



Dan Bucks
Director

Montana Department of Revenue



Brian Schweitzer
Governor

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TO: Dan Bucks, Director

FROM: Larry Finch, Administrator
Vern Fogle, Tax Policy Analyst
Tax Policy and Research

SUBJECT: H.R. 1369 – Montana Impact

Introduced March 17, 2005 in the US House of Representatives, H.R.1369 would provide 4R Act-like protections to interstate natural gas pipelines. The major features of the bill include:

- States (and their political subdivisions) may not assess natural gas pipeline property at a ratio of assessed value to true market value that is higher than the ratio of assessed value to true market value of all other “commercial and industrial property” within the taxing jurisdiction.
- States (and their political subdivisions) may not levy or collect an ad valorem property tax on natural gas pipeline property at a tax rate that exceeds the rate applicable to all commercial and industrial property in the same assessment jurisdiction.
- States (and their political subdivisions) may not impose any other tax that “discriminates” against a natural gas pipeline providing transportation subject to the jurisdiction of the Federal Energy Regulatory Commission (FERC). (“Discriminates” is not specifically defined, but is left to the courts to decide.)
- The term “commercial and industrial property” means property devoted to commercial or industrial use and subject to a property tax levy, but *does not include public utility property* and land used primarily for agricultural purposes or timber growth.
- The term “natural gas pipeline property” means all property, real, personal, and intangible owned or used by a natural gas pipeline providing transportation or storage of natural gas *subject to the jurisdiction of the Federal Energy Regulatory Commission.*

The first three bullet points essentially act to provide natural gas pipeline property the same nondiscriminatory protections afforded railroads under the federal 4-R Act. To

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implement these provisions of the bill, it is likely that state legislation would be enacted that provides for a separate property class that would include all natural gas pipeline property in the state.

Although H.R.1369 applies only to pipelines regulated by FERC, those pipelines comprise nearly all of the value of all natural gas pipelines in Montana. Nearly all of the benefit of H.R.1369 would accrue to Northern Border and Williston Basin Pipeline Companies, and Northwestern Energy, which owns a substantial amount of FERC-regulated natural gas transmission lines. From the standpoint of simplicity, and in order to avoid future abuses and litigation, it would make little sense to try to segregate FERC-regulated pipelines from unregulated pipelines and tax them in different classes. The tax impact analysis that follows assumes that virtually all natural gas pipelines in the state would be placed in a single property class and taxed at the tax rate provided for in the federal legislation.

The fourth bullet above, which defines “commercial and industrial property”, may be particularly troublesome for the states because it goes well beyond 4-R protection in that it excludes from the definition of commercial and industrial property all utility property. Generally speaking, and particularly in Montana, utility property has been taxed at higher property tax rates than other property. Historically, this occurred in most if not all states because utility property generally is subject to state regulation by Public Service Commissions.

Because the rate setting process applied to regulated utility companies allowed for the automatic “flow through” of property taxes to the utility’s customers, states frequently viewed regulated utilities as “cash cows” from which to generate property taxes, and taxed these properties at rates higher than other property.

While the recent era of deregulation in the electric energy generation and telecommunications sectors has acted to reduce the tax rate differential between utility property and other property, there nevertheless remains a significant differential between the tax rates applied to utility and other commercial and industrial properties.

The following table shows the tax year 2005 classes of property used to determine the Class 12 (railroad and airlines) taxable valuation (assessment) rate, and the current statutory taxable valuation rate applicable to each:

<u>Class</u>	<u>Description</u>	<u>Tax Rate</u>
4	Commercial properties	3.22%
7	Noncentrally assessed public utilities	8%
8	Business equipment	3%
9	Utility property	12%
13	Elec. gen./telecom properties	6%

After the Class 4 tax rate was adjusted for the requisite sales/ratio study, these tax rates resulted in a weighted average tax rate for Class 12 properties of 3.74%.¹ However, under H.R.1369 the tax rate for natural gas pipelines would be calculated without including Classes 9 and 13, as these classes include "public utility" property. This results in a weighted average tax rate of just 2.13% for natural gas pipeline properties under H.R.1369. The following analysis assumes this tax rate for all natural gas pipeline properties if the federal legislation were to pass.

H.R.1369 Direct Impact on Property Tax Revenue

Currently, natural gas pipeline properties are classified as Class 9 utility property and taxed at a taxable valuation rate of 12%. Reducing the taxable valuation rate on these properties from 12% to 2.13% is estimated to reduce property taxes statewide by a total of \$22,548,678. Of this amount, \$17,122,096 represents loss in revenue to local governments, while \$5,426,582 represents loss in revenue to the state general fund and the university system.

H.R.1369 Ancillary Impact on Class 12 Property Tax Revenue

In addition to the direct impact on property tax revenue, H.R.1369 will act to further reduce the taxable valuation rate applied to Class 12 railroad and airline properties. This is because under current law pipelines are included in Class 9 at 12% when calculating the Class 12 tax rate, but under H.R.1369 these properties would be in their own class and taxed at 2.13%. This acts to reduce the composite tax rate applied to Class 12 properties from 3.74% to 3.43% (based on TY2005 data).

This reduction in the Class 12 tax rate reduces property taxes an additional \$1,992,394; with \$1,427,793 representing a loss in revenue to local governments and \$564,601 representing a loss in revenue to the state general fund and the university system.

H.R. Total Impact on State and Local Government Revenues

The following table provides a summary of the estimated revenue impact of H.R.1369 on state and local government revenues. Overall, revenues are reduced a total of \$24,541,072. Of this amount, \$22,548,678 is attributable to the reduction in the taxable valuation rate applied to pipelines, and \$1,992,394 is attributable to the ancillary impact from the attending reduction in the Class 12 railroad and airline tax rate.

State accounts are reduced a total of \$5,991,183. Of this amount, the general fund is reduced a total of \$5,635,270 and the university account is reduced a total of \$355,913.

¹ The weighted average rate is low because over half of the market value associated with all of the above properties is in Class 4, which has a statutory rate of 3.22% to begin with.

Local government revenues are reduced a total of \$18,549,889.

Impact of H.R.1369 on State and Local Government Revenue					
Tax Reduction Category	State General Fund	University System	Total State	Local Governments	Total Taxes
A. Reduce Pipelines Tax Rate From 12% to 2.13%					
Northwestern Energy	(1,364,858)	(86,202)	(1,451,060)	(5,904,690)	(7,355,750)
All Other Pipelines	(3,739,352)	(236,170)	(3,975,522)	(11,217,406)	(15,192,928)
Total Pipelines Tax Reduction	(5,104,210)	(322,372)	(5,426,582)	(17,122,096)	(22,548,678)
B. Reduce Class 12 Tax Rate from 3.74% to 3.43%	(531,060)	(33,541)	(564,601)	(1,427,793)	(1,992,394)
C. Total Reduction in All Taxes	(5,635,270)	(355,913)	(5,991,183)	(18,549,889)	(24,541,072)

SUMMARY TABLE

PREDICTED EFFECT OF HR 1369 IN THE US CONGRESS

LOSS IN COUNTY AND LOCAL TAXES

COUNTY	TOTAL	GAS PIPELINES	NORTHWESTERN ENERGY GAS TRANSMISSION	RAILROADS AND AIRLINES
18 BEAVERHEAD	32,084		22,930	9,154
22 BIG_HORN	275,020	231,573	24,627	18,820
24 BLAINE	576,789	445,717	108,800	22,272
43 BROADWATER	15,329		1,551	13,778
10 CARBON	390,226	159,628	218,880	11,718
42 CARTER	328,904	328,904		
02 CASCADE	188,481		103,830	84,651
19 CHOUTEAU	121,006	9,685	102,006	9,315
14 CUSTER	193,200	167,330		25,870
37 DANIELS	7,128			7,128
16 DAWSON	776,657	708,315		68,342
30 DEER_LODGE	85,018		78,947	6,071
39 FALLON	687,812	684,098		3,714
08 FERGUS	31,827		24,661	7,166
07 FLATHEAD	222,206		157,556	64,650
06 GALLATIN	231,848		180,024	51,824
50 GARFIELD	0			
38 GLACIER	1,657,571	387,500	1,234,816	35,255
53 GOLDEN_VALLEY	18,946	5,764	5,781	7,401
46 GRANITE	104,349		85,052	19,297
12 HILL	384,000	247,783	58,522	77,695
51 JEFFERSON	72,881		61,033	11,848
36 JUDITH_BASIN	21,485		2,449	19,036
15 LAKE	13,199		254	12,945
05 LEWIS_CLARK	710,540		652,571	57,969
48 LIBERTY	134,434	96,676	25,463	12,295
56 LINCOLN	42,345			42,345
25 MADISON	43,262		25,859	17,403
41 MCCONE	54,845	50,899		3,946
47 MEAGHER	212		212	

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PREDICTED EFFECT OF HR 1369 IN THE US CONGRESS

LOSS IN COUNTY AND LOCAL TAXES

COUNTY	TOTAL	GAS PIPELINES	NORTHWESTERN ENERGY GAS TRANSMISSION	RAILROADS AND AIRLINES
54 MINERAL	19,956		120	19,836
04 MISSOULA	570,373		479,920	90,453
23 MUSSELSHELL	643		643	
49 PARK	111,334		92,464	18,870
55 PETROLEUM	0			
11 PHILLIPS	839,326	819,192	19	20,115
26 PONDERA	66,175		49,851	16,324
09 POWDER_RIVER	55,829	55,829		
28 POWELL	259,255		238,991	20,264
45 PRAIRIE	45,129	22,399		22,730
13 RAVALLI	47,993		33,369	14,624
27 RICHLAND	116,146	105,486		10,660
17 ROOSEVELT	3,833,525	3,793,113		40,412
29 ROSEBUD	44,896	23,198	53	21,645
35 SANDERS	39,111		284	38,827
34 SHERIDAN	19,468			19,468
01 SILVER_BOW	616,382	10,741	581,765	23,876
32 STILLWATER	132,573	20,005	99,971	12,597
40 SWEET_GRASS	113,049		102,051	10,998
31 TETON	545,237		523,885	21,352
21 TOOLE	415,244	28,063	356,216	30,965
33 TREASURE	16,119	2,984		13,135
20 VALLEY	2,695,449	2,668,514	21	26,914
44 WHEATLAND	22,441		16,535	5,906
52 WIBAUX	78,503	72,302		6,201
03 YELLOWSTONE	424,129	71,708	152,708	199,713
TOTAL	18,549,889	11,217,406	5,904,690	1,427,793