FISCAL NOTE

Bill #:	SB513	**Title:**	Tax on excess profits of electrical generation and transmission facilities
Primary Sponsor:	Jim Elliott	**Status:**	Senate 3rd Reading

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Sponsor signature Date Chuck Swysgood, Budget Director Date

Fiscal Summary

	FY2002 Difference	FY2003 Difference
Expenditures:		
General Fund	$122,760	$26,642
Revenue:		
General Fund	$(5,468,000)	$(5,468,000)
State Special Revenue	$81,000,000	$81,000,000
Net Impact on General Fund Balance:	**$(5,590,760)**	**$(5,494,642)**

Yes	No		Yes	No	
	X	Significant Local Gov. Impact	X		Technical Concerns
	X	Included in the Executive Budget	X		Significant Long-Term Impacts
	X	Dedicated Revenue Form Attached		X	Family Impact Form Attached

Fiscal Analysis

ASSUMPTIONS:

1. This bill provides for an excess profits tax that applies to the sale of electricity after June 30, 2001.
2. The excess profits tax applies to "producers", who are defined as persons who generate electricity and are required to pay the current law electric energy producer's license tax under 15-51-101; and who sell, or have sold, electricity in the state within the preceding 5 years.
3. Excess profits on the sale of electricity occurs when revenue from the sale of electricity exceeds the cost of producing the electricity by at least 125%. However, sales of electricity by producers to Montana customers where the revenue from the sale is less than 150% of the cost of producing the electricity are exempt from the excess profits tax.

4. The excess profits tax rate applies only to that portion of total sales revenue that represents the excess of the sales price over the cost of producing the electricity sold. The excess profits tax rate varies depending on the ratio of sales revenue to cost of production according to the following schedule:

If the ratio of sales revenue to cost of production is:	Then the excess profits tax rate is:
less than 125%	0%
at least 125% but less than 150%	25%
at least 150% but less than 175%	50%
at least 175% but less than 200%	75%
at least 200% or higher	100%

5. The excess profits tax applies only to producers who are generating electricity in an unregulated environment. The excess profits tax will not apply to generation of electricity by Montana-Dakota Utilities. This represents 1.39% of all electricity generated in Montana.
6. The excess profits tax will not apply to generation of electricity that is produced by producers who have not sold electricity in state for the past five years. This represents 49.36% of all electricity generated and subject to the electric energy producer's license tax.
7. Based on assumptions 5 and 6, the excess profits tax could potentially apply to 49.25% of all electricity subject to the electric energy producer's license tax. This represents approximately 11,436,000,000 kilowatt hours (Kwh) per year (HJR2). Of this amount two-thirds, (7,624,000,000 Kwh) will be consumed in state; and one-third (3,812,000,000 Kwh) will be exported out of state.
8. Given the excess profits tax base definition and tax rate schedule in assumption 4, a profit-maximizing firm will sell all electricity sold in state (7,624,000,000 Kwh) at a rate equal to 149.9999% of cost. (Selling at a rate less than this amount will reduce profit, and selling at a rate in excess of this amount will greatly reduce profit.) In so doing, there will be no excess profits tax paid on these sales, but all sales will occur at 149.9999% of cost.
9. This leaves a total of 3,812,000,000 Kwh of generation (all of which is sold out of state), potentially subject to the excess profits tax. *The excess profits tax does not apply to revenue from electrical energy generated in Montana and sold to customers in another state by an electric utility at a price that is regulated by a public service commission or similar agency in the state where the electrical energy is sold*. 75% of the revenue from these out-of-state sales falls into this category and would not be subject to the excess profits tax. 25% of the revenue from these sales is attributable to spot market sales or to sales under direct contract with an industrial customer in another state at prices not regulated by the PSC in that state. The average selling price for all of these sales is $0.10 per Kwh. The average cost of production is $0.015 per Kwh. This results in excess profits tax of $81,000,000 in fiscal 2002 and 2003 [3,812,000,000 Kwh X 25% X ($0.10 - $0.015) = $81,000,000].
10. This proposal will reduce corporation license taxes. If all of the above excess profits tax paid can be used to reduce taxable income for Montana producers, and if all producers are subject to the corporation license tax, then corporation license tax collections would be reduced $5,468,000 per year. ($81,000,000 X 6.75% = $5,468,000). It is not known if this condition will hold after multi-state corporations' apportionment formulas are taken into account. However, for the purpose of this fiscal note, this entire amount is shown as a revenue reduction to the general fund.
11. The department of revenue has identified additional administrative expense associated with this bill of $122,760 in fiscal 2002; and $26,642 in fiscal 2003. The department would require an additional 0.5FTE to administer the provisions of this bill (audit and accounting). Other operating expenses would be incurred to

establish and maintain computer programming and data processing systems for the new tax; and provide for forms development and distribution.

FISCAL IMPACT:

	FY2002 Difference	FY2003 Difference
FTE	0.5	0.5
Expenditures:		
Personal Services	$22,578	$23,947
Operating Expenses	94,637	2,695
Equipment	5,545	0
TOTAL	$122,760	$26,642
Funding:		
General Fund (01)	$122,760	$26,642
Revenues:		
General Fund (01)	$(5,468,000)	$(5,468,000)
State Special Revenue (02)	$81,000,000	$81,000,000
Net Impact to Fund Balance (Revenue minus Expenditure):		
General Fund (01)	$(5,590,760)	$(5,494,642)
State Special Revenue (02)	$81,000,000	$81,000,000

LONG-RANGE IMPACTS:

The revenue impact shown above for the short-run will be greatly reduced in the long run as Montana producers renegotiate contracts to sell for the profit-maximizing rate of 149.999% of cost, regardless of whether the sale is in state or out-of-state. In the long run, the excess profits tax will be reduced to approximately $7 million per year.

TECHNICAL NOTES:

1. This fiscal note makes the implicit assumption that in-state producers will continue to meet in-state demand for electricity. To the extent that in-state producers are able to effectively side-step the excess profits tax through contractual arrangements to sell all power out of state at rates below those which would trigger the profits tax, in which the contractual arrangements provide for revenues from other stipulations in the contract that result in the same amount of revenue for the producer, Montana consumers may have to purchase power from out of state to obtain electric energy. In this case the excess profits tax would be reduced, and rates paid by some consumers could reflect average western grid prices.
2. The cost of production for any producer would have to reflect the average cost of all production from all sources of generation, as there is no way to associate production from a particular facility with individual purchase contracts. The average cost of production could, however, be applied to each individual contract for sale to determine excess profits by sale contract.