Legislative Analysis

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NONFERROUS METALLIC MINERALS
EXTRACTION SEVERANCE TAX

House Bills 6007-6012 (Substitutes H-1)
Sponsor: Rep. Matt Huuki
Committee: Tax Policy

Complete to 11-28-12

A SUMMARY OF HOUSE BILLS 6007-6012 AS REPORTED FROM COMMITTEE

House Bill 6008 would create the Nonferrous Metallic Minerals Extraction Severance Tax Act. Under that new act, ultimately, there would be a 2.75% severance tax levied on the value of certain minerals extracted from the earth in the state or "beneficiated" in the state. (The tax is described in more detail later.)

The term "beneficiation" refers to processes necessary to prepare nonferrous metallic mineral ore for sale or transfer, including milling, processing, grinding, separating, concentrating, and pelletizing.

Generally speaking, a taxpayer subject to the mineral severance tax would be exempt from taxes levied under the General Property Tax Act, the state Income Tax Act, the General Sales Tax Act, and the Use Tax Act.

Revenue from that tax would be distributed 65% to local units of government and 35% to a newly created Rural Development Fund for programs that promote the sustainability of land-based industries and support infrastructure in rural communities.

House Bill 6009 would create the Rural Development Fund Act. The Department of Agriculture and Rural Development would determine which projects are to be funded, with the advice of and based on criteria developed by a five-member board that would include the department director and four members appointed by the Governor with the advice and consent of the State Senate. Two members would be residents of the Upper Peninsula and two would be residents of the Lower Peninsula, and no more than two members could be from the same political party. (See Fiscal Impact for a more detailed explanation of this Fund.)

House Bill 6007 would amend the General Property Tax Act to specify that any mineral-producing property subject to the new severance tax would be exempt from the collection of taxes under the property tax act. It also provides that as of December 31, 2012, any mineral located at an open mine is exempt from property taxes. This would not apply to the surface property, surface improvements, or personal property at the open mine.

House Bill 6010 would amend the General Sales Tax Act to exclude the sale of tangible personal property to a qualified taxpayer for use at a producing mine or at a facility where

beneficiation of minerals occurs. House Bill 6011 would provide the same exemption in the Use Tax Act. The exemptions apply only to the extent that the property is used for the specified exempt purposes and is limited to the percentage of exempt use to total use as determined following a formula or method devised by the Department of Treasury.

House Bill 6012 would exempt the Income Tax Act to allow a taxpayer to deduct from taxable income any income derived from a producing mine and/or beneficiation of minerals, beginning in the 2013 tax year.

A more detailed explanation follows.

House Bill 6008: Nonferrous Metallic Minerals Extraction Severance Tax Act

The tax rate and base

The new severance tax would be levied on taxable minerals. The rate would be 2.75% of the taxable mineral value for the immediately preceding calendar year.

The term "taxable minerals" refers to the first marketable mineral or mineral product sold or transferred by the taxpayer that is taxable under the act. The term also includes a mineral that has been sold or transferred by a taxpayer following beneficiation in this state and a mineral that is otherwise taxable under the act.

The term "mineral" means a naturally occurring solid substance that can be extracted from the earth in this state primarily for its nonferrous metallic mineral content for commercial, industrial, or construction purposes. The term does not include low-grade iron ore defined and taxed under 1951 PA 77 or any property defined and taxed under 1963 PA 68. (Although "nonferrous" is not defined, it usually refers to metals not composed of or containing iron.)

Taxable mineral value refers to gross mineral value less deductible costs. Gross mineral value is the total value received by a taxpayer for the sale or transfer of taxable minerals, whether or not in a beneficiated state, including premiums, bonuses, subsidies, or noncash considerations, with no deductions.

Deductible costs would refer to costs that could be deducted in the first three years a taxpayer was subject to the severance tax for environmental obligations assumed by, or actual costs incurred by, the taxpayer that would otherwise be incurred by the state or a local governmental unit in order to comply with state or federal environmental laws or regulations, up to 40% of the amount of the minerals severance tax levied in that year.

The deduction would be limited to the obligations assumed or actual costs incurred by the taxpayer in the three years immediately preceding the year that the producing mine became subject to the tax. The amount of obligations or actual costs incurred that exceed the allowable deduction could be carried forward only for the first and second year in which a producing mine was subject to the tax.

For taxable minerals that are to be shipped or transported outside the state for beneficiation outside the state, the gross mineral value would have to reflect the total

value of the minerals immediately prior to the shipment or removal based on the average daily price of the mineral as quoted in published market indices in accordance with rules of the Department of Treasury (referred to as Treasury).

Taxpayer-to-taxpayer sales

If a taxpayer sells the minerals to another taxpayer, the seller would have to add to the sales price, or to the value of the consideration with respect to a transfer, the mineral severance tax the seller paid under the act and itemize the tax paid on the invoice. A taxpayer that purchased taxable minerals from another taxpayer could claim a credit against the tax for the severance tax paid by the seller that was itemized on the invoice.

Taxpayer report to Treasury and local units

Each year a taxpayer would submit a report to Treasury and local tax collecting unit showing (1) total amount of minerals sold, transferred, or beneficiated during the preceding year; (2) the taxable mineral value of the minerals sold, transferred, or beneficiated; (3) a schedule of all deductible costs; and (4) any other information Treasury requires to valuation purposes and to substantiate a taxpayer's deductible costs.

When severance tax begins

Treasury is required to determine when property is to be classified as mineral-producing property and must notify all local assessing authorities of property so classified.

Mineral-producing property would be subject to the severance tax beginning January 1, the calendar year immediately following the year in which the property is determined to be mineral-producing property by Treasury.

"Mineral-producing property" refers to real and personal property in Michigan that is part of a producing mine or used directly in association with a producing mine on a parcel on which the shaft, incline, or adit (an almost horizontal entrance) is located, or a contiguous parcel. Mineral-producing property also includes, among other things, mineral rights; leases, options, and mining rights; mineral stockpiles and inventories; buildings, improvements, fixtures, and nonmobile equipment located on, beneath, or appurtenant to a mine; and property owned primarily used by the taxpayer in the transportation of minerals from a producing mine to the point where beneficiation activities begin; and property used for beneficiation of extracted minerals if the person who owns or controls the property is a taxpayer.

The term does not include real and personal property used for transportation of minerals between locations unless specifically cited in act.

First year of severance tax

In the first year that a minerals severance tax is levied on a taxpayer, the tax for that year would be equal to the greater of the following, less the amount of the partial minerals severance tax paid by the taxpayer: (1) the minerals severance tax; or (2) the amount of general ad valorem property tax that was levied on the mineral-producing property in the immediately preceding year.

A taxpayer would pay the minerals severance tax to the local tax collecting unit on or before February 15 beginning in the calendar year immediately following the second year in which Treasury declares the property to be mineral-producing property.

Partial mineral severance tax
In the first calendar year immediately following the year Treasury classifies the property, the taxpayer would have to pay by July 15 a partial mineral severance tax equal to the summer levy of the ad valorem taxes levied on that property in the immediately preceding calendar year under the General Property Tax Act.

Property tax exemption
Beginning December 31, 2012, minerals located at an open mine are exempt from property taxes.

Interim minerals severance tax
Beginning January 1, 2013 and through December 31 in a year in which Treasury declares property at that open mine to be mineral-producing property, an interim minerals severance tax is levied on all minerals that were valued by the State Geologist for open mines opened beginning January 1, 2011, through June 30, 2013.

The interim minerals tax would be equal to 50% of the general ad valorem taxes levied on that open mine in 2012 attributable to those minerals valued by the State Geologist for 2012. The interim tax would be in addition to any general ad valorem taxes levied on the mine's surface property, surface improvements, and personal property.

The interim tax would be paid in two installments, 50% when the summer levy is due and 50% when the winter levy is due. Sums collected under interim tax would be distributed by the local tax collecting unit to school districts, the state, and local governmental units in the same proportion as property taxes are distributed.

Credit for producing mine beginning operations in 2014 or 2015
If a producing mine began operation in 2014 or 2015, then for the first five years that the mine was subject to the severance tax, the taxpayer could claim a credit of not more than 20% of the amount of the ad valorem property tax levied on the open mine in 2012 attributable to those minerals valued by the State Geologist under the General Property Tax Act in 2012, plus the amount of the interim minerals severance tax paid for each year through the end of the year in which Treasury determined the property to be mineral-producing property, plus interest. However, a taxpayer that was delinquent on any ad valorem taxes on the producing mine would not be eligible to claim this credit.

When property is no longer mineral-producing
If the Treasury determines that property is no longer mineral-producing property, it must notify the taxpayer and the local assessing authorities, and the property will become subject to the General Property Tax Act.

A taxpayer that ceases operation of a producing mine for 30 or more consecutive days would have to notify the department in writing within seven business days of ceasing operations.

Taxpayer records/Department report
Each taxpayer would have to prepare, keep, and preserve a complete and full record for each tax year of all minerals extracted from the earth or beneficiated in the state, and that record would be open at all times to the inspection of the Department of Treasury. Annually the department would have to publish the value of all minerals reported.

Distribution of revenue
The Department of Treasury would have to allocate the mineral severance tax and determine all deductible costs against the property, and the local tax collecting unit would collect the tax (and collection charges). Property listed and taxed under the act would be subject to the return and sale for nonpayment of taxes in the same manner, at the same time, and under the same penalties as property under the General Property Tax Act.

If property was located in more than one tax-collecting unit, the Treasury (or a person designated by the Treasury) would determine the portion attributable to each unit.

The tax would be distributed as follows: (1) 65% by the local tax collecting unit to school districts, the state, and local units, in the same proportion as property taxes are distributed; and 35% to Treasury for deposit into the Rural Development Fund.

If a local unit failed to make a required distribution or remittance, the Treasury would deduct an equivalent amount from revenue sharing revenues and distribute those revenues to the entities entitled to receive a distribution.

The Treasury, in determining distributions, would have to modify distributions so all minerals severance tax revenue lost due to the deduction of deductible costs would not reduce the distributions to local units. The department would also have to modify distributions so that revenue lost due to the credit provided to mines beginning operations in 2014 and 2015 would not reduce distributions to the Rural Development Fund.

Act administration
The specific taxes would be administered by the Department of Treasury under the Revenue Act and the Nonferrous Metallic Minerals Extraction Severance Tax Act; when the two acts conflict, the severance tax act would control. The department could promulgate rules to implement the act.

Upon an action being filed under the direction of the Attorney General in Ingham County Circuit Court, the court would have the power to restrain by injunction any taxpayer or person that had failed to comply with the act and to restrain any taxpayer or person from continuing to extract minerals while delinquent in the filing of any report, or the paying of any tax, penalty, or cost required under the act.

House Bill 6009: Rural Development Fund Act

House Bill 6009 would establish a new state-restricted fund, the Rural Development Fund, within the state Treasury. The State Treasurer would be empowered to receive money for deposit into the fund from any source including but not limited to state or federal appropriations, transfers, or grants; gifts bequests, or donations; and funds

generated from the nonferrous metallic minerals extraction severance tax that would be created under House Bill 6008. It is understood that the primary source of revenue to the fund would be an earmark of a portion of nonferrous metallic minerals extraction severance tax revenue.

The bill would give to the State Treasurer the authority to invest money in the fund; related interest and investment earnings would be credited to the fund. Money in the fund would remain in the fund at the end of each fiscal year and not lapse to the state General Fund.

The Michigan Department of Agriculture and Rural Development would be the administrator of the fund and would be required to prepare an annual report of fund revenues and expenditures, as well as a report on the status of projects funded by the Rural Development Fund. The department would also be required to report on the criteria used by the department for the allocation of funds.

The bill would establish allowable uses for the fund. Money in the fund could be expended, upon appropriation, for grants, loans, and loan guarantees to fund projects meeting established criteria. However, money from the fund could not be spent for projects that include telecommunication facilities owned and operated by a local unit of government, an educational institution, or any other governmental entity.

Money in the fund could also be used for administrative expenses of the Michigan Department of Agriculture and Rural Development. In addition, up to $250,000 of fund revenue could, each state fiscal year, be transferred to the Nonferrous Metallic Mineral Surveillance Fund created in Section 63217 of 1994 PA 451, the Natural Resources and Environmental Protection Act. [This fund was established in amendatory act 2004 PA 449. For additional information on this fund, see the House Fiscal Agency Analysis of Enrolled House Bill 6243 of the 2003-2004 Legislative Session.]

The bill also provides a process for developing specific criteria in selecting projects for funding, and a process for selecting specific projects. The bill would establish a new Rural Development Fund Board and directs the board to develop criteria for evaluating project proposals for funding from the Rural Development Fund. The bill indicates that the criteria should give preference for projects in the region in which nonferrous metallic minerals extraction severance tax revenue is generated and which "address the expansion and sustainability of land-based industries, worker training related to land-based industries, and energy, transportation, communications, water, and wastewater infrastructures to benefit rural communities." The bill also directs the board to review the criteria annually and to update as necessary.

("Land-based industries" refers to food and agriculture, forestry, mining, oil and gas production, and tourism.)

The bill directs the department to solicit project proposals for funding from the Rural Development Fund from "individuals, organizations, businesses, local units of government, federally recognized tribes, and educational institutions." The bill also

directs the department, with the advice of the board, to determine which projects should be selected for funding based on the criteria established by the board.

The bill also directs the department to provide the board with personnel sufficient to perform the board's powers, duties, and functions under law.

FISCAL IMPACT:

State and Local Revenue

The fiscal impact of these bills depends predominately on the value of certain nonferrous minerals extracted or beneficiated in the state, which would be the tax base of the new 2.75% severance tax, and the state and local taxes paid under current law by these mining entities. Under these bills, the mining entities would be exempt from property taxes, sales and use taxes to the extent the purchases are used at mining or beneficiating facilities, and from the state income tax.

Reportedly, over the estimated life (7 to 10 years) of the Kennecott mine (not including other mines), these bills would increase state revenue by an estimated $21 million and local revenue by an estimated $13 million. The data and assumptions behind these figures have not been independently reviewed by House Fiscal Agency.

Rural Development Fund

House Bill 6009 could increase state costs to the extent that it establishes new activities and program responsibilities for the Michigan Department of Agriculture and Rural Development. However, it is likely that much or all of this additional work could be supported by existing department resources. The FY 2012-13 state appropriations act (Article I of 2012 PA 200) includes funding for 10.0 FTE positions in the department's Agricultural development line item, a line item that supports the department's rural development initiatives.

The bill could also increase local revenue to the extent that it would create a new grant program available to local units of government. The bill would create a new fund source, the Rural Development Fund, which could be used to fund local infrastructure projects that would otherwise be funded from other local revenue sources, or not constructed at all.

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■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.