

Property Taxation and Energy Development

This document examines some of the implications for local governments from energy development, and the relationships between property taxation and the development of significant energy projects. Part A provides an example of the tax implications stemming from the development of a hypothetical coal-fired electric energy generation plant. Part B provides questions and answers of relevance to local governments when contemplating the development of large energy-related projects.

Part A - Taxes from a Hypothetical Power Plant

The tax revenue that would be generated by development of a new coal-fired power plant would depend on the size and characteristics of the plant and its location. The estimates that follow are for a 500 MW plant built at an unspecified location in the eastern half of the state. Cost, employment, and labor income figures are based on information in the Roundup Power Project Environmental Impact Statement, scaled for the difference in size. Coal consumption is based on information from the Northwest Power and Conservation Council's Fifth Northwest Power Plan, and coal prices are based on coal severance tax returns.

The following table shows the basic assumptions for the analysis. Construction cost for the plant is estimated to be \$440 million. If the plant operates at a 90% capacity factor, it will produce almost 4 billion kilowatt-hours of electricity a year. The industry average capacity factor is closer to 85%, but 90% may be attainable for a new plant. If the plant operates at a lower capacity factor, all of the following information that depends on electricity production and coal consumption would be correspondingly lower.

Hypothetical 500 MW Coal-Fired Power Plant	
Construction Cost	\$440 million
Annual Electricity Production	3.942 billion kWh
Annual Coal Consumption	2.459 million tons
Planning and Construction	5 years

The power plant's owners would directly pay four types of state taxes: two taxes on electricity, corporation license tax, and property tax.

Electricity Taxes

The electric energy producer's license tax is paid by businesses that generate electricity in Montana. The rate is \$0.0002 per kWh. The wholesale energy transactions tax is a tax on electricity sent over transmission lines in the state. The rate is \$0.00015 per kWh. The net output of a plant located in Montana would be subject to this tax, but who pays the tax depends on where the electricity consumers are located. If the electricity is sold out of state, the owner of the generation plant pays the tax, but if the electricity is sold in the state, the electricity distribution company pays the tax. The following table shows annual estimated payments of these two taxes attributable to a 500MW power plant.

Hypothetical 500 MW Coal-Fired Power Plant Annual Electricity Taxes		
Electric Energy Producers License Tax		
billion kWh		3.942
Tax Rate, \$/kWh	x	<u>\$0.0002</u>
Tax, \$ million		\$0.788
Wholesale Energy Transactions Tax		
billion kWh		3.942
Tax Rate, \$/kWh	x	<u>\$0.00015</u>
Tax, \$ million		\$0.591

Property Taxes

The plant would pay local property taxes and would pay the 101 state mills that go for public schools and the university system. The next table shows the state property taxes that would be collected based on a value of \$440 million.

Power plants are in property class 13, with taxable value equal to 6% of market value. The tax is calculated by multiplying the taxable value by 101 mills (101 thousandths of a dollar of tax per dollar of taxable value).

Hypothetical 500 MW Coal-Fired Power Plant State Property Taxes		
Property Tax (101 state mills)		
Cost of Plant, \$ million		\$440
Tax Rate (Class 13)	x	<u>6%</u>
Taxable Value, \$ million		\$26.40
State Mill Levies	x	<u>101</u>
Tax, \$ million (taxable value x mills / 1000)		\$2.67

Corporation License Tax

It is almost certain that a large power plant would be owned by a corporation, so that the owner would pay corporate license tax. The amount of tax the power plant owner would pay in any year depends on many factors. They include the revenue from selling electricity and the depreciation, debt service, and other costs that are deducted from revenue in calculating taxable income. Most corporations that own a power plant will also have other business interests. The corporation will pay taxes based on the total net income or loss of all its businesses, not just on the net income from the power plant. If the corporation operates in other states as well as in Montana, its total net income will be apportioned between Montana and the other states based on the fraction of its sales, property, and payroll in Montana.

Because there are so many factors that affect corporation license tax, it is only possible to give a very rough estimate of the additional tax that a power plant would generate. The following table shows one way of producing such a rough estimate. It assumes that the plant is financed half with debt and half with equity investment, so that the owners have an equity stake of \$220 million. If they require a 10% annual return on their investment, that is net revenue of \$22 million. Applying the tax rate of 6.75% gives about \$1.5 million in tax. However, the owners are likely to use accelerated depreciation to front-load accounting costs, resulting in lower tax liability in the early years of the plant's life.

Hypothetical 500 MW Coal-Fired Power Plant Corporation License Tax	
Corporation License Tax (Example Only)	
Cost of Plant, \$ million	\$440
Equity Interest at 50%	\$220
Net Return on Equity	x <u>10%</u>
Net Revenue, \$ million	\$22
Tax Rate	x <u>6.75%</u>
Tax, \$ million	\$1.49

Coal Severance Tax

The power plant's coal supplier will pay coal severance tax on coal mined for the plant. The taxable value is the tonnage multiplied by the contract sales price, which is the price less taxes and royalties paid to the federal, state, or tribal government in excess of \$0.15 per ton. The tax rate depends on whether burning the coal produces at least 7,000 Btu per pound and whether it is from a strip mine or an underground mine. The following table shows the calculation of coal severance tax for the coal used at the hypothetical power plant. It uses the average contract sales price in FY 2004, \$6.78,

and assumes that the power plant uses high Btu coal from a strip mine, which is taxed at 15%. Coal severance tax on coal for the power plant would be about \$2.5 million.

Hypothetical 500 MW Coal-Fired Power Plant Coal Severance Tax Paid by Coal Supplier	
Coal Consumption, million tons	2.459
Contract Sales Price	x <u>\$6.78</u>
Taxable Value, \$ million	\$16.672
Tax Rate	x <u>15%</u>
Tax, \$ million	\$2.501

Royalties

The coal mine would pay royalties to the mineral rights owners. Much of the coal in the state is owned by the federal government or the state. Royalty rates vary, but many are in the neighborhood of 15% of the market price. The following table shows an estimate of royalties that would be paid on coal for the power plant. The market price of \$8.75 was calculated from the contract sales price by assuming that all of the coal is taxed at 15% and that half of the 15% royalties are government or tribal royalties excluded from the contract sales price. With an average royalty of \$1.31 per ton, total royalties are about \$3.2 million.

Hypothetical 500 MW Coal-Fired Power Plant Annual Coal Royalties	
Market Price of Coal, \$/Ton	\$8.75
Royalty Rate	<u>15%</u>
Royalty per Ton	\$1.31
Million Tons of Coal	<u>2.459</u>
Royalties, \$ million	\$3.227

All royalties on state-owned coal are paid to the state. Half of royalties on federal coal are paid to the state, and then 25% of the federal royalties the state receives are paid to county governments.

Individual Income Tax

Power plant and coal mine employees would pay state income tax on their wages and salaries. As they buy local goods and services, they would create income for local businesses and their employees. Because of the size of the power plant and mine workforce and payroll, the employees' spending would cause additional jobs and probably new businesses in the area.

The following table shows wages and salaries of the power plant and mine employees and an estimate of the wages and salaries of the secondary employment created by their spending. Total additional wages and salaries are \$12.3 million. In 2005 and later years, the average effective income tax rate is estimated to be 3.4%. At this rate, the additional income taxes will be about \$0.418 million.

Hypothetical 500 MW Coal-Fired Power Plant Income Tax	
Wages and salaries, \$ million	
Power Plant	\$6.447
Coal Mine	\$3.547
Secondary Employment	<u>\$2.305</u>
Total Wages and Salaries	\$12.299
Average Tax Rate	x <u>3.4%</u>
Taxes, \$ million	\$0.418

Employment

Planning, design and permitting of a power plant generally take at least one year, and actual construction takes about four. The following table shows employment for plant operation and construction during the four-year construction period and after the plant is in operation beginning in the fifth year.

Hypothetical 500 MW Coal-Fired Power Plant Employment During Constuction and Operation					
	----- Construction Period -----				Operation
	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5+</u>
Operation	0	0	43	86	107
Construction	<u>39</u>	<u>539</u>	<u>814</u>	<u>209</u>	<u>0</u>
Total	39	539	857	294	107

Some of the construction and plant employees may be hired locally, but many will come from outside the area. Many of the construction workers will be in the area temporarily and may not bring families with them. People moving into the area either permanently or temporarily will increase the demand for local public services.

Construction/Valuation Time Frame

The power plant will begin paying property taxes during construction, but not on the full value of the plant. The plant will be assessed each year based on the finished value and the percent completed as of January 1. The plant will then pay taxes based on this assessed value the following November and May. The assessed value will be added to the property tax base as newly taxable property. In general, local governments can set mill levies to raise the same amount of tax from existing properties as last year, plus one-half the average rate of inflation for the last three years.

Newly taxable property is excluded from this calculation in its first year, and becomes part of the base in its second year. Thus, the power plant will increase the local government's tax base and its spending limits. However, there is a lag in these additional local revenues.

The following table shows an example of this lag. The top part of the table shows calendar year tax assessments, and the bottom part shows fiscal year tax payments to local governments, school districts and the state. Each column shows information for a calendar year and for the fiscal year ending on June 30 of that calendar year.

Hypothetical 500 MW Coal-Fired Power Plant Example of Property Tax Payments During Construction						
	----- Construction Period -----				Operation	
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6+
Percent Complete January 1	0%	25%	50%	75%	100%	100%
Assessed Value, \$ million	\$0	\$110	\$220	\$330	\$440	\$440
Taxable Value, \$ million	\$0	\$6.6	\$13.2	\$19.8	\$26.4	\$26.4
Mill Levy	<u>500</u>	<u>500</u>	<u>500</u>	<u>500</u>	<u>500</u>	<u>500</u>
Tax, \$ million	\$0	\$3.3	\$6.6	\$9.9	\$13.2	\$13.2
----- State and Local Government and School District Fiscal Year Revenue -----						
Paid in November	N/A	\$0	\$1.7	\$3.3	\$5.0	\$6.6
Paid in May	<u>N/A</u>	<u>\$0</u>	<u>\$1.7</u>	<u>\$3.3</u>	<u>\$5.0</u>	<u>\$6.6</u>
Fiscal Year Total	N/A	\$0	\$3.3	\$6.6	\$9.9	\$13.2

Construction begins during year 1, and for simplicity, it is assumed that 25% of the value of the plant is added each year and that the combined mill levy for local governments, school districts, and the state is 500 mills. On January 1 of the first year, construction has not started, and there is no power plant to assess. Assessed value and taxable value are both \$0, and applying 500 mills to an assessed value of \$0 gives property tax of \$0.

Property taxes paid during the fiscal year ending on June 30 of year 1 are based on property values as of January 1 of the previous calendar year. Construction had not begun during that year, so the table shows "N/A."

At the beginning of year 2, the plant is 25% complete. The assessed value is \$110 million, so that with a tax rate of 6%, taxable value is \$6.6 million. With a total mill levy of 500 mills, the plant's property tax is \$3.3 million.

Property taxes paid during the fiscal year ending on June 30 of year 2 are based on assessed values as of January 1 of year 1. Thus, schools, local governments, and the state receive no revenue from the power plant in this fiscal year.

At the beginning of year 3, the plant is 50% complete, and its tax of \$6.6 million is based on half the final value. Property taxes paid during the fiscal year ending on June 30 of year 3 are based on assessed values as of the beginning of year 2.

Taxable value increases each year until year 5, which is the year after the plant is 100% complete. Property taxes based on the final taxable value are first paid in the fiscal year ending in year 6.

The table shows the total mill levy remaining at 500 as the power plant enters the tax base, but this is unlikely. The statewide 101 mills for education would stay the same. However, it is almost certain that local mill levies would be reduced. A power plant of this size would increase the local tax base by more than 25% in all but five counties in Montana. It would more than double the tax base in about three-fourths of the counties and more than quadruple the tax base in almost half of the counties. While the power plant, its employees, and secondary development that occurs because of the power plant would increase the demand for local public services, the increase in the tax base is likely to more than pay for any increase in services.

How much local mill levies decrease would depend on the proportional increase in the tax base and local decisions about increases in services. For example, if the tax base increased by 50% and local spending increased by 5%, local mill levies would be reduced by 30%. If the tax base quadrupled and local spending increased by 30%, local mill levies would be reduced by 70%. With such a wide range of possibilities, the table shows what revenue would be with unchanged mill levies rather than trying to show revenue with a typical or average reduction in mill levies.

The following table shows a timeline of employment, taxable value as of the January 1 assessment dates, and tax payments.

Hypothetical 500 MW Coal-Fired Power Plant Timeline of Employment, Taxable Value, and Property Tax																																
	----- Year 1 -----				----- Year 2 -----				----- Year 3 -----				----- Year 4 -----				----- Year 5 -----				-- Year 6 --											
	Jan	May	Jun	Nov	Jan	May																										
Employment	39	39	39	39	539	539	539	539	857	857	857	857	294	294	294	294	107	107	107	107	107	107										
Taxable Value, \$ million	\$0				\$6.6				\$13.2				\$19.8				\$26.4				\$26.4											
Property Tax Payment, \$ million	N/A				\$0				\$1.7				\$1.7				\$3.3				\$3.3				\$5.0		\$5.0		\$6.6		\$6.6	

Summary

A new 500 MW power plant would pay the electric energy producers license tax, the wholesale energy transactions tax, statewide and local property taxes, and corporation license tax. Its coal supplier would pay the coal severance tax. Employees at the power plant, the coal mine, and new employees at other businesses that are added because of the power plant development would pay individual income tax. The following table shows revenue from all of these taxes when the power plant is completed and in operation. For local property taxes, it shows the revenue that would be generated with approximately average local mill levies. However, existing local mill levies vary widely across the state, and local governments and schools would be likely to reduce mill levies in response to the large increase in taxable value from a power plant.

Summary of Tax Revenue (\$ million annually when fully built)	
Electric Energy Producers License Tax	\$0.788
Wholesale Energy Transactions Tax	0.591
Property Tax	
101 statewide mills	2.666
399 local mills	10.534
Corporation License Tax	1.485
Coal Severance Tax	2.501
Individual Income Tax	0.418
Total Tax Revenue	<u>\$18.984</u>

The table does not show royalties paid to the mineral rights owner. Royalties are likely to be about \$3.2 million per year. If the state owns the coal, the state would receive the royalties. If the federal government owns the coal, the state and county would receive shares of the royalties.

Part B – Implications of Energy Development for Local Governments

Large scale energy development holds many implications for local governments and can affect local tax bases in a variety of ways depending on the circumstances of each project. The following sections address several questions pertaining to energy development and local governments.

- ***Under what circumstances would projects of this nature be “locally assessed” as opposed to being “centrally assessed”, and what difference does it make?***

Central Assessment v. Local Assessment - Definitions

Some business properties are self-contained economic units. Others are part of an interdependent network where the value of the coordinated operation as a whole is greater than the value of the individual parts. Central assessment or unit valuation of property was developed to account for this interdependence of values when a coordinated operation functions across county or state lines. When property is centrally assessed, the value of the coordinated operation is appraised, and then that overall value is allocated to the parts of the operation in each taxing jurisdiction. When property is locally assessed, each unit of property is assessed individually.

The general principle and examples of types of property that are to be centrally assessed are set forth in 15-23-101, MCA. Types of property on the list are clearly centrally assessed. Types of property that are not on the list are to be centrally assessed if the general principle applies. This must be determined on a case-by-case basis. Numerous state and federal court cases have further clarified the principle and its application to specific types of property.

Whether a large energy facility would be centrally assessed or locally assessed would depend on the character of the facility, the ownership, and how the facility is related to other property owned by the same company. Without knowing all the details, it is impossible to say whether any particular type of project would be centrally or locally assessed. The following examples show how application of the general principle makes it more or less likely that a particular project would be centrally assessed.

- A power plant owned by an integrated public utility, connected to the utility's transmission lines, and operated in concert with the utility's other power plants to supply electricity to the utility's retail customers would almost certainly be centrally assessed.
- A group of power plants in different counties, owned by a single company, and operated in a coordinated manner from a central dispatch office to supply electricity for large retail or wholesale customers probably would be centrally assessed.

- A single power plant that is entirely in one county and is owned by a company that has no related facilities and that delivers electricity into a transmission line owned by an unrelated company probably would be locally assessed.
- A coal liquefaction plant that is entirely in one county and sells its product at the plant for the buyer to haul off by rail or truck would almost certainly be locally assessed.

Central Assessment v. Local Assessment – Implications for Valuation

The principles and mechanics of assessment are different for centrally assessed and locally assessed property. Because of this, the assessed value of a particular facility may depend on whether it is a stand alone, locally assessed property, or part of a group of centrally assessed properties.

Central Assessment

A property that is centrally assessed would be valued using the unit valuation approach and unit valuation methodologies. Under this approach, all of the integrated property of a company is evaluated annually in its current going concern status, and the appraiser assigns a unit value to all of the property of the company that acts as a single operating unit. For interstate operations, a share of the unit value of all the integrated property is allocated to Montana, and this share of total market value is subsequently allocated among the various county and other taxing jurisdictions (cities, towns, and school districts) in which the property is located. The centrally-assessed plant located in Montana is assigned a share of the unit value of all the integrated property of the company.

Local Assessment

The approach used to provide a value for locally assessed properties will depend on the nature of the property being assessed. A coal gasification or coal liquefaction plant that is locally assessed would probably have its real property (land and buildings) classified as Class 4 property. Class 4 property is appraised cyclically. Under current law, Class 4 properties are subject to reappraisal once every six years with the new value phased in over the following six-year period. This is significantly different from centrally assessed properties which are appraised every year.

Complex properties such as coal liquefaction or gasification plants, or a coal-fired electric generation plant, likely would be appraised by Department of Revenue industrial appraisers. For the Class 4 property component of the plant, an appraiser typically would consider all three approaches to establishing market values – the cost, income, and market value approaches – to arrive at a final market value for the property, with the most weight generally placed on the cost approach.

For locally assessed coal liquefaction or gasification operations, property other than land and buildings typically would be classified as business equipment in Class 8. This

is important because for a typical coal liquefaction or gasification plant the business equipment portion of the plant could comprise as much as 90% of the overall cost of the plant when initially built. Class 8 properties are appraised annually, with Department of Revenue industrial appraisers establishing the market value of the plant and equipment in the first year of operation. However, in subsequent years the amount, type and nature of Class 8 business equipment is generally self-reported by the taxpayer, and the central responsibility for reporting any major additions or deletions to business equipment property lies largely with the owner of the property. While the Department's industrial appraisers pay a great deal of attention to large industrial properties, every property may not receive a thorough examination or audit every year.

Differences in Valuation

During construction particularly, but also in the early years of operation, one might reasonably expect small differences in the valuation of similar properties regardless of whether they are locally assessed or centrally assessed. However, in later years the values could diverge because the locally assessed plant and the centrally assessed plant are very different animals. Whereas the locally assessed plant is operated as a stand-alone unit, the centrally assessed plant is part of an integrated operation that includes other properties in other locations, perhaps scattered across several states.

Consider two similar coal gasification plants built in the same year. One is a stand-alone facility delivering gas into an unrelated pipeline for sale to unrelated customers and is locally assessed. The other supplies gas to electric generation plants owned by the same company and is centrally assessed. The value of the locally assessed plant depends on the market price for gas, among other factors. The value of the centrally assessed plant depends on the profits the parent company makes from selling electricity, not on the price of gas. The value of the centrally assessed plant may be higher or lower than the value of the locally assessed plant. The values differ because the plants are operated in different contexts and the owners see different results because of these contexts.

Central Assessment v. Local Assessment – Implications for the Tax Base

Whether a large energy development is locally assessed or centrally assessed may have significant implications for state and local government tax bases.

Coal-Fired Electric Generation Plant

With respect to an *investor-owned, coal-fired generation plant*, it makes no difference if the plant is locally assessed or centrally assessed. Under the current law property classification scheme, all such generation facilities are classified as Class 13 property and taxed at a taxable valuation rate of 6%.

Coal Liquefaction or Gasification Plant

With respect to a new coal liquefaction or coal gasification plant, classification issues become more complex. If the plant is a stand-alone plant, with no electric energy generation component, and no attached pipeline (or interconnecting pipeline) that crosses county or state borders, the plant would likely be locally assessed with the land and building classified as Class 4 property (taxed at 3.22% in 2005, declining to 3.01% by 2008), and the machinery and equipment classified as Class 8 business equipment (taxed at 3%).

However, if a coal liquefaction or coal gasification plant were to include a component that produces electricity as part of the operation, and is connected to electric energy transmission lines, or is connected to a pipeline that crosses a county or state border, then classification becomes more complex. In these cases classification will depend on a host of factors including who the owners of the pipelines and transmission lines are, whether the pipelines and electric transmissions lines are regulated by FERC, the nature of the pipelines (gathering v. transmission), and whether the specific pipelines under specific ownership actually cross county or state lines. Because Montana currently has no coal gasification or liquefaction plants, classification of the plant property will likely be decided only if and when such a plant is actually constructed, and whether or not legislation is enacted to specifically address particular circumstances pertaining to these types of property.

Abatement and Other Tax Planning Options

There are at least three existing statutory provisions providing taxpayers, local government officials, and local development officers with tools to address the taxation of new energy development that could impact the state and local tax base significantly. These include the local option abatement, the energy generation facility exemption, and tax increment financing.

Local Option Abatement Program

MCA, 15-24-1401 and 1402 provide for a local option property tax abatement for qualifying "new industry". Generally "new industry" requires an investment of at least \$125,000 in new improvements within the jurisdiction granting the abatement. Under this abatement program, qualifying improvements are taxed only on 50% of their normal taxable valuation in the first five years after a construction permit has been issued. After that, the exemption percentage is increased annually in equal increments until full taxable valuation is reached in the tenth year.

The abatement is provided for by passage of a resolution of the governing body following a public hearing on the matter; no vote of the electorate is needed.

The abatement applies only to mill levies of the approving taxing jurisdiction (county or municipality), and the high school and elementary school district in which the property resides; it does not apply to mill levies of other taxing jurisdictions, including the 101 mills levied statewide for state purposes.

As its name implies, the local option abatement will reduce property tax revenues below what they otherwise would be for the authorizing local government and local school districts, but not for state government. This results in higher local government mills than those that would occur without granting the abatement; but in the absence of the abatement the company may choose to locate elsewhere where an abatement would be offered.

Electric Generation Property Tax Exemption

Senate Bill 508 (2001 Legislative Session, and subsequently codified at 15-24-3001, MCA) provided new tax incentives for the construction of electric energy generation and related delivery facilities (transmission lines). Among other things, that bill provided that facilities constructed after May 5, 2001 and before January 1, 2006 may be exempt from property taxation for a 10-year period (5-year period for oil or gas turbines) beginning on the date that construction commences.

To be exempt from property taxation, the owner is required to offer contracts to sell half of the facility's output at a cost-based rate, including a rate of return not to exceed 12%, for a 20-year period from the date of the facility's completion.

The legislation also provided for payment of a local government electric generation facility impact fee in lieu of property taxes exempted under 15-24-3001, MCA. For coal-fired generation plants the fee in the first two years of construction was not to exceed 0.75% of the total cost of constructing the facility.

Given that this property tax exemption and impact fee legislation applies only to generation facilities built before January 1, 2006, these provisions of law are likely to be of no value to future development unless the Legislature extends the sunset date.

Tax Increment Financing

Another tool that local government officials have at their disposal is tax increment financing. Using the state's tax increment financing laws, county officials could designate an area in which an electric generation or other energy-related facility is going to be built as an industrial infrastructure district. A portion or all of the district could then be designated as a tax increment financing district (TIFD) prior to construction of the project. Any subsequent new construction, including real property and business equipment, added within the boundaries of the TIFD become a part of the TIFD "incremental taxable value".

All of the revenue generated from all of the mills levied by all taxing jurisdictions in which the TIFD is located against this incremental taxable value (including the statewide 95 mills levied for education – but excluding the 6 mills levied for the university system), accrues to the TIFD authority, and can be used to purchase infrastructure needed to support the new development. Usually, a TIFD district will immediately issue bonds that in future years will be serviced with property tax revenues arising from the new construction within the TIFD.

Note that using a TIFD in this manner deprives the state general fund, local governments, and school districts of revenues that otherwise would accrue to them from the new energy development project. In effect, this requires mill levies that will be higher than they otherwise would be in the absence of the TIFD district. It could be argued that the county government would have to levy additional mills to provide for up-front impact costs from the new development in any event, but other options may be made available to avoid that outcome, as discussed later in this document.

- ***Does it matter if the developer is a cooperative rather than a private, for-profit company?***

If the company is a cooperative rather than an investor-owned utility, it is likely that all of the property would be included in Class 5 and taxed at a tax rate of 3%. This is half the tax rate of any property owned by an investor owned utility that otherwise would be taxed at 6% under Class 13 (electric energy generation).

- ***As the project moves forward, at what point does new construction become part of the property tax base of local governments; how are these values established?***

Any taxable property that is in place as of January 1 of each year is subject to taxation, including all construction work in process (CWIP). The value of CWIP or incomplete property is valued the same as all property...on a market value basis.

- ***What is the timing relationship between when new local impact costs are likely to arise, and when new property taxes will actually be received?***

As the “Construction/Valuation Timeframe” section of Part A showed, property tax revenues may not be received until as late as the third year of a major construction project. Construction during the first year of the project is not taxed; construction completed during the first year and in place on January 1 of the second year is taxed based on its value on January 1 of the second year, but the revenue is not received until very late in the second year (November) and early in the third year (May).

On the other hand, the initial impact costs associated with building new roads and other infrastructure may arise even before construction of the project begins. (See following

sections for a discussion of the options currently available for county governments to address these up-front impact costs.)

- ***Does the growth in new construction over time result in additions to the tax base sufficient to offset new “impact costs” for local governments?***

Analysis done for Environmental Impact Statements for a number of potential energy facilities have shown that, in particular cases, it is likely that additional revenue from new, large energy-related projects will, over time, be sufficient to cover the initial impact costs faced by local governments. However, this may not always be true. Most proposals have been in rural areas where the facility would significantly increase the local tax base while requiring relatively minor infrastructure investments from local governments. A facility that directly and indirectly required significant local infrastructure investments might not generate enough local property tax revenue at current mill levies to pay for the investment.

While a carefully sited project is likely to generate local tax revenue that, over time, is sufficient to cover the costs of impacts on local governments, the timing of impact costs relative to increased property tax revenue may be a problem.

Local governments may face additional difficulties when large energy facilities reach the end of their useful lives. The same situation may arise as when a mine or industrial plant shuts down – local governments and school districts may find it difficult to maintain facilities and provide the same level of services with a greatly reduced tax base and possibly declining population.

- ***Large-scale, energy-related economic development projects can impose significant up-front costs on local governments. What tools are available to local governments to address and pay for these costs?***

Large-scale, energy-related developments can impose significant new costs on local governments. Historically, the cost of building new roads to accommodate new development has been the predominant cost; but meeting the needs of new development, including the influx of workers and their families that may accompany new development, may also require increased expenditures in the areas of public safety, housing, education, water and sewer infrastructure, and costs for administration and planning.

The need for additional revenues will depend on the circumstances of each new development project, and the existing resources available. Smaller projects may require fewer added costs and fewer resources. The need for additional expenditures may be reduced to the extent that there is excess capacity in school rooms and teachers, public safety facilities, housing accommodations and other amenities required

to enable development in the impacted area. But in areas where no excess capacity exists, and if the development is large, added costs may be substantial.

Unfortunately, the means that local governments have to address added costs stemming from large-scale energy development projects involving new coal-fired or other electric energy generation facilities, or coal liquefaction or gasification plants, appear to be somewhat limited.

As noted earlier, additional property taxes arising from these projects may not materialize until several years after new infrastructure and other related costs are incurred.

The current law mill levy limitations in 15-10-420, MCA preclude county commissioners from levying new mills other than to cover half the rate of inflation, which is likely needed just to cover additional inflationary costs from existing services. That section of law also authorizes local governments to impose additional mills if approved by the electorate. But taxpayers may be hesitant to provide more property tax revenue to pay for the infrastructure and other costs needed to accommodate new development, particularly if they see little or no direct new benefit to them from the development.

Local governments are authorized to issue tax and revenue anticipation notes, but are limited to “short-term obligations” that by statute must mature within 13 months, and must be issued in anticipation of taxes budgeted to be received and appropriated for expenditure during the fiscal year in which the obligations are issued (7-6-1101 and 1102, MCA). This appears to preclude any ability to issue tax anticipation notes in anticipation of the property taxes associated with a new energy development project.

General bonding is unlikely to be an option as well. Local governments are restricted in their ability to bond in a variety of ways, and in this case would likely be required once again to put the bond to a vote. As discussed above, it may be difficult to get the electorate to go along.

As discussed earlier, 15-24-3001, MCA, which provided for exempting new electric energy generation from property taxes under certain conditions, also required the payment of up-front local impact fees to local governments. But that legislation applies only to plants built before the end of 2005.

Local governments also have the tax increment financing option, which allows them to capture the property taxes associated with any new development occurring within the TIF district. Based on anticipated future property tax revenues, the TIF district authority can issue bonds immediately to shift revenue from future years to the present. However, there are strict limitations on what tax increment revenue can be used for; primarily, it can be used to pay for infrastructure development within the TIF district. This will be of little help in paying for added housing, education, public safety, water and sanitation, and administration and planning costs occurring outside the district.

Local governments need some means of obtaining the funds required by and related to new development before the actual revenue from that new development (property taxes) is available. One answer lies in up-front local impact fees paid by the developer that in later years can be used to offset property taxes paid by the developer. Montana already has one model in place for this approach: the hard rock mining impact statutes.

Designed to mitigate the adverse economic and tax-related impacts associated with large-scale development of hard rock mines, Montana's hard rock mining Impact laws are codified in Title 90, Chapter 6, Parts 3 and 4. Among other things, those sections of law:

- gave recognition to the need for additional revenues for local governments to address the up-front costs associated with large-scale mining development before additional property taxes begin to flow from the development;
- gave recognition to the fact that communities and areas other than those within the immediate area of the development may also be impacted significantly by the new development;
- created the Hard-Rock Mining Impact Board to oversee and administer the provisions of hard rock mining impact laws;
- required the development and production of detailed hard rock development impact plans designed to address the several and varied issues related to the initial development of hard rock mines;
- provided for the prepayment of property taxes by the developer of the mine to provide up-front funding for local government infrastructure and other impact costs, and the crediting of pre-paid taxes against future property tax liabilities of the developer, as specified in the impact plan;
- provided for the issuance of special local government facility impact bonds to acquire revenue for the construction of major local government facilities necessitated by the development, to be paid through a special assessment against the property of the developer under an agreement between the developer and the local government;
- and provided for property tax base and property tax revenue sharing between all jurisdictions adversely affected by the new development through rules established in statute.

While Montana's hard rock mining impact laws provide a model for legislation that could be extended to cover impact costs associated with new energy development, they are not the only laws that provide for new development impact fees.

Senate Bill 115 (2005) provided for a new wind generation facility impact fee for local governments and school districts. Under that bill, the owner or operator of a wind generation facility used for commercial purposes is subject to an initial local government and school district impact fee not to exceed 0.5% of the total cost of constructing the wind generation facility, for the first 3 years after construction of the wind generation facility commences.

Senate Bill 185 (2005) provided for new local government impact fees to fund improvements to, or new development of, local government facilities required to service new private sector development. The fee is to provide for additional water supply, wastewater collection, transportation, storm water collection, and other facilities approved as part of an impact fee ordinance or resolution. Particulars of how the impact fee must be calculated, allocated, reimbursed if necessary, etc. must all be established prior to implementation of the fee as detailed in an impact fee plan.

To ensure that local governments have the ability to provide funding to address future large-scale energy development, the Montana Legislature could consider extending either the hard-rock mining impact fee legislation, or the wind energy impact fee legislation in a manner that sufficiently addresses impact fees associated with these types of development projects.