

# UTILITY REPLACEMENT TAX TASK FORCE MEETING

## MINUTES November 30, 2009

The Utility Replacement Tax Task Force met at 1:30 p.m. on November 30, 2009 in the fourth floor conference room of the Hoover state office building, Des Moines, Iowa. The meeting concluded at 3:18 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 via telephone**, 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 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; Joann Wright, Northern Natural Gas Company; Dwayne Vande Krol, Hawkeye Renewables; Michelle Mapes, Green Plains Renewable Energy; J. D. Schlieman, Hawkeye Energy Holdings; Brad Zumbaum and Matt Eide, POET, LLC; Monte Shaw, IA Renewable Fuels Association; Ed Wallace, Iowa Taxpayers Association; 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. Introductions were then made.

### Prior Meeting Minutes

It was moved by Coonan, seconded by Henter, to approve the November 2, 2009 meeting minutes. The motion carried unanimously.

**Approval of Final Language for 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 summarized the proposed legislation provided at the last meeting. He said the subcommittee brought the proposal forth to the full Task Force. There was difficulty in trying to separate the various components of the cogeneration facility subject to different types of taxation. Those components include the electric portion and the steam portion. The proposed legislation allows the Department of Revenue to assess and tax the electric side of the facility relating to the replacement tax. This information would be provided to the local assessor to be applied as a credit against the full value of the facility as determined by the local assessor. The intent is to prevent any double taxation of the property.

Co-Chair Schuling said ADM raised an issue regarding the applicability of statutory machinery and equipment exemptions to the locally assessed property. The Department redrafted proposed language in an attempt to make it clearer that existing machinery and equipment exemptions would apply to the facility. The City of Clinton objects to the latest proposed language saying that the changes potentially create inconsistencies with, current law. Schuling explained the provisions of Iowa Code Section 427B.17(5).

Tim Krumm asked if it was possible to be a high capacity power plant and also be a cogeneration facility. Krumm feels the amended language is overly broad, potentially applying to a cogeneration facility that is also a high capacity self generator. Donn Stanley said the latest proposed language did not address whether the cogeneration plant was the same as the electric plant and noted that he understands the concerns of the City. Krumm said all of the drafted legislation relates to a new section dealing with cogeneration facilities. He said nothing amends Iowa Code 427B.17. He said if a goal of the Task Force was not to deal with whether or not the machinery and equipment exemptions apply, it would seem that goal has been met with the original proposed language.

Donn Stanley said a lot of the ambiguity is driven because there is not a bright line between the dual uses of the property, between the steam and electric portions, leaving doubts as to the applicability of the existing language. He said the purpose of the clarifying language was to address the ambiguity.

Co-Chair Schuling said he did not disagree with Krumm in that he thought the original language dealt with the issues. He noted that he thought the Task Force was ready to go forward with that legislation but wanted the opportunity for ADM and Clinton to agree on language. He said the goal was to come up with something that did not change the intent of current law. Krumm agreed.

Andy Anderson said ADM wants the clarifying language added in order to avoid any future conflicts. He said they feel entitled to a machinery and equipment exemption under the proposal, but the clarifying language would help them in explaining it to ADM officials.

Member Evans said as he understands the situation, the two parties are not that far apart in that ADM wants the machinery and equipment exemption to apply to their machinery and equipment, and the City does not want the existing machinery and equipment statutes over-applied. Member Evans said he thought the intent of the Task Force was to address the Iowa Code Chapter 437A aspects of the co-generation facility while leaving the machinery and equipment issues alone. He said in a strict attempt to try to accommodate the parties some discussion of machinery and equipment had ensued. He said the language wanted by ADM does not sit well with Clinton. Evans said the Task Force members are not machinery and equipment experts.

Anderson said if the issue can be resolved at the Task Force level, it would not have to be resolved in the legislature. Anderson said he feels the Task Force needs to address the machinery and equipment issues as part of their duties to make the plant fit into the overall tax structure of the state.

Co-Chair Schuling said the Task Force is not set up to interpret the law, especially with regard to machinery and equipment. He said the Task Force was created to deal with the replacement tax. Schuling said his intent was to work on language which supported or clarified, but did not change, existing law.

Member Peterson said a new mechanism has been created to address this and any future similar facilities. He said the machinery and equipment exemptions for the manufacturing part of the facility should not be an argued point with assessors. He said the manufacturing facilities declare their machinery and equipment which is exempted. He said none of those procedures are changed with the proposed language. Peterson said the problem with trying to clarify something that is already muddy is that it many times becomes even muddier. He said it made sense to simply not address the issue, and let whatever law that is in place relating to machinery and equipment stand, the way it has stood for some twenty years.

Member Kemp said he agrees with both members Peterson and Schuling. He said he is concerned about dealing with an issue that is likely to be muddied more with intervention. He said addressing the machinery and equipment issue would go beyond the purview of the Task Force. Kemp said he recognized that it was part of the system but there are many parts to the property tax system beyond the scope of the Task Force.

Member Smith said she would appreciate having a copy of the proposed language, saying it is difficult to discuss something without seeing the language. Copies were provided to all at the meeting.

Member Evans said what he is hearing is that ADM and the Attorney General's Office have agreed to some language. Andy Anderson said ADM agrees to the language as drafted by the Attorney General's Office. In clarification Donn Stanley said the Attorney General's Office was charged by the Task Force to come up with some language. He said the drafted language was approved by Anderson and then provided to the City of Clinton. He said Clinton has raised a number of issues that are not frivolous. Stanley said the language as drafted may not be the right solution to fix the problem, noting that Jim Miller wrote the initially proposed legislation, which was thought to be fine in the first place. Stanley said he understands the concerns of Clinton and agrees with Anderson in that the issue may ultimately be decided by a court, whether or not the original proposal is amended.

Member Coonan said he felt the approaches taken were good faith attempts to reach a compromise between the parties. He said the Task Force did not appear to be at a point where they can vote because the Task Force wants to vote on language that both parties feel comfortable with.

Tim Krumm said they were willing to look at additional revisions, but he fears what ADM wants is a statement that the machinery and equipment exemptions apply, and the City will not agree to that.

Member Smith said she hoped the machinery and equipment issue could be settled before the start of the session. She said she felt it would be a bad idea to let the legislators decide how to interpret machinery and equipment exemptions.

Member Peterson said the subcommittee and Task Force members have worked hard to come up with a reasonable compromise. He said the method makes sure that both the taxpayer and tax collector have been treated equitably. He said it seems that the machinery and equipment aspect is something that is already settled.

It was moved by Peterson, seconded by Kemp to approve for legislative drafting the proposed cogeneration facility legislation presented to the Task Force on November 2.

Discussion on motion:

Member Peterson said he feels that any machinery and equipment exemption entitlement that ADM has on their facility should stand as it statutorily stands now. He said any actions taken by the Task Force should in no way diminish any claim that ADM would have for machinery and equipment exemptions under current statutes. Member Coonan asked if Peterson's comments could be included as an intent statement in a legislative cover letter.

The motion carried unanimously.

## **Duplication of Tax on Pipeline Laterals**

Member Evans said Joann Wright updated the direct connect schedule that was passed out at the last meeting because the Platinum Company was inadvertently listed as a direct connect, but is actually being served by a local distribution company. He said the numbers are now slightly smaller. Evans said he felt the minutes from the last meeting accurately reflected his comments, those made by Joann Wright, and those by Donn Stanley as well. Evans summarized the discussion from the last meeting. He said he believes that there is an unintended duplication of property tax and replacement tax on property in situations where there is a direct connect pipeline lateral from Northern Natural Gas, which is an interstate pipeline not subject to the replacement tax, but is centrally assessed by the Department of Revenue on a unit valuation basis. He said the ethanol plants are also paying replacement taxes associated with the delivery of therms by the direct connect. Evans said it was also discussed that the taxation may not be illegal and apparently it is not. He said there was discussion of whether or not there is a duplication of tax, acknowledging some difference of opinion. Evans said Stanley and others made a lot of good points, but wanted to echo the simple mathematical “with” and “without” approach in support of his views. He said if a tax changes as a result of ownership, then perhaps there is a duplication. He cited an example saying if Hawkeye purchased the lateral to its plant from Northern Natural Gas, there would only be one tax, the tax that Hawkeye pays. He said that portion of the unit valuation relating to the Northern Natural Gas tax liability would go away. He said that is evidence mathematically of a tax duplication. Member Evans then offered some proposed legislation for consideration by the Task Force, which amends Iowa Code Section 438.13, that he felt may eliminate what he feels is the inadvertent double taxation.

Donn Stanley said a lot of his relevant comments are in the last meeting’s minutes but offered a summary. He stated that not only is there no constitutional prohibition against the alleged double taxation, but there is no double taxation, adding this was the main point. Stanley said there is an operational property tax paid by Northern Natural Gas. He said there is an energy tax, which is the replacement tax, paid by the ethanol plants, just like is paid by the other consumers served by Northern Natural Gas. Stanley said not only are the taxes different, but the taxpayers are different, saying it is the natural gas company in one instance, and the consumer in the other. He said the tax is paid differently. Northern Natural Gas pays their tax to the 58 counties and sub-governments within, and the energy tax goes to the units of government surrounding the plant. He said in no way does this end up being a double tax. Stanley referred to the “with” and “without” Hawkeye Company example presented by member Evans saying if the lateral ownership goes from Northern Natural Gas to Hawkeye, Hawkeye does not pay additional replacement tax, which is an example of why the replacement tax is not a property tax. He said if it was a property tax, and property was added, you would pay more money for the extra property. He said Northern Natural Gas is only taxed on its operational property, while the end users of the gas pay a replacement tax.

Donn Stanley said the disconnect between the two types of tax are evidenced by the handout showing the wide variation in replacement tax liabilities. He said the Hawkeye

Menlo plant has the most miles of pipe, 20.75 miles, with an imputed value of 828,249, and estimated replacement tax liability of 21,801. Stanley said the company with the closet estimated replacement is the MRES Power Plant, with only 450 feet of pipe, with an estimated replacement tax liability of 18,262. He said under this formula the 21 miles of pipe would have about the same value as the 450 feet of pipe. He also pointed out the differences with companies having two and three miles of pipe, which he says underscores the fact that these are different types of taxes. Member Evans asked Hawkeye when the plant was placed in service. J. D. Schlieman said the plant was placed in service in September or October, saying the therm usage only represents about a quarter of a year, leaving a distorted relationship. Donn Stanley acknowledged that fact but said he doubts the other companies all started deliveries in the fall, and you can see the same issue using other companies as examples.

Steve Evans said along with the work he does in Iowa, he works with many other states and counties on valuation issues as well. He has found, for example, a pipe of say 400 yards, may be of a very low cost, using the cost approach, but using an imputed impact and income approach, or using a discounted cash value approach, could have an immense value to the economic enterprise being served. Evans referenced some historic discussions he had with state officials in the pre-ethanol plant days where there were just a few direct connects, noting that many local assessors seemed to overlook the fact that a low cost line could have a great economic value to the enterprise being served.

J. D. Schlieman said another plant, the Hawkeye Shell Rock plant, just started up in the fourth quarter. He said the cost data for the Fairbank plant included some costs relating to the Northern Natural Gas main pipeline and other infrastructure, which means the listed costs are not simply the costs of the pipeline. He said there is the new subset of entities (direct connect ethanol plants) that in essence pay both the centrally assessed taxes and replacement taxes. Schlieman said he didn't want to argue the legality of such, but the fairness of the double economic burden, saying that is the issue they want the Task Force to address. He did not favor the proposal by member Evans because it provides property tax relief to Northern Natural Gas. He said the ethanol plant group, possibly through the Iowa Renewable Fuels Association, would like further dialog with the Task Force to explore another remedy, prior to the legislative session.

Dwayne Vande Krol said Schlieman summed up the issue well saying that it is not a legal issue, but an economic burden being borne by the ethanol plants. Co-Chair Schuling asked Vande Krol if he felt the ethanol plant was paying the tax twice. Vande Krol said the plant had the burden of the tax twice, once through the replacement tax, then again through what is built into the rates. Co-Chair Schuling said that seemed to be different than what member Evans has said. Member Evans said no, that is exactly his view, in that Northern Natural Gas pays the tax, and then as part of the rate making processes, passes along its tax.

Member Evans said the end user companies with the direct connections pay a replacement tax, but those companies being supplied by a local distribution company do not. He said the companies with a direct connection are paying a double tax, one being a

direct tax, the replacement tax, the other is through higher rates paid to the interstate pipeline. Donn Stanley asked member Evans how the replacement tax gets paid for those companies being supplied gas by a local distribution company. Member Evans said the local distribution company supplying gas to a consumer pays the replacement tax. He said that was one of the many costs of service that the LDC presents to the Utilities Board in establishing the rates. Stanley asked if the costs incurred by the interstate pipeline to the point of handoff to the local distribution company would be included in the rates charged to the local distribution company, which in turn would be included in the rates charged by the LDC to the consumer. Evans said yes. Stanley then asked how different that impact was compared to the impact to the direct connect consumers. Stanley asked if it was not true that the end consumer ends up paying whatever costs were accumulated by the suppliers until the point of delivery, including the delivery taxes. Member Evans said yes, if things are done right, the consumer pays all of the costs along the path. J. D. Schlieman said, however, in the example just stated, the LDC owns the pipe, and that was what the replacement tax was designed to replace. Schlieman said in their situation the replacement tax is paid on the pipe plus there is an additional property tax paid on the pipe by the interstate pipeline. Stanley said the replacement tax isn't being paid on the lateral, the replacement tax is based on the therms of energy delivered, not on any specific piece of property. Stanley said the property could change without the tax changing. Schlieman said the difference is that the lateral line in the one instance has no property tax assessment, but in the case for his company, it does have a property tax assessment that Northern Natural Gas is paying. Stanley said there is a property tax assessment until the time the line goes to someone paying the replacement tax, whether it is a direct connect consumer, whether it is the LDC, or whether it is a municipal utility. He said there is a property tax assessed until there is a hand off to the consumer.

J. D. Schlieman said maybe he has a misunderstanding, but using the Fairbank plant in Buchanan County as an example, there is a 7 1/2 mile lateral connected to the Northern Natural Gas main line. Northern Natural Gas owns the 7 1/2 mile lateral that is part of their centrally assessed property tax. But he said at their Iowa Falls plant their gas is delivered by Alliant Energy, which connects to the Northern Natural Gas main line. He said Alliant owns a two mile distribution line lateral which provides the connection from the interstate pipeline to the plant. He said Alliant does not pay property tax on the lateral, leaving only one tax that is being collected relative to that lateral. Schlieman said with regard to the Fairbank plant lateral, there is a replacement tax being collected from Hawkeye, and there is a property tax being collected from Northern Natural Gas, all on the 7 1/2 mile lateral. He contrasted this to the Iowa Falls plant with the 2 mile lateral owned by Alliant, which has only one tax collected. Donn Stanley said the property tax collected before you get to the lateral is passed on to you, the consumer. Schlieman said the Northern Natural Gas property tax includes tax on both their main line and the lateral. Stanley said Northern Natural Gas pays property tax on every piece of property they own which represents built in supply costs. Schlieman again pointed out that in the two examples previous stated, in one the one instance where the gas is purchased through the LDC, there is only one tax associated, and in the other instance, with the direct connect lateral, there are two taxes.

Member Kemp said the way he understands the workings of the replacement tax would be if someone is contending double taxation involving replacement tax, and they stop paying, someone else has to pick up the tax to make up for the loss. Member Evans said the original intent of the replacement tax was to replace the property tax that would otherwise be there. Evans said however, the property tax is still there, and instead of replacing the tax, there is a brand new tax. He referenced a MidAmerican owned 12.6 mile lateral that brings gas to a generating plant in Pleasant Hill. He said a lot of therms go through the lateral. He said their tax is based on economic value determined by therms. He added as a side note there is an additional electric generation tax paid on the electricity generated at the plant. Evans said if Northern Natural Gas owned the lateral, they are not subject to replacement tax, they are subject to unit valuation. He said Northern Natural would pay their property tax on the lateral, then would increase the rates charged to MidAmerican. He said MidAmerican would still pay the large replacement tax and also pay the higher rates for the transportation service provided. Evans recapped saying that if MidAmerican owned the lateral, there is one large tax, but if Northern Natural Gas owned the lateral, the large replacement tax is still there and there is in addition a property tax, which is passed on to the customer. He said this is the double taxation the ethanol plants are facing.

Member Smith asked if this was all new money. Alan Harding said these are new customers. Smith asked if this was 1.3 million dollars going to the districts that that was not there before. Harding confirmed that as correct. Member Evans said the existing plants as of 12-21-1998, even if they had a direct connect, were not put under the replacement tax system.

Member Coonan asked where the Department stood on the issue, asking if they held the same opinion as the Attorney General's Office. Co-Chair Schuling said he only had one vote on the issue. Schuling said he felt it was a different tax, referring to the earlier discussion with regard to the tax MidAmerican is paying on the lateral going to the generating facility. He said this not a property tax but an excise tax based on therms of energy. He said state law says you pay a tax on your property, and then there is a different tax, the replacement tax, due on what goes through the pipeline. Schuling said he feels that these are two different taxes. He added again, that he has just one vote.

Joann Wright said she feels you have to look back to the original intent of the law that says this is a replacement of property tax on lateral lines. Co-Chair Schuling said that was back in 1995 and 1996, in order to make things revenue neutral, but there has been no comparison to the property tax since that time. Wright said MidAmerican owns miles and miles of small diameter pipe that is not subject to property tax, but is subject to replacement tax. Wright said her company has miles and miles of small lines that are subject to property tax and not to replacement tax. She said her customers however, are subject to replacement tax on those miles and miles of lines of which MidAmerican is exempted. Co-Chair Schuling said the lines are not subject to replacement tax based on the miles of lines, but are subject to a replacement tax based on the energy going through the lines.

Member Evans said that maybe he was too close to the origin of the tax. He says on a Federal level he argues origin of claim. He said under an origin of claim argument he wouldn't feel that the Department or Attorney General's office would fare well. He says this was a property replacement tax. Evans said the property that is there today doesn't generate a new tax directly, but when MidAmerican built their new lateral to their power plant, it generated a lot of new taxes for local governments. He said the tax is tied to property and is allocated on property. He said you use general property tax equivalents for many of the calculations. He said it is so integrated in its origins and in its operations with property today, that he does not feel the Department would fare well, at least in a Federal court.

Co-Chair Schuling said he was not sure on that issue. Schuling said Northern Natural Gas is assessed on property and is not sure it is a valid argument that just because someone else pays a replacement tax, that Northern Natural Gas should not have to pay a property tax on a line that they own. Schuling said the law says pipeline companies pay a property tax on all of their property.

Member Evans said while it may not be illegal, it is a question of equity. Evans said we have an inadvertent inequity in the replacement tax, in combination with the long-standing unit valuation means of taxation. He said this is of the nature of the kind of issue that the Task Force can address, has addressed, and should address.

Monte Shaw said there continues to be reference to two different taxes, one on property, and another one being an excise tax. He said the excise tax is also being referred as a replacement tax, which is replacing property taxes that are no longer assessed. Shaw said he felt it hard to argue that these are two different taxes, but rather a different way of taxing property, one being valued in the traditional methods, and the other being that you are essentially assessing a property tax based on a throughput business model. He said they are being charged taxes twice. Shaw said they are paying the property tax through the FERC rates and they are also paying the replacement tax. He said there might be some disagreement on the solution, being a number of different points of view, and would like to continue the dialog with the Task Force. He referenced an earlier comment about there being a number of companies exempted at an earlier point in time, and felt that should be part of the equity discussions. He wondered if they were paying a BTU tax, as opposed to an alternative property tax, and felt discussion should continue along those lines as well.

Michelle Mapes said she would like to echo what has already been said. She referenced current law saying the tax was to replace property tax and it was to be revenue neutral. She said they fail to understand being subject to the duplicate taxation. Co-Chair Schuling said the only company paying a tax on the line is the company that owns it, which is an interstate pipeline company. Mapes said, with reference to revenue neutrality, there continues to be more revenue created. She added that listed amounts for the Great Plains plant represent only five months of operation.

Member Peterson said he wanted to address revenue neutrality, noting that the revenue neutrality was addressed at one earlier point in time. He did not feel there was any expectation that the revenue in place in 1999 was the revenue to be in place over time. Peterson said the replacement tax system was put in place at the request of the utility companies in order to create a tax system that ultimately made them more competitive, not only in the State of Iowa, but outside the State of Iowa. He said at the inception of the replacement tax program there was a lot of concern about there being a highly competitive environment from state to state. He noted that some of that reform did not happen. Peterson said he feels that the system, to a large degree, was created to be beneficial to the Iowa utilities. He said it creates some degree of predictability with some modest growth over time. He acknowledged the increase in taxes over the last ten years, but noted that is because of new facilities and additional gas and electricity in the system. Peterson said the idea of revenue neutrality was at one point in time, with the goal being to replace the existing property tax with the new replacement tax. He said he felt the program has been generally successful, but with a few glitches. Peterson said he was not sure about the double taxation issues and was not prepared to make a final decision. He felt there were more factors than whether or not it is legal. With regard to equity, he said he pays his taxes along with other peoples' taxes. He said we all pay someone else's taxes. He noted that he is not passing judgment on whether that is right or wrong, but someone has to pay for things like schools. He said it is not a perfect system. Peterson said primarily because member Evans has been a good participant, and because he values his opinion, he is not ready to say it is a closed issue, but neither he is ready to adopt the language proposed by Evans.

Member Henter agreed to the comments made by Member Peterson. He said he does not know if this is a glitch. He said he is not comfortable with either a yes or no vote at this time.

Member Coonan said given the concerns of the ethanol industry, and the impact, the issue warrants more discussion. He said it sounds like the ethanol industry and the utilities will be taking a further look at the issue, which sounds like the best course.

Member Kemp said he agreed with the comments just made. He said he is not ready to make a decision. He said at this point he is still open to the issues, in that he could come to the conclusion that this is double taxation, or he may come to the conclusion that these are two separate taxes that are equitable and fine.

Member Smith agreed with member Kemp's comments and feelings.

Member Rubino felt things should be left alone with no changes.

Co-Chair Schuling said he hears that the Task Force wants to continue to look at the issue and wondered if the sentiment was to do something yet this legislative session or in the following session.

Member Peterson said he has a concern along the lines of how the tax flows back to the entities that are impacted within the local communities. He said he is concerned about such things as the increased maintenance of the county roads to and from the ethanol facilities. He said he is trying to figure out whether or not the whole picture fits together to help defray some of the additional costs related to the increased traffic on the county roads. Co-Chair Schuling said this information could be gathered.

Co-Chair Schuling said there will be another Task Force meeting in late January or February to address the direct connect issues.

### **Adjournment**

Co-chair Schuling asked if there was anything else, hearing none, thanked the membership and closed the meeting at 3:18 PM.