

## COAL SEVERANCE TAX

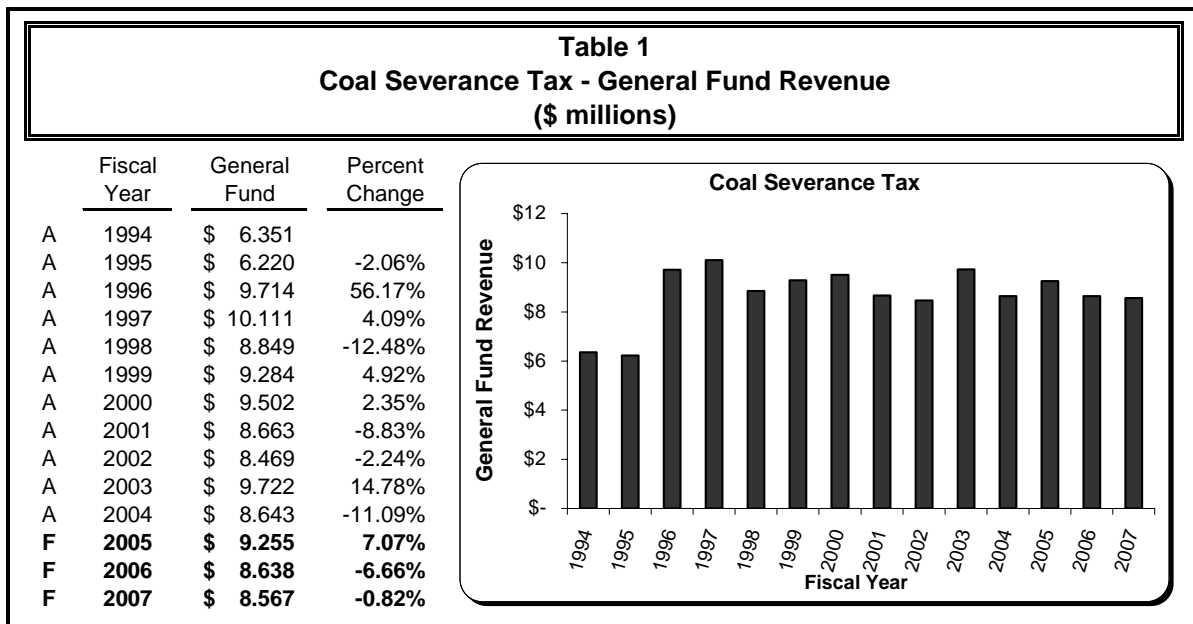
### Revenue Description

Coal mines in Montana pay a severance tax based on the value of coal produced (15-35-103, MCA). The tax rate on coal from surface mines is 10% if the heat content is less than 7,000 British thermal units (Btu) per pound and 15% if the heat content is at least 7,000 Btu per pound. The tax rates for coal from underground mines are 3% for coal with less than 7,000 Btu per pound and 4% for coal with more than 7,000 Btu per pound. Each producer is exempt from tax on 20,000 tons per year, and mines producing less than 50,000 tons per year are exempt from the tax. The first two million tons of coal used as feedstock in a coal enhancement facility is exempt from the tax.

Coal severance taxes are distributed to several accounts. In FY 2000 through FY 2002, the general fund received 26.79% of coal severance tax revenues. HB 10 and HB 18 passed by the 2002 special session temporarily increased the general fund allocation to 33.04% for FY 2003 and set it at 27.4% beginning in FY 2004.

### Historical and Projected Revenue

Table 1 shows actual coal severance tax general fund collections through FY 2004 and projected collections for FY 2005 through FY 2007.



The general fund figure for FY 2004 in the table is a SABHRS number that underestimates actual general fund revenue from the coal severance tax by about \$740,000. This is due to under estimating the fourth quarter coal tax, which is accrued

at fiscal year end by \$2.7 million ( $\$2.7 \times 27.4\% = \$740,000$ ). Thus, the projected change from FY 2004 to FY 2005 is a 1.3% decrease rather than the 7.1% increase indicated in Table 1. Coal severance tax general fund collections are projected to decrease 6.7% in FY 2006 and 0.8% in FY 2007. This decrease is primarily due to projected decreases in the price for coal.

### Forecast Methodology and Projection Calculation

There are five steps to estimating general fund revenue from the coal severance tax: 1) estimating production; 2) estimating prices; 3) determining taxable value; 4) calculating total tax collections; and 5) allocating tax collections to the various funds.

#### Coal Production

In the fall of 2004, the budget office surveyed coal producers in Montana about their expectations of production through 2007. Results of this survey and recent news reports were used to forecast production. At this time, there is considerable uncertainty about coal production. Several long-term contracts have recently expired. Because of this, one mine has closed and another has reduced its output. At the same time, one existing mine is expanding production, and a new mine has started production on a small scale with plans for expansion. This forecast assumes that new customers will not be found to replace the contracts that have been lost and that the new mine will not have significant production until after FY 2007.

Taxable production is total production minus exemptions. Each producer is allowed to deduct 20,000 tons from total production per calendar year. If a mine produces less than 50,000 tons, all of this production is exempt. In addition to this exemption, producers are allowed to deduct up to two million tons of coal produced as feedstock for coal enhancement facilities. Table 2 shows coal production, exemptions, and taxable production.

Production decreased steadily through FY 2003, then increased about 1.6 million tons in FY 2004, and is forecast to be above 32.1 million tons a year through FY 2007. The five producers each are expected to exempt 20,000 tons. Feedstock exemptions are forecast to be zero.

<b>Table 2</b>				
<b>Calculation of Taxable Coal Production</b>				
<b>(million tons)</b>				
<b>Fiscal Year</b>	<b>Total Production</b>	<b>20,000 T/mine Exemption</b>	<b>Feedstock Use Exemption</b>	<b>Taxable Production</b>
A 1998	35.860	- 0.100	- 0.259	= 35.501
A 1999	35.191	- 0.100	- 0.116	= 34.975
A 2000	35.257	- 0.100	- 1.482	= 33.675
A 2001	32.733	- 0.073	- 0.342	= 32.318
A 2002	33.259	- 0.110	- 0.000	= 33.149
A 2003	30.346	- 0.100	- 0.000	= 30.246
A 2004	31.927	- 0.093	- 0.000	= 31.834
<b>F 2005</b>	<b>33.013</b>	- <b>0.100</b>	- <b>0.000</b>	= <b>32.913</b>
<b>F 2006</b>	<b>32.215</b>	- <b>0.100</b>	- <b>0.000</b>	= <b>32.115</b>
<b>F 2007</b>	<b>32.758</b>	- <b>0.100</b>	- <b>0.000</b>	= <b>32.658</b>

## Coal Price and Taxable Value

The contract sales price excludes taxes and state, federal, and Indian royalties of more than 15 cents per ton. From 1996 through 2004, the average contract sales price of Montana coal has moved in the same direction as the national average price, but has shown larger relative movements.

Future contract sales prices for each company were estimated by applying Global Insight's forecast of annual percentage changes in the national average coal price to each company's actual contract sales price for the last quarter. The average contract sales price is projected to decrease in FY 2005 and again in FY 2006 primarily because the expiring long-term contracts had higher prices than contracts that will continue through the period.

Taxable value is the product of taxable production and contract sales price. Table 3 shows taxable production, average contract sales price, and the taxable value of coal production.

The average contract sales price is decreases in all three years of the forecast. Taxable production is forecast to increase in FY 2005, decrease in FY 2006, then increase in FY 2007 due to the timing of when some mines' production declines and other mines' production increases.

Fiscal Year	Taxable Production (million tons)	x	Average Contract Sales Price (\$/ton)	=	Taxable Value (\$ millions)	Percent Change
A 1998	35.501	x	\$6.776	=	\$240.554	
A 1999	34.975	x	\$5.995	=	\$209.692	-12.83%
A 2000	33.675	x	\$6.723	=	\$226.388	7.96%
A 2001	32.318	x	\$6.231	=	\$201.362	-11.05%
A 2002	33.149	x	\$6.380	=	\$211.487	5.03%
A 2003	30.246	x	\$6.596	=	\$199.490	-5.67%
A 2004	31.834	x	\$7.218	=	\$229.792	15.19%
<b>F 2005</b>	<b>32.913</b>	x	<b>\$6.922</b>	=	<b>\$227.842</b>	-0.85%
<b>F 2006</b>	<b>32.115</b>	x	<b>\$6.628</b>	=	<b>\$212.868</b>	-6.57%
<b>F 2007</b>	<b>32.658</b>	x	<b>\$6.466</b>	=	<b>\$211.161</b>	-0.80%

## Calculating Coal Severance Tax Collections

Most coal production is taxed at 15%, but about 1% is low energy-content coal, which is taxed at 10%. Underground coal production is taxed at 4% of taxable value. Underground production is expected to be a minor component of production in FY 2005, FY 2006, and FY 2007. The overall coal tax rate is projected to be 14.82% in FY 2005, and 14.81% in both FY 2006 and FY 2007. The forecast assumes that collections will equal liability in future years. Collections recorded on the state accounting system for a single year may be higher or lower than tax liability for that fiscal year because an estimate of taxes due for the last quarter is accrued at fiscal year end. However, collections and liability balance over a longer time span.

The coal severance tax is forecast by multiplying taxable value by the severance tax rate, as shown in Table 4.

The second column of the table shows total taxable value. The third column shows the average tax rate. The fourth column shows coal severance tax liability. The last column shows annual change in tax liability.

<b>Table 4</b>					
<b>Coal Severance Tax Liability</b>					
<b>(\$ millions)</b>					
Fiscal Year	Taxable Value	Average Tax Rate	Tax Liability	Percent Change	
A 1998	\$240.554	x 14.96%	= \$35.976		
A 1999	\$209.692	x 14.94%	= \$31.328	-12.92%	
A 2000	\$226.388	x 14.94%	= \$33.821	7.96%	
A 2001	\$201.362	x 14.95%	= \$30.100	-11.00%	
A 2002	\$211.487	x 14.94%	= \$31.594	4.96%	
A 2003	\$199.490	x 14.92%	= \$29.766	-5.79%	
A 2004	\$229.792	x 14.90%	= \$34.230	15.00%	
<b>F 2005</b>	<b>\$227.842</b>	<b>x 14.82%</b>	<b>= \$33.776</b>	<b>-1.33%</b>	
<b>F 2006</b>	<b>\$212.868</b>	<b>x 14.81%</b>	<b>= \$31.526</b>	<b>-6.66%</b>	
<b>F 2007</b>	<b>\$211.161</b>	<b>x 14.81%</b>	<b>= \$31.268</b>	<b>-0.82%</b>	

### Coal Severance Tax Allocation

Table 5 shows the statutory allocation of the coal severance tax revenue. HB 10 and HB 18 passed by the 2002 special session increased the general fund to 33.04% for FY 2003. Beginning with FY 2004, the general fund share is 27.40% of collections.

<b>Table 5</b>	
<b>Allocation of Coal Severance Tax Revenues</b>	
<b>Fiscal Years 2005 through 2007</b>	
Account	Percent Allocation
Coal Tax Trust Fund	50.00%
Long Range Building Program Account	12.00%
Local Impacts	7.75%
Parks Trust Fund	1.27%
Renewable Resource Loan Debt Service Fund	0.95%
Capitol Art Protection Trust Fund	0.63%
General Fund	27.40%
	<u>100.00%</u>

Table 6 shows the coal severance tax allocation for FY 2004 through FY 2007. The difference between the SABHRS FY 2004 total tax and the actual FY 2004 tax is the underestimate of the \$2.7 million accrual.

<b>Table 6</b>					
<b>Coal Severance Tax Allocation by Fund</b>					
<b>(\$ millions)</b>					
Account	SABHRS FY 2004	Actual FY 2004	FY 2005	FY 2006	FY 2007
Coal Tax Trust Fund	\$15.772	\$17.115	\$16.888	\$15.763	\$15.634
Long Range Building Program Account	\$3.785	\$4.108	\$4.053	\$3.783	\$3.752
Local Impacts	\$2.445	\$2.653	\$2.618	\$2.443	\$2.423
Parks Trust Fund	\$0.401	\$0.435	\$0.429	\$0.400	\$0.397
Renewable Resource Loan Debt Service Fund	\$0.300	\$0.325	\$0.321	\$0.299	\$0.297
Capitol Art Protection Trust Fund	\$0.199	\$0.216	\$0.213	\$0.199	\$0.197
General Fund	\$8.643	\$9.379	\$9.255	\$8.638	\$8.567
Total Coal Severance Tax	<u>\$31.545</u>	<u>\$34.230</u>	<u>\$33.776</u>	<u>\$31.526</u>	<u>\$31.268</u>