

UTILITY REPLACEMENT TAX TASK FORCE MEETING

MINUTES November 02, 2009

The Utility Replacement Tax Task Force met at 1:32 p.m. on November 02, 2009 in the fourth floor conference room of the Hoover state office building, Des Moines, Iowa. The meeting concluded at 3:16 p.m. A quorum was present.

Participants

Task Force members attending the meeting included **Mark Schuling**, Co-chairperson, Director of the Iowa Department of Revenue; **Tim Coonan**, Iowa Association of Electric Cooperatives; **Steve Evans**, Vice President Taxation, MidAmerican Energy Company, investor owned utilities; **Jim Henter**, President, Iowa Retail Federation; **Alan Kemp**, Executive Director, Iowa League of Cities; **Bill Peterson**, Executive Director, Iowa State Association of Counties; **Michael Rubino via telephone**, Manager of State and Local Taxes, Deere & Company; **Larry Sigel**, President, Iowa School Finance Information Services; and **Julie Smith**, General Council, Iowa Association of Municipal Utilities.

Members absent were **Dick Oshlo**, Co-chairperson, Director of the Iowa Department of Management; and **Deborah Krauth**, Nyemaster Law Firm, public member.

Others attending were Jim Miller and Donn Stanley, Iowa Attorney General's Office; Dale Hyman, Alan Harding, Lori Marchese, Roland Simmons and Mark Berkenpas of the Department of Revenue; John Donnelly, attorney for Iowa Association of Electric Cooperatives; Mark Douglas, Iowa Utility Association; Rodger Holm, Clinton City Mayor; John Moreland, Clinton City Assessor; Jeff Horne, Clinton City Administrator; Paul Walter, Clinton City Attorney; Tim Krumm and Bill Sueppel of Meardon, Sueppel & Downer representing the City of Clinton; Joe Robertson of Archer Daniels Midland Company; Andrew Anderson and Todd Langel of Faegre & Benson representing Archer Daniels Midland Company; Megan Osweiler, Iowa League of Cities; Joann Wright, Northern Natural Gas Company; and Michael Albers, Iowa Department of Management, recording secretary.

Opening Remarks

Co-chair Schuling opened the meeting by welcoming the membership and those in attendance. He noted that the sub-committee had met about once a month over the past six months working on the proposed legislation. Introductions were then made.

Prior Meeting Minutes

It was moved by Henter, seconded by Sigel, to approve the March 30, 2009 meeting minutes. The motion carried unanimously.

Proposed Legislation Regarding the Taxation of Co-generation Utility Facilities like the Plant Owned by the Archer Daniels Midland Company in Clinton

Co-Chair Schuling provided an overview of the events leading up to the proposed legislation. The issue was brought to the Task Force by the City of Clinton in March. There was a co-generation facility being built in the City of Clinton by ADM. The facility was going to be creating both electricity and steam and it did not fit well within the current replacement tax statutes. Under current law the facility is under assessment by the Iowa Department of Revenue, subject to the replacement tax. In studying the issue it was thought there was a good possibility that only the electric portion of the plant was being assessed leaving the steam portion not assessed. The issue then turned to how the steam portion could be locally assessed without risking double taxation. After considerable discussion by the Task Force a sub-committee consisting of members Steve Evans, Bill Peterson, Larry Sigel and Co-Chair Schuling further studied the issue. Mike Rubino and Alan Kemp also attended a number of the sub-committee meetings. Many of the potential resolutions were found to have issues upon further study. The last proposal seems to have consensus among the members and potentially consensus from the City of Clinton and ADM. The proposed legislation provides for a replacement tax on the electric generating property. The entire facility would be locally assessed to make sure the steam portion is assessed under Iowa law, with a local assessment valuation credit calculated from what is annually paid through replacement tax, deducted from the local assessment. This would leave only the steam portion locally assessed. Provisions of local assessment law, including applicable abatement and exemption provisions, would still apply. Information will be required to be provided to the Department early enough so as to allow valuation information to be provided back to the local assessor by March 31, since the local assessors assessment date is April 15. The new provision only applies to new co-generation facilities built after January 1, 2009.

A matrix was put together and distributed showing the workings of the tax along with the affect on consumers and taxpayers. Several examples were laid out because of potential machinery and equipment exemptions. Co-Chair Schuling emphasized that it was not within the purview of the Task Force to determine what property qualified for any M&E exemptions as that was something that occurs at the local assessor level.

Alan Harding then reviewed the items on the matrix. One of the items particularly noted was that each co-generation facility would be classified as a separate taxpayer for reporting purposes meaning that the entire replacement tax would be allocated to the taxing districts where the facility is located. He also noted that there would be sufficient deliveries of electricity to trigger a threshold adjustment, something that would not happen if the Department did not assess the property. If this threshold adjustment were not to occur there would be an adverse affect on other consumers and taxpayers. Harding also noted that the consistency principals stated in Iowa Code Chapter 437A are met because co-generation facilities like this will pay applicable generation and delivery taxes like other taxpayers producing electricity and selling to consumers in the State of Iowa.

Co-Chair Schuling mentioned that they just received a letter from Faegre & Benson. He paraphrased what he thought was the intent as follows. It would appear to be legislation that may work but there is an interest in having clearer language stating that the machinery & equipment and abatement provisions that exist under Iowa Code would also apply to this property.

Schuling said nothing in writing was received from the City of Clinton. Bill Sueppel said that Clinton was generally satisfied with this approach but noted that they had not had an opportunity to review the letter from Faegre & Benson.

Co-Chair Schuling asked for comments from the sub-committee members.

Member Peterson thanked the Department, taxpayer and taxing entity for their willingness to work together on this issue. He said the proposal serves as a happy medium in terms of treating the replacement tax aspects as they were intended to be treated under the replacement tax law while at the same time offering a reasonable solution to tax property previously left untaxed. He noted that the tax estimates in the matrix are not that meaningful because the percentage of M&E exemption is unknown. Peterson said the proposal was something that the Association of Counties could support.

Member Evans echoed member Peterson's comments. He said other far more complicated approaches were explored to arrive at both the electricity and non-electricity sides but noted that this proposal is mathematically and probably rationally pretty sound. He said while not perfect the method allows the assessor to perform a full assessment while at the same time allowing the replacement tax side to function, for the most part, unaffected. Evans said the proposal seemed like a satisfactory and appropriate way to resolve the matter.

Member Sigel echoed what both members Peterson and Evans said. He said another thing he liked about the proposal was that it solved the issues for this co-generation plant and for any future co-generation plants as well.

Member Kemp said he had nothing new to add that was in addition to what was already said. He said the committee has come through again by looking at an issue that was not originally anticipated and made reasonable adjustments to make the law work.

Member Rubino said he likes the fact that the proposal is repeatable and is formula driven.

Member Henter thanked the members of the sub-committee, AG's office and the Department for their work. He said he has been a member of the Task Force since the beginning and wanted to echo member Kemp's comments regarding the history of the Task Force fixing the various issues brought before them.

Member Coonan asked if there were other non-utilities covered under the replacement tax. Co-chair Schuling said there is a similar facility, the ADM Cedar Rapids plant, but

since it is a depreciated plant, the value ends up close to what it would have been if assessed locally.

Member Smith thanked the sub-committee for all the work during the summer.

Co-Chair Schuling then moved to the written issue brought forth by Andrew Anderson. Anderson questioned whether the language is specific enough with regard to the application of other Iowa Code abatement and exemption provisions. Schuling said the Department would not have a problem looking at clarifying the language because there was no intent to say the abatement and exemption provisions do not apply. Anderson said he would like to be part of the dialog noting he does not want to see the M&E exemption lost for their manufacturing processes. Co-Chair Schuling said the intent would be to say existing statutes are applicable to the property being assessed locally under this new section in Chapter 437A. Tim Krumm said he would not want anything done that prejudices whether or not the M&E exemptions apply. Member Peterson voiced concerns about making additional statements that may potentially muddy the issue. In contrast member Smith thought it would be good to clarify this potentially unclear language.

It was moved by Sigel, seconded by Smith, to have the Department of Revenue, City of Clinton and ADM work together in fine-tuning the proposed legislation and bring it back to the next meeting in final form. The motion carried unanimously.

Proposed Legislation to Statutory Extend the Task Force

Co-Chair Schuling said this is the second time during his tenure that the Task Force has come into play to order to make necessary changes. Member Rubino noted he was against the first extension six years ago but his experience with the Task Force has led him to believe this is a great forum in which to work through issues such as this for the good of everybody.

It was moved by Henter, seconded by Peterson, to propose that the Task Force be statutorily extended for another three years and to include this language in the legislative proposal. The motion carried unanimously.

Proposed Legislation for Providing a Method to Credit or Refund Monies Already Deposited in the Chapter 426B Fund

Alan Harding said there was a recent situation where a taxpayer asked for a ruling by the Director because they had misreported their generation tax. He said the company was owed a refund but there was no tool in current statute to get the money out of the fund so they had to go through a settlement process. He said the proposed language provides a method to refund or apply a credit in a manner similar to any other tax.

It was moved by Henter, seconded by Sigel, to include this language in the legislative proposal. The motion carried unanimously.

Proposed Legislation Requiring Taxpayers to Report the Disposals of Gas and Transmission Property by Local Taxing District When They Meet the Major Addition Criteria

Co-Chair Schuling said this is information that the Department needs in order to perform assessments. Alan Harding said there is an existing statute which requires reporting of major addition disposals relating to power plants and buildings, but nothing for disposals of gas or transmission property. He said the Department does not want to allocate replacement tax to a taxing district that no longer has Gas or Transmission operating property. Member Evans said this was an obvious oversight in the original legislation.

It was moved by Peterson, seconded by Henter, to include this language in the legislative proposal. The motion carried unanimously.

Duplication of Tax on Pipeline Laterals

Co-Chair Schuling said this is a new issue being raised by member Evans. He said Evans and Joann Wright, Property Tax Manager for Northern Natural Gas Company a subsidiary of Mid/American Energy Holdings Company, met with Alan Harding, Donn Stanley, Jim Miller and Dale Hyman last Thursday to discuss this issue.

Member Evans said the taxation may not be illegal or unconstitutional but it is a matter of equity and alignment with the replacement tax principals citing revenue neutrality, competitive tax equity and ease of administration. He said he felt this issue could be handled under “Iowa Deductions” and then asked Alan Harding to explain “Iowa Deductions”. Harding said an “Iowa Deduction” is to ensure property is not both locally and centrally assessed. Northern Natural Gas Company is subject to central assessment on all of its operating property and locally assessed on land and buildings not used in the operation of the business. Licensed vehicles would be another example of an “Iowa Deduction”.

Member Evans said this was an inadvertent double taxation of situations having to do with laterals coming off interstate pipelines, particularly to ethanol plants. He said this happens when ethanol plants make a choice to deal directly with interstate pipelines for gas as opposed to dealing with the local distribution company. Evans stated that companies who used pipeline laterals to bypass the local gas distribution company as of December 31, 1998 were not subject to the replacement tax and their lateral pipelines remain locally assessed. He said companies who used pipeline laterals to bypass the local distribution company after December 31, 1998 are subject to replacement tax and are not locally assessed. Evans said an ethanol plant can be served by either the local distribution company’s lateral, or in a bypass situation, a lateral that either they pay for and own or a lateral that an interstate pipeline company pays for and owns. He said in all situations the bypass customer still pays the appropriate cents per therm in replacement taxes.

Evans stated that there are 12 to 14 situations that Northern Natural Gas is aware of where there are issues with double taxation. He said where an ethanol plant is a by-passer there are two items of tax coming out of one lateral that feeds the plant, the property tax on the centrally assessed pipeline, and the excise tax paid by the ethanol plant on the therms that pass through the pipeline.

Joann Wright discussed a handout showing 16 companies as being double-taxed where Northern Natural Gas delivers gas to an end-user. It shows two methods of arriving at a double-taxation valuation. One method shows an imputed value of \$57,161,407, the other using cost data shows \$23,208,966.

Evans then detailed proposed remedies. He said you could use the mathematical approach proposed to address the City of Clinton/ADM issue where the value associated with the replacement tax is subtracted from the pipeline's overall assessed valuation as an "Iowa Deduction" or you could use a cost assessment ratio to determine how much property value is associated with the replacement tax, and then subtract that derived value from the pipelines overall value as an "Iowa Deduction". He said the appropriate means to allocate the resulting adjusted value across taxing districts needs to be discussed.

Member Smith asked who wins and who loses under the proposal. Evans said the replacement tax paid by the ethanol plant would be left alone. He said the ethanol plant, through the rates it pays, is paying the property tax as well, so the ethanol plant is probably the current loser. Evans said the ethanol plant is paying the appropriate replacement tax, and then paying a higher tax than what it would otherwise because of the lack of an adjustment to the tax being paid by the centrally assessed pipeline company. He said the issue is then what is the appropriate adjustment to be made to the centrally assessed pipeline company's value. He said after the adjustments the centrally assessed pipeline company would pay less tax leaving less tax to be charged to the ethanol plant.

Member Sigel asked Harding about the impact to local governments wondering if the impact was just to the local taxing district or to the whole system. Harding said either deduction probably would be allocated over the entire Iowa value, to every taxing district. Joann Wright said the current method is to allocate value based upon costs in each taxing jurisdiction, but in order to minimize the effects to other taxing districts, alternative methods to allocate the deductions could be discussed and implemented. She said to minimize the affects to other districts perhaps one method would be to not report any costs in those districts where the feeder laterals are located.

Donn Stanley said he really appreciated the opportunity to meet with Evans and Wright last week. He said there was probably too much emphasis being placed on the legality of the alleged double taxation as the main point of the analysis of the situation is that this is not a double taxation at all. He said under this scenario the ethanol plant pays the tax as the consumer of the therms of energy just as a municipal or public utility would and then pass the tax down the chain to the customer. Stanley said this is a replacement excise tax based on therms, not a property tax. He said Northern Natural Gas is not paying an

excise tax; they are paying a property tax based upon the value of their property. Stanley said there are really two transactions, two taxes – one excise and one property, to two different taxpayers. The excise tax is on the energy that is shipped along the pipeline and the property tax is on the pipeline. Northern Natural Gas is not paying both taxes. Northern Natural is only paying the property tax on the pipeline it owns. Stanley said Northern Natural Gas is not assessed two taxes, they only pay one, and you can not be double taxed when you only pay one tax.

Stanley said there was an initial snapshot of what property was worth at the inception of the replacement tax program, creating a basis for the tax, but there is no continuing assessment of property. It is now an excise tax program. He said as long as the therms stay the same and the rate stays the same the tax stays the same. He also noted that the taxing entities are quite different going to the point members Smith and Sigel were making in that one tax is local and the other tax goes all over the state among the 58 counties where Northern Natural Gas has operating property. He said because it is two different taxes paid by two different taxpayers to different taxing jurisdictions he does not think it is analogous at all to the City of Clinton/ADM situation.

Stanley said the ethanol plant is not paying more tax than the other customers. He said if the internalized costs of the Northern Natural Gas property tax payments were not passed on to the ethanol plants, but were passed on to other Northern Natural Gas customers, the other customers would be disadvantaged, thus violating the principle of tax neutrality. Stanley said he did not see this as ease of administration, or tax neutrality, or a remedy to a double tax that does not exist.

Member Evans said he did a lot of economic evaluations for his company and one of the principals often used to determine value added or not added was a “with” or “without” concept. If for example Northern Natural Gas were to sell a lateral to an ethanol plant something happens. He said the replacement tax still gets paid, but Northern Natural Gas no longer pays a tax, yet it’s the same pipe and the taxes go down. He said that is the “with” and “without” concept.

Member Rubino asked how the pipe is taxed if owned by the ethanol plant. Evans said it would still pay the same replacement tax based on therms. Rubino asked for verification if it was like a consumption tax based upon the number therms consumed. Evans said he differed with Stanley, it is not a consumption tax, and it is still a tax on property despite what Stanley says. He said the property is valued, instead of on financial statements, on activities like the output or throughput. He said it is just another way of determining the value of the pipe. Evans said for example, if the ethanol plant buys the lateral, the value goes off the central value of Northern Natural Gas, to the ethanol plant, but the ethanol plant is already paying the replacement tax. He said this is the “with” or “without” principal. He asked if this is a fair or an equitable result when you can have the same situation, and depending upon who owns the lateral, there can be two taxes or one. Evans said he feels the Task Force has the authority to at least make a recommendation that this inequity be remedied, even if the tax is not illegal.

Member Sigel asked if the lateral is sold, does the total tax liability go down. Stanley said the total tax liability would go down for Northern Natural Gas because they would own less property. Member Sigel said he understood, but would the ethanol plant's tax liability go up to compensate? Stanley said no, because it's a different tax based on therms. He said the ethanol plant's tax liability only goes up or down if the therms go up or down. Stanley confirmed that the ethanol plant would not pay tax on the lateral if they owned it. Stanley said the number of pipes or the value of the pipes doesn't matter unless the amount of energy changes. He said the main point is that these are different taxes and that by definition in Iowa Law is not double taxation.

Co-Chair Schuling asked for comments on where the Task Force wanted to go on this issue. Member Peterson said we have two different entities paying a tax and that doesn't seem like double taxation. He said if we have to get back together to review language regarding the machinery & equipment we could discuss this issue as well, and that would give us a chance to digest some of the information member Evans has presented. Co-chair Schuling said that is workable at the next meeting. Member Kemp said he agrees in that he wants an opportunity to review the material. Co-Chair Schuling said the department will take a look at the issue before the next meeting. Schuling said we will come back to the next meeting with two issues, hopefully there will be agreement between all of the parties for legislation dealing with the ADM property in Clinton, and then we will discuss again the issue on the lateral pipelines raised by member Evans. Member Smith asked for the information via email. Member Evans said he would put it into a package. Co-Chair Schuling said to get the information to him and he will make sure everyone gets it.

Adjournment

Co-chair Schuling asked if there was anything else, hearing none, thanked the membership and closed the meeting at 3:16 PM.