

Draft Idea for a Gross Operating Revenues Tax

An Alternative to Property Tax for Utility, Pipeline, and Railroad Operating Property

Objectives

- Create an easy-to-calculate and easy-to-understand tax that replaces the property tax on utility, pipeline, and railroad operating property.
- Provide predictability and stability to utility, pipeline, and railroad companies and the jurisdictions where the property is located.
- Remove subjectivity from the market valuation process currently used to assess utility, pipeline, and railroad operating property, thereby reducing litigation.

Idea Summary

The Minnesota Department of Revenue is exploring options to remove utility, pipeline, and railroad operating property from property tax and replace it with a gross operating revenues tax.

Utility, pipeline, and railroad companies would be subject to the tax, which would be determined by multiplying three factors together:

- A company's gross operating revenues
- Allocation factor
- Rate applied to gross operating revenues

A company's gross operating revenues may be reduced when calculating the tax.

The tax would be distributed to each unique taxing area and further distributed to each taxing jurisdiction within that area.

Additionally, only local jurisdictions would be required to assess railroad operating buildings. This is a change to how they are assessed now. Currently, Revenue and local jurisdiction can each assess a portion of a building, which can lead to confusion and inconsistent assessments for the same building.

Tax Calculation

The equation to calculate the gross operating revenues tax for each company is the company's gross operating revenues times the company's allocation factor times a rate.

$$\text{Tax} = \text{Company's Gross Operating Revenues} \times \text{Allocation Factor} \times \text{Rate}$$

Company's Gross Operating Revenues Reduction

The first factor of the equation is a company's gross operating revenues.

Gross operating revenues would be reduced for two types of companies:

- Electric cooperatives that pay a per member tax:
 - Reduce by a factor of the cooperative's property outside city limits, divided by its total operating property in Minnesota.
- Companies that pay Solar or Wind Energy Production Taxes:
 - Reduce by the portion of gross operating revenues generated by solar energy generating systems or wind energy conversion systems.

Allocation Factor

The allocation factor helps reduce the gross operating revenues of companies with operating property located in more than one state or country. It accounts for both:

- Operating property located outside of Minnesota.
- Revenues generated from operations located outside of Minnesota.

For companies with operating property solely in Minnesota, the allocation factor is 1.

For companies with operating property outside of Minnesota, the allocation factor varies by market segment as shown in these formulas:

Electric Companies

The allocation factor for electric companies is the sum of two components.

The first component is the original cost of operating property in Minnesota divided by the original cost of system operating property, multiplied by 0.9.

The second component is the gross operating revenue from operations in Minnesota divided by the system gross operating revenue, multiplied by 0.1.

$$\begin{aligned} & \text{Allocation Factor for Electric Company} \\ &= \left(0.90 \times \frac{\text{Original Cost of Operating Property in Minnesota}}{\text{Original Cost of System Operating Property}} \right) \\ &+ \left(0.10 \times \frac{\text{Gross Operating Revenue from Operations in Minnesota}}{\text{System Gross Operating Revenue}} \right) \end{aligned}$$

Gas Distribution and Water Companies

The allocation factor for gas distribution and water companies is the sum of two components.

The first component is the original cost of operating property in Minnesota divided by the original cost of system operating property, multiplied by 0.75.

The second component is the gross operating revenue from operations in Minnesota divided by the system gross operating revenue, multiplied by 0.25.

Allocation Factor for Gas Distribution or Water Company

$$= \left(0.75 \times \frac{\text{Original Cost of Operating Property in Minnesota}}{\text{Original Cost of System Operating Property}} \right) + \left(0.25 \times \frac{\text{Gross Operating Revenue from Operations in Minnesota}}{\text{System Gross Operating Revenue}} \right)$$

Pipeline Companies

The allocation factor for pipeline companies is the sum of two components.

The first component is the original cost of operating property in Minnesota divided by the original cost of system operating property, multiplied by 0.75.

The second component is the throughput of product in Minnesota divided by the system throughput of product, multiplied by 0.25.

Allocation Factor for Pipeline Company

$$= \left(0.75 \times \frac{\text{Original Cost of Operating Property in Minnesota}}{\text{Original Cost of System Operating Property}} \right) + \left(0.25 \times \frac{\text{Throughput of Product in Minnesota}}{\text{System Throughput of Product}} \right)$$

Railroad Companies

The allocation factor for railroad companies is the sum of three components.

The first component is miles of track in Minnesota divided by system miles of track, multiplied by 0.3.

The second component is the gross operating revenues from transportation operations in Minnesota divided by the system gross operating revenues from transportation operations, multiplied by 0.4.

The third component is the cost of road property in Minnesota divided by the cost of system road property, multiplied by 0.3.

Allocation Factor for Railroad Company

$$= \left(0.3 \times \frac{\text{Miles of Railroad Track in Minnesota}}{\text{System Miles of Railroad Track}} \right) + \left(0.4 \times \frac{\text{Gross Operating Revenues from Transportation Operations in Minnesota}}{\text{System Gross Operating Revenues from Transportation Operations}} \right) + \left(0.3 \times \frac{\text{Cost of Road Property in Minnesota}}{\text{Cost of System Road Property}} \right)$$

Rate Applied to Gross Operating Revenues

The last factor is the rate. The rate would depend on the market segment. The rate applied within a market segment may be tiered, based on gross operating revenues.

The rate would be adjusted based on inflation, using the January through December 12-month percentage change in consumer price index for all items.

Exemptions

The tax would have these exemptions:

- Solar energy generating systems and wind energy conversion systems subject to Solar and Wind Energy Production Taxes.
- Electric generation systems whose owner uses all its electric generation for personal use and does not sell any of the electricity generated.

Tax Distribution

Companies would pay the tax to the county treasurer where the property is located. The county treasurer would distribute the tax to the local taxing jurisdictions.

First, Revenue would calculate the tax assigned to each unique taxing area.

For utility and pipeline companies, tax distributed to each unique taxing area is the original cost of operating property in the unique taxing area divided by the company's original cost of operating property in Minnesota, multiplied by the company's total tax.

Tax Distributed to Unique Taxing Area

$$= \text{Company Total Tax} \times \left(\frac{\text{Company Original Cost of Operating Property in Unique Taxing Area}}{\text{Company Original Cost of Operating Property in Minnesota}} \right)$$

For railroad companies, tax distributed to each unique taxing area is based on an average of the company's operating acres component and miles of track component.

The operating acres component in each unique taxing area is equal to the number of operating acres in the unique taxing area times the average estimated market value per acres for the city or township within the unique taxing area, divided by the total operating acres components for all unique taxing areas in Minnesota.

The mile of track component in each unique taxing area is equal to the miles of track in the unique taxing area, divided by the company's total miles of track in Minnesota.

Tax Distributed to Unique Taxing Area

$$= \left(\left(\frac{1}{2} \right) \times \left(\frac{\text{Operating Acres in Unique Taxing Area} \times \text{Avg. Estimated Market Value of City or Township}}{\text{Total Operating Acre Components for All Unique Taxing Acres in Minnesota}} \right) \right) + \left(\left(\frac{1}{2} \right) \times \left(\frac{\text{Miles of Track in Unique Taxing Area}}{\text{Miles of track in Minnesota}} \right) \right)$$

Revenue would share publicly the amount of tax due by the company and the portion of tax for each unique taxing area.

Second, the auditor will determine the tax distribution to each local taxing jurisdiction within the unique taxing area. Each local taxing jurisdiction's tax would be determined based on the taxing jurisdiction's portion of the unique taxing area's overall tax rate.

Unique Taxing Areas

To determine the correct tax distribution to each unique taxing area, each county would submit boundary information for each unique taxing area in its county.

Utility and pipeline companies would provide the original cost of their operating property (not including land) by unique taxing area.

Railroad companies would provide the number of operating acres and miles of track by unique taxing areas.

Timeline of the Tax

This is a timeline to show the process of the tax.

In the first calendar year:

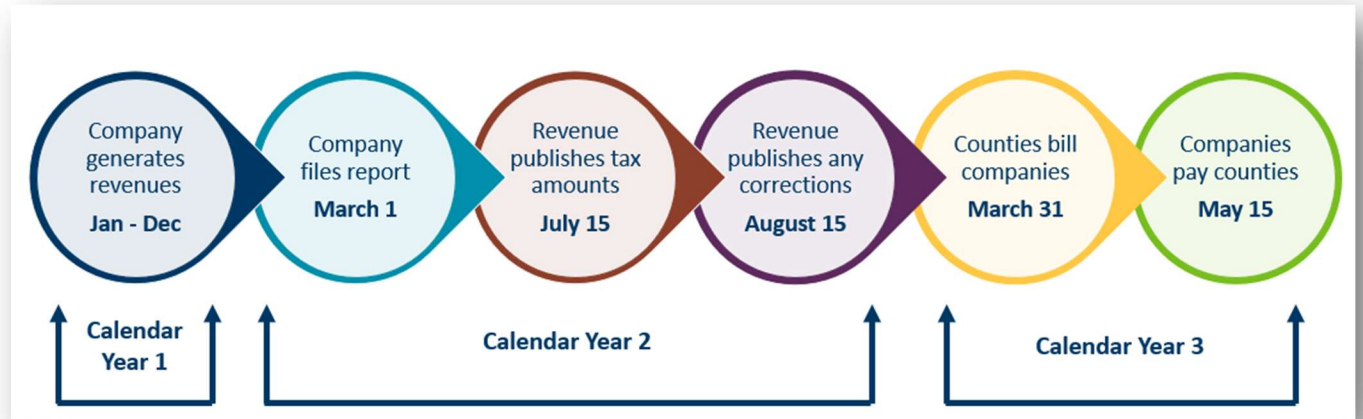
- Companies would generate operating revenues from January to December.

In the second calendar year:

- Companies would report to Revenue their operating revenues and other required information by March 1.
- Revenue would publish on its website the tax distribution amounts by July 15 and make corrections by August 15.

In the third calendar year:

- Counties would bill companies for the tax by March 31.
- Companies would pay the counties by May 15.



Aid to Local Jurisdictions

The tax would update the Electric Generation Transition Aid and create a new Local Jurisdiction Transition Aid.

Electric Generation Transition Aid

The Electric Generation Transition Aid provides aid to eligible taxing jurisdictions when certain electric generation units retire. Eligible taxing jurisdictions include county, home rule charter or statutory city, town, or school district.

If an electric generation property's tax capacity is more than 4% of the eligible taxing jurisdiction's total tax capacity in the year before the retirement, that jurisdiction may be eligible for aid when the unit retires. The generation unit must be nuclear or powered by coal or natural gas.

The goal of this aid is to help relieve jurisdictions that lose a large portion of their tax base due to a retirement of an electric generation unit. Revenue wants to keep this goal with the gross operating revenues tax.

This would effectively update the Electric Generation Transition Aid to factor in the amount of gross operating revenues tax collected rather than changes in tax capacity when an electric generation unit is retired.

Note: The Minnesota Legislature passed the Electric Generation Transition Aid in 2023. [See Minnesota Statute 477A.23](#) for more details.

New Local Jurisdiction Transition Aid

The new aid would be the Local Jurisdiction Transition Aid for jurisdictions impacted by the change in property tax on utility, pipeline, and railroad operating property and the new gross operating revenues tax.

In the first three years of the gross operating revenues tax, if a local jurisdiction receives less tax than it previously received in property taxes on utility, pipeline, and railroad operating property, the jurisdiction would be eligible for aid. Once a jurisdiction qualifies, the aid amount will decrease by 10% each year until the aid is below \$10,000. At that point, the aid will be eliminated. The aid amount will not increase.

Aid would be eliminated if a local unit's net tax capacity increases by more than 10% in the year the aid is calculated from the year before the aid was calculated.

Revenue would certify the aid on December 1 for aid payable the following year. Aid would be paid 90 days after certification.

Analysis of Rates Applied to Gross Operating Revenues

We did an analysis to estimate the rate to apply to gross operating revenues. This rate was estimated for 75 of 121 companies. Data was unavailable for the remaining companies, and we are in the process of collecting their data.

Based on the analysis, we determined rates for each market segment for the gross operating revenues tax.

How Rates Were Estimated

We estimated the rates to apply to gross operating revenues by using the 2023 assessment year Minnesota Apportionable Value and multiplied by 3% to estimate the taxes payable in 2024.

We used gross operating revenues ending December 31, 2022, and applied the allocation factor from the company's 2023 valuation to get allocated gross revenues.

For railroads, we reduced the Minnesota Apportionable Value by the estimated market values for buildings.

For electric cooperatives paying a per member tax, we further reduced the gross operating revenues by a factor for their distribution lines located outside city limits. We estimated this factor by taking the cooperative's distribution lines located within city limits, divided by the total distribution lines.

We calculated a rate by taking the 2024 tax estimate, divided by allocated gross operating revenues. This is the rate specific to each company that would result in approximately the same tax when using gross operating revenues as the taxation method. This rate varied for each company and cooperative.

Example Rate Calculation for Company A

Gross Operating Revenues on December 31, 2023	\$25,000,000
Allocation Factor for 2023 Assessment Year	0.25
Allocated Gross Operating Revenues	$\$25,000,000 \times 0.25 = \$6,250,000$
Minnesota Apportionable Value for 2023 Assessment Year	\$21,000,000
Estimated Taxes Payable in 2024	$\$21,000,000 \times 0.03 = \$630,000$
Estimated Rate to Apply to Gross Operating Revenues	$\$630,000 / \$6,250,000 = 0.10$

Companies' Percent Change in Tax

After calculating the rate for each company, we evaluated each market segment separately to identify trends in the rates. We applied the rates specific to each market segment as well as to a tiered level of gross operating revenues within each segment. We made two analyses to estimate the rates to ensure companies do not have an estimated tax increase greater than 10% and 5%, respectively.

Revenue is not advocating for specific rates in the analyses but is identifying rates to complete our analyses of tax impact if certain rates are selected.

Analysis 1

The rates in analysis 1 were estimated to keep each company's tax increase below 10%.

We estimate:

- 12 companies would have a tax increase between 5.3% and 9.4%.
- 50 companies would have a tax decrease greater than 10%.

The overall tax paid by utility, pipeline and railroad companies would be reduced by approximately \$13.7 million.

Figure 1 shows the estimated percent change in tax for the 75 companies we analyzed. Twenty companies would see an increase in tax, according to this estimate.

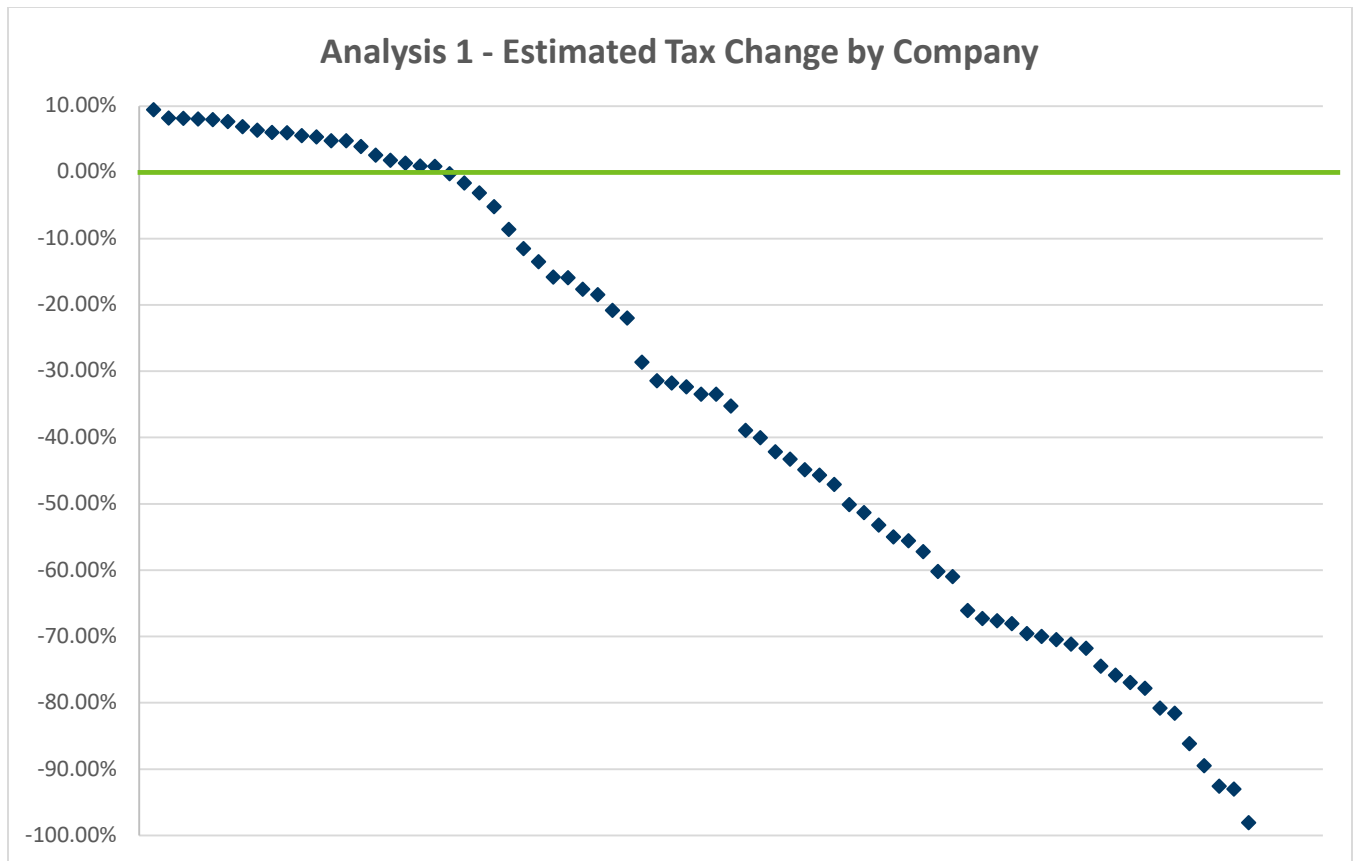


Figure 1: When rates are estimated to keep each company’s tax increase below 10%, 20 out of 75 companies analyzed would see an increase in tax.

Analysis 2

The rates in analysis 2 were estimated to keep each company’s tax increase below 5%.

We estimate:

- 12 companies would have a tax increase between 2.59% and 4.90%.
- 51 companies would have a tax decrease greater than 10%.

The overall tax paid by utility, pipeline and railroad companies would be reduced by approximately \$32.8 million.

Figure 2 shows the estimated percent change in tax for the companies we analyzed. Eighteen companies would see an increase in tax, according to this estimate.

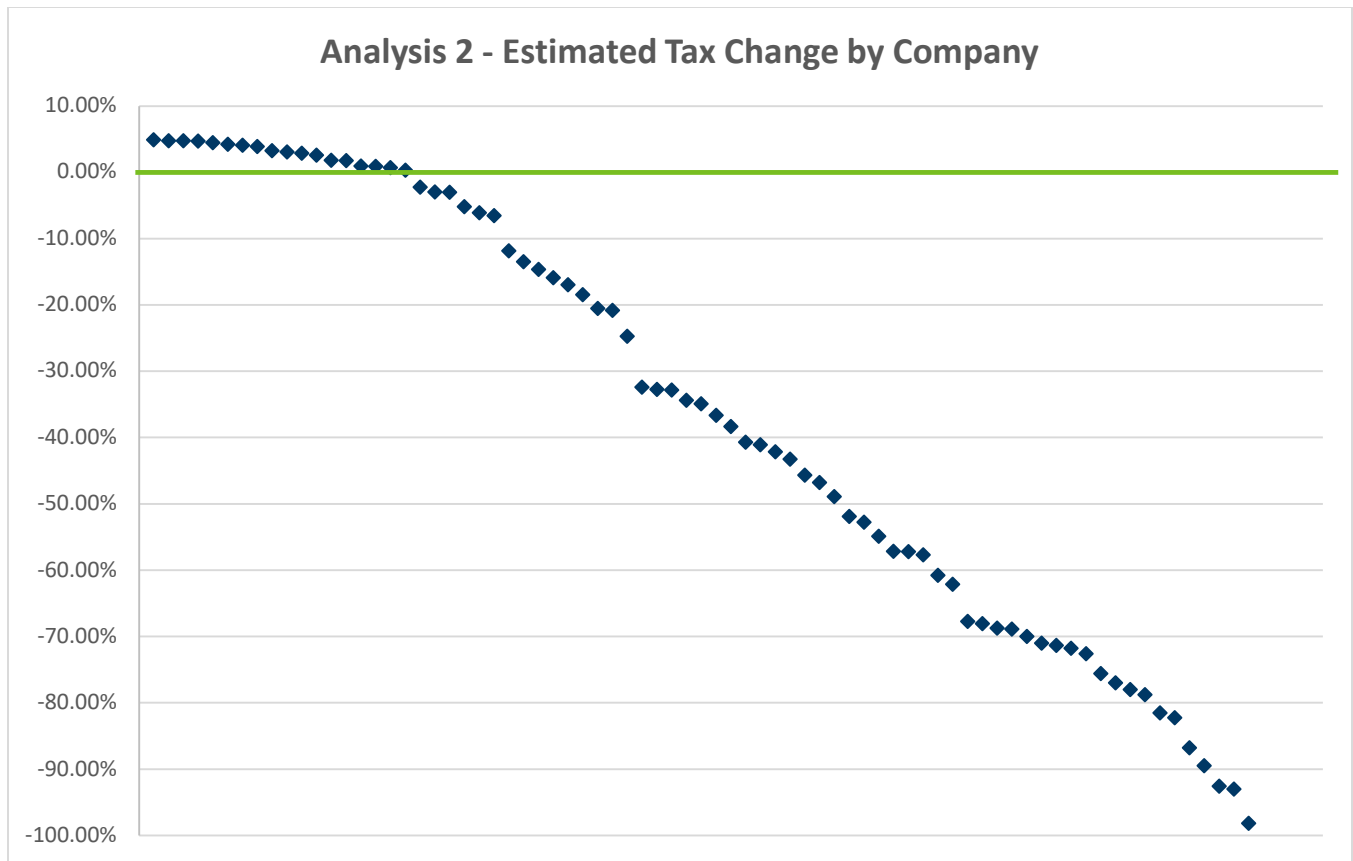


Figure 2: When rates are estimated to keep each company’s tax increase below 5%, 18 out of 75 companies analyzed would see an increase in tax.

Unavailable Data

We did not have the data to reduce gross operating revenues for companies that pay Solar or Wind Energy Production Taxes. The gross operating revenues of those companies include revenues generated from wind or solar energy conversion systems. The result is a lower estimated rate than if we had the data to reduce revenues.

For several companies and cooperatives, we do not collect gross operating revenue data, allocation data, or percentage of property outside city limits. We were not able to estimate a rate or the impact of this option to those companies and cooperatives.

We are working to collect this data from those companies to help us analyze the data better. As we collect additional data, we will continue to adjust the rates in analyses 1 and 2 to ensure companies do not have an estimated tax increase greater than 10% or 5%.

For electric cooperatives, a better estimation of the factor to reduce gross operating revenues for property in rural areas is the cooperative’s total operating property outside of city limits, divided by the cooperative's total operating property. However, we used the information we had available: the distribution lines within cities and

the total distribution lines. We do not have enough data to estimate if this resulted in a higher or lower rate to apply to gross operating revenues.

How Did We Get Here?

A 2021 law directed the Department of Revenue to review the process and rules for valuations of utility and pipeline operating property. Revenue values this property under Minnesota Rules, Chapter 8100. We certify the values to counties, which calculate, bill, and collect property taxes.

As part of this review, we held a series of public meetings to gather feedback. These listening sessions and workgroup discussions included local government officials, representatives of utility and pipeline companies—including lobbyists and attorneys—state regulators, and other stakeholders.

Even though the stakeholder engagement and review focused on utility and pipeline operating property, much of the local jurisdiction feedback is applicable to railroad operating property as well. However, we did not engage railroad companies as part of the review directed by the 2021 law.

Stakeholders shared things they like and dislike about the valuation process, and they were asked to rate the relative importance of core tax principles in relation to that process. They ranked the principles as follows:

1. Stability
2. Transparency
3. Efficiency
4. Responsiveness
5. Competitiveness

Stakeholders ranked stability and transparency as the two most important principles for the valuation process.

We heard concerns of stability, litigation, timeline, administrative appeal process, and complexity.

Considering this feedback, we began exploring options to replace property tax on utility, pipeline, and railroad operating property with an objective, simple, and predictable tax.

In the levy-based system, each property owner pays its share of the levy based on the property's market value. It would be unfair if utility, pipeline, and railroad operating property were paying a portion of the levy but not use a market value calculation for determining the share. Moving to an alternative tax, similar to the Solar and Wind Energy Production Taxes, is a way to remain fair to other properties that pay their share of the levy.

We considered applying a method similar to the Solar and Wind Energy Production Taxes. However, not all properties we value produce something measurable. We considered looking at miles of distribution, transmission, pipeline, and railroad, combined with number of meters, amount of throughput, voltage rating of substations, etc. This became very complicated, and we are focused on creating a simple tax calculation that is easy to understand.

As a result, we consider a gross operating revenues tax to be simple, predictable, and stable—one that could replace property tax on utility, pipeline, and railroad operating property.

Provide Feedback

Email your comments to sa.property@state.mn.us. Include your name and, if applicable, your employer.

Public comments are voluntary and will help us make improvements to this project. We will review public comments and may discuss or reference the comments at future public meetings.

Please visit our website at <https://www.revenue.state.mn.us/idea-gross-operating-revenues-tax> to learn about how to join one of our feedback sessions.

Contact

If you have questions, email us at sa.property@state.mn.us.