centrally assessed property tax instead of gross receipts tax and locally assessed property taxes on its land.

Neither could Verendrye Electric Cooperative's total property tax, if it were centrally assessed, be estimated accurately because the Tax Department did not have the required information to multiply individual taxing district mill rates by the taxable value located in each taxing district. However, the state supervisor of assessments testified that preparing a sample assessment for Verendrye Electric Cooperative for 2003 using Verendrye Electric Cooperative's capital structure and returns resulted in an estimated 2003 property tax of \$634,569.39, while under current law Verendrye Electric Cooperative paid \$363,023.91. Using the investor-owned utility capital structure and rates, the state supervisor of assessments testified that the estimated 2003 property tax for Verendrye Electric Cooperative was \$263,042.95, compared to \$363,023.91 paid.

Representatives of the Association of Rural Electric Cooperatives testified that in light of the study conducted by the state supervisor of assessments, the ad valorem system would not be easy to administer nor could one predict whether it would be revenue-neutral to political subdivisions. In addition, it would take each cooperative several years of work to assign investment costs properly to political subdivisions. They testified that the system would be subjective, unpredictable, and difficult to administer. They testified that implementing the ad valorem property tax plan would be very burdensome to electric cooperatives, require added staff for the Tax Department to administer the plan, and lead to unpredictable tax impacts on cooperatives and unknown revenue impacts on local taxing districts.

Proponents of the proposal noted that the Tax Commissioner would be able to assign a cost to rural electric cooperative property in instances in which adequate records of original cost were not available. Investor-owned utility representatives also noted that Minnesota, Montana, Wyoming, and Colorado, as well as other states, use an ad valorem property tax system for rural electric cooperatives. As a result, those states have already determined a system value for those generation and transmission cooperatives that own property in those states, a system value that could be used to value cooperative property in North Dakota.

The following table is a summary of present taxation law and the bill draft and amendments posed to the bill draft during the 2003-04 interim.

Property	Present Law	Allocation	Bill Draft 50121.0200	59306.02 Amendments to Bill Draft 50121.0200
Coal severance	37.5 cents/ton          2 cents/ton	30% coal fund  70% coal-producing counties • 30% to cities • 30% to school districts • 40% to counties  Lignite research fund	No change	No change

<b>Property</b>	<b>Present Law</b>	<b>Allocation</b>	<b>Bill Draft 50121.0200</b>	<b>59306.02 Amendments to Bill Draft 50121.0200</b>
Coal conversion in lieu of property tax on facility	For electricity generating with 10,000 kilowatt capacity .65 mill x 60% installed capacity x hours taxable period + .25 mill/kilowatt-hour of electricity produced  For coal gasification - Higher of 4.1% of gross receipts or 13.5 cents/1,000 ft <sup>3</sup> of gas produced	15% to producing county  85% state general fund  Through 2009, first \$41,666.67 from .25 mill/kilowatt-hour from sale in state general fund	Expand to noncoal plants of 5 megawatts or more	Same

Property	Present Law	Allocation	Bill Draft 50121.0200	59306.02 Amendments to Bill Draft 50121.0200
Property tax	Investor-owned All operative property is centrally assessed unless transmission line after September 30, 2002  Rural electric cooperatives exempt except for land	To counties based on property in county	Removed	Removed
Gross receipts	Rural electric cooperatives <ul style="list-style-type: none"> <li>• 2% on transmission and distribution cooperatives</li> <li>• 2% on generation cooperatives unless subject to coal conversion taxes then exempt</li> </ul>	To counties based on mile of line  First 2 years to county with generating facility  Third and subsequent years <ul style="list-style-type: none"> <li>• First \$50,000 to county</li> <li>• Second \$50,000 to county and state general fund remaining 25% to county and 75% to state general fund</li> </ul>	Removed	Removed
Transmission line voltage of 41.6 kilovolts or more	Rural electric cooperatives \$225/mile for lines 230 kilovolts or larger  \$300/mile for rural electric cooperatives and investor-owned utilities for line in services after September 30, 2002	To counties based on miles of line	Removed for rural electric cooperatives	Limited to alternating current lines
City privilege			Removed for rural electric cooperatives	Same
Transmission facilities			<ul style="list-style-type: none"> <li>• Less than 50 kilovolts - \$75/mile</li> <li>• 50 to 99 kilovolts - \$150/mile</li> <li>• 100 to 199 kilovolts - \$300/mile</li> <li>• 200 to 299 kilovolts - \$450/mile</li> <li>• 300 to 399 kilovolts - \$600/mile</li> <li>• 400 kilovolts or more - \$900/mile</li> </ul>	
Distribution tax		To county of retail sale then proportionally to levies to taxing districts	52 cents/megawatt-hour	
Retail sales		To counties based on miles of line then proportionally to levies to taxing districts	188% of revenue on retail sales	Changed allocation to county of retail sale
Direct current transmission line tax				Less than 300 kilovolts: <ul style="list-style-type: none"> <li>• \$450/mile for 2006</li> <li>• \$500/mile for 2007</li> <li>• \$550/mile for 2008</li> <li>• \$600/mile for 2009</li> <li>• \$650/mile for 2010 and on</li> </ul> For 300 kilovolts or more: <ul style="list-style-type: none"> <li>• \$900/mile for 2006</li> <li>• \$950/mile for 2007</li> <li>• \$1,000/mile for 2008</li> <li>• \$1,050/mile for 2009</li> <li>• \$1,100/mile for 2010 and on</li> </ul>