Gross Operating Revenues Tax Idea – Second Consolidated Responses to Written Feedback

The Minnesota Department of Revenue introduced a preliminary idea to remove utility, pipeline, and railroad operating property from property tax and replace it with a gross operating revenues tax. For more information about our idea, please visit the Idea for a Gross Operating Revenues Tax page on our website.

As part of this idea, the department collected feedback. We initially collected feedback to help inform the first round of public meetings. During this phase of analyzing the idea, we received feedback from over 60 people and organizations. We published our consolidated responses to written feedback on August 23, 2024. Our responses focused on feedback we received through June 4, 2024.

This response document focuses on feedback we received from June 4, 2024, through December 31, 2024. Some comments we received during this time were addressed during the second round of listening sessions, which is summarized in this document.

We continue to collect feedback and will provide consolidated responses periodically.

Improvements to Current System

"The department's Cap Rates are often out of step with economic and industry circumstances…. [and] seemingly arbitrary changes in industry cap rate from one year to the next."

The department completes a thorough analysis of the capitalization rates to apply in the valuations each year. We accept comments from parties before finalizing the capitalization rates to consider disagreements that taxpayers may have with the rates. The capitalization rates used in the valuation are often contested by taxpayers as a small adjustment in the rates can result in a large difference in the taxable value of the operating property. The decisions made in determining the capitalization rates are subjective. As such, there is room for people to reasonably disagree on the appropriate rate. The department generally publishes new models at least a year in advance before placing weight on a new model to allow time for those interested to provide comments.

"The department's valuation analyses ignore information presented by utilities that might support an external obsolescence determination… [and] does not give any consideration to the valuation that the parties agreed upon for the previous year."

The department completes valuations each year on a stand-alone basis. Market values change over time. Each year, we complete the valuations of utility, pipeline, and railroad operating property independent of previous settlement agreements. The Rules providing the framework for valuations of these properties is straightforward when following the Rule without adjustments. Allowing deviations from the "default" Rule to align with last year's settled value would increase uncertainty around the valuations. It would increase complexities to the initial valuation about where and how far we should deviate. Rather, the department completes the valuations following the Rule and then may reach a binding settlement during the administrative appeals process, if in the best interest of the state. We consider information provided by the taxpayers with their financial filings as well as any information submitted as part of an administrative appeal request.

"If the idea were simply to make the state's valuation of utility property based on that property's ability to generate revenue (as indicated by EBITDA [earnings before interest, taxes, depreciation] or NOI [net operating income] or whatever metric is appropriate), and then provide the valuation to counties for application of the property tax rate established by locally-elected leadership (as is down now), I would be in favor."

"We believe property taxes … should be grounded in physical assets. We are concerned that moving to a revenue driven methodology will shift a greater share of the property tax burden to rural electric cooperatives."

"Establish baselines for utilities and readjust when events like new machinery or decommissioner occur, otherwise just trend to a county or state tax rate based on market growth for each year."

When the department completes valuations of utility, pipeline, and railroad operating property, we generally use a cost approach, which is the depreciated cost of the assets, and an income approach, which is the earning ability of the assets. We have heard from some that favor more reliance on the cost indicator and others that favor more reliance on the income indicator.

There is also another subset of companies that may qualify to be valued at a specific calculation using the original cost of the operating property less 2.5% depreciation each year.

As an update to the current system, the department understands the suggestion to use a more formulaic approach to valuation when determining the market value of operating property. Setting the market value and adjusting for additional plant or retirements and adjusting for market growth is another idea. Using a proxy for market value with a subjective calculation is another idea that would require statute changes. Other ideas are a property-based calculation, such as miles of transmission line or number of meters, to calculate a tax. We are not opposed to anyone exploring these ideas.

Updated Timeline for Current System

"Another problem in the current implementation of the system has to do with the various statutory deadlines by which steps in the valuation and allocation process have to be completed."

"A very intriguing proposal was floated that was intended to address these concerns: the timeline for assessing utility property would be offset by a year."

The idea of a "lag" year would result in the valuations for utility, pipeline, and railroad operating property being one assessment year behind other properties.

This would allow for the timelines to fit better into stakeholders' schedules on each end of the valuation timeline. We've heard from companies that the deadline of March 31 for reporting financial information to the department is before their financials are ready. For local governments, we've heard the deadline for the department to certify the final utility and pipeline values is after local governments have already had to make budgeting decisions.

However, we've also heard concerns about equity from stakeholders with this approach. Taxpayers pay their share of the levy in the taxing jurisdiction based on their market value and class rate. If the market value is set at a different date for certain properties, it could mean they pay more or less than their share of the levy had the market values been set at the same date.

Limited Information

"The limited information the department has provided to date provokes many more concerns than it addresses and more questions than it answers."

"Information provided surrounding this topic does not address the potential negative impacts to local jurisdictions and does not provide any certainty as to the potential significant tax burden shifts that may occur."

The department continues to publish additional information on our website, including summary information which analyses the potential dollar impact of this idea using hypothetical rates and a lookback of summary information going back to the 2019 assessment year.

The summary information and the lookback of summary information show significant shifts for some local jurisdictions, even though the statewide change is small. We are reviewing an entirely new way to tax certain properties. It is difficult to eliminate shifts, but the department would recommend an aid to help local jurisdictions that do experience negative shifts.

Other States' Taxation Methodologies

"We would like to suggest a review of how North Dakota calculates a transmission line tax and a generation tax in lieu of property tax and the ease of filing in that state."

Centrally assessed public utilities are investor-owned power, gas, and pipeline companies. The taxable value of a utility's North Dakota real and personal operating property is subject to the mill levies of the taxing districts in which the property is located. Assessments for property tax purposes of railroads, investor-owned utilities, and airlines are determined by the State Board of Equalization. The assessed value of centrally assessed property is 50% of the true and full value.

Taxes Paid in Lieu of Property Taxes for Rural Electric Cooperatives

The property of rural electric cooperatives is subject to generation, distribution, and transmission taxes under N.D.C.C. Ch. 57-33.2. Other companies engaged in electric generation, distribution, and transmission may file an irrevocable election to be taxed under N.D.C.C. Ch. 57-33.2.

Resources:

- North Dakota Office of State Tax Commissioner: Centrally Assessed Property
- North Dakota Office of State Tax Commissioner: Property Tax
- Chapter 57-06 Assessment and Taxation of Public Utilities

N.D.C.C. Ch. 57-33.2:

In North Dakota, transmission lines are subject to an annual tax per mile or fraction of a mile based on their nominal operating voltages on January first of each year. Transmission lines placed in service after January 1, 2009, and before December 31, 2013, are exempt from the tax for the first taxable year after the line was initially placed in service and the transmission line tax is reduced by 75% for the second taxable year, 50% for the third taxable year, and no reduction after the fourth taxable year. Transmission lines 230kV or greater and placed in service after January 1, 2009, are also allowed a reduced tax for the first three years.

In North Dakota, an electric distribution company is subject to a tax equal to $0.80 per megawatt-hour for retail sale of electricity delivered to a customer in North Dakota during the calendar year. This tax does not apply to the sale of electricity to any coal conversion facility that became operational before January 1, 2009, and is subject to tax under chapter 57-60.

In North Dakota, electric generation facilities, not including coal conversion facilities, are subject to a tax based on the rated capacity of the generation unit and the electricity generated during the year.

The revenue from these taxes is allocated to the county and the taxing districts in which the property is located. The county auditor is required to provide each company subject to tax an accurate map of the county showing the boundaries of each taxing district within the county. By April 15 of each year, each company is required to file with the county auditor of each county, the length and nominal operating voltage of its transmission and distribution line within each taxing district in the county.

Other States' Methodologies

You can also read more about valuation framework used by other states in our Review of Minnesota Rules report.

Administrative Costs

"The complicated and subjective portion of the appraisal is eliminated, and the administrative and internal costs are minimized."

"The proposed tax calculation is simplified; however, we still need all the underlying details we provide today to use in the proposed calculation. The administrative burden doesn't disappear."

We see the Idea as being a simpler return with much less data collected by the department.

If we transition to this new taxing mechanism, the companies would still be required to report their property records report, detailing their original cost of operating property within each taxing jurisdiction. However, the companies would no longer have to differentiate between property types. In addition, we would like to see implementation of a statewide GIS that collects the unique taxing area boundaries and allows for easier administration for the companies to identify how much of their property is within each taxing jurisdiction. As required in North Dakota, counties provide the companies with the taxing jurisdiction boundaries for the companies to accurately report the location of their property.

For the market value report, the companies would no longer have to report detailed plant or income information or excludable property information. The companies would be required to report allocation statistics and the gross operating revenues for the current year.

Tax Calculation

"We can properly accrue what we owe as our revenue is earned with no adjustments or material issues. We can properly book the tax in the year the revenue Is earned with only small adjustment for the tax rate."

Our goal is to create a tax that is easy to calculate, estimate, and budget for.

We Continue to Collect Feedback

You can continue to send feedback to State Assessed Property, and we will periodically give consolidated responses.

Likewise, we encourage you to explore any ideas you have for improvements to the current system or for a new system to achieve the goals of predictability, stability, and transparency.