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Revenue Interim Committee

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**FINAL REPORT TO THE 68<sup>TH</sup> MONTANA LEGISLATURE**

# **HJ 6 COAL SEVERANCE TAX TRUST FUND STUDY FINAL REPORT**



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This report is a summary of the work of the Revenue Interim Committee, specific to the Revenue Interim Committee’s 2021-2022 study as outlined in the Revenue Interim Committee’s 2021-22 work plan and House Joint Resolution 6 (2021). Members received additional information and public testimony on the subject, and this report is an effort to highlight key information and the processes followed by the Revenue Interim Committee in reaching its conclusions. To review additional information, including audio minutes, and exhibits, visit the Revenue Interim Committee website: <https://leg.mt.gov/committees/interim/ric/>.

A full report, including links to the documents referenced in this print report, is available at the Revenue Interim Committee website: <https://leg.mt.gov/committees/interim/ric>.

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# HJ 6 COAL SEVERANCE TAX TRUST FUND STUDY REPORT

## BACKGROUND

The [House Joint Resolution 6](#) study of the coal severance tax trust fund ranked fifth among 2021-2022 interim studies. The Revenue Interim Committee (RIC) devoted one-third of staff time to the study.

[Article IX, Section 5](#) of the Montana Constitution requires the Legislature to dedicate 50% of coal severance tax revenue to a trust fund. The Legislature may appropriate the interest earned on the trust fund, but the principal may only be appropriated with a three-quarters vote of the Legislature.

The 1975 Legislature both enacted the coal severance tax (to replace the coal license tax) and passed legislation to place the constitutional amendment creating the coal severance tax trust fund on the ballot. The constitutional amendment passed in 1976 with 63% of votes in support.

The Montana Constitution requires the deposit of 50% of coal severance tax revenue in a trust fund.

The committee began the trust fund study by collecting background information on the distribution of the coal severance tax and considering coal extraction forecasts and coal export opportunities.

The study then shifted to consideration of revising the inputs, the outputs, and the investment of the trust fund. Discussion of revisiting the allocations of coal severance tax revenue and whether to use the trust fund to pay for infrastructure costs did not result in any committee recommendations. Nor did the committee recommend expanding the trust to include other severance taxes or production taxes.

Learning about other states' natural resources fiscal policies generated interest in how Montana's investment of the trust fund compares with other states' investments of severance and royalty trust funds.

## FINDINGS AND RECOMMENDATIONS

The committee found that Montana's constitutional prohibition on investing the coal severance tax trust fund in corporate stocks is out of step with 12 states with severance or royalty trust funds [reviewed](#) for the HJ 6 study.

Based on this finding, the committee recommends that the Legislature conduct a study of the investment of the coal severance tax trust fund, including an evaluation of state programs funded with coal tax permanent funds and consideration of allowing investment of the fund in corporate stock.

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## COAL SEVERANCE TAX DISTRIBUTION AND FORECASTS

The coal severance tax, provided for in [15-35-103](#) is imposed on each ton of coal produced in the state. The tax is a percentage of the contract sales price and varies based on the heating quality of the coal and how the coal is mined.

Production of 50,000 tons or less in a calendar year is not subject to the coal severance tax. However, if production exceeds 50,000 tons, the severance tax is levied on all production in excess of 20,000 tons.

### COAL SEVERANCE TAX RATES

Heating Quality (BTU/lb)	Surface Mining	Augur Mining <sup>1</sup>	Underground Mining
Under 7,000	10% of value	3.75% of value	3% of value
7,000 and over	15% of value	5% of value	4% of value

## Coal Severance Tax Distributions

Half of coal severance tax revenue is distributed to the trust fund and the other half funds a variety of state programs. The Legislative Fiscal Division maintains a detailed [Coal Severance Tax Trust Fund brochure](#) showing dollars distributed to each fund and how the funds are spent.

A committee review of trust fund and non-trust fund coal severance tax revenue distributions and of [estimated Montana infrastructure costs](#) resulted in no recommended changes to the allocation of revenue.

## Trust Fund Distributions

There are six subtrusts within the trust fund, but only three currently receive revenue. The revenue first goes to the Coal Tax Bond Fund to pay principal and interest on coal severance tax bonds used for renewable resource projects. The remaining revenue is split: 75% to the School Facilities Fund and 25% to the Big Sky Economic Development Fund.

The three subtrusts that do not receive revenue still earn interest that is designated for various projects. Those funds are the Montana Coal Endowment Fund, the Montana Coal Endowment Regional Water System Fund, and the Permanent Fund.<sup>2</sup>

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<sup>1</sup> The tax rate for augur mining applies only to coal that would be uneconomical to recover using conventional strip-mining methods.

<sup>2</sup> [SB 258](#) (2021) renamed two of the funds. Some materials may still refer to them as the Treasure State Endowment Fund and the Treasure State Endowment Regional Water System Fund.

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## Other Distributions

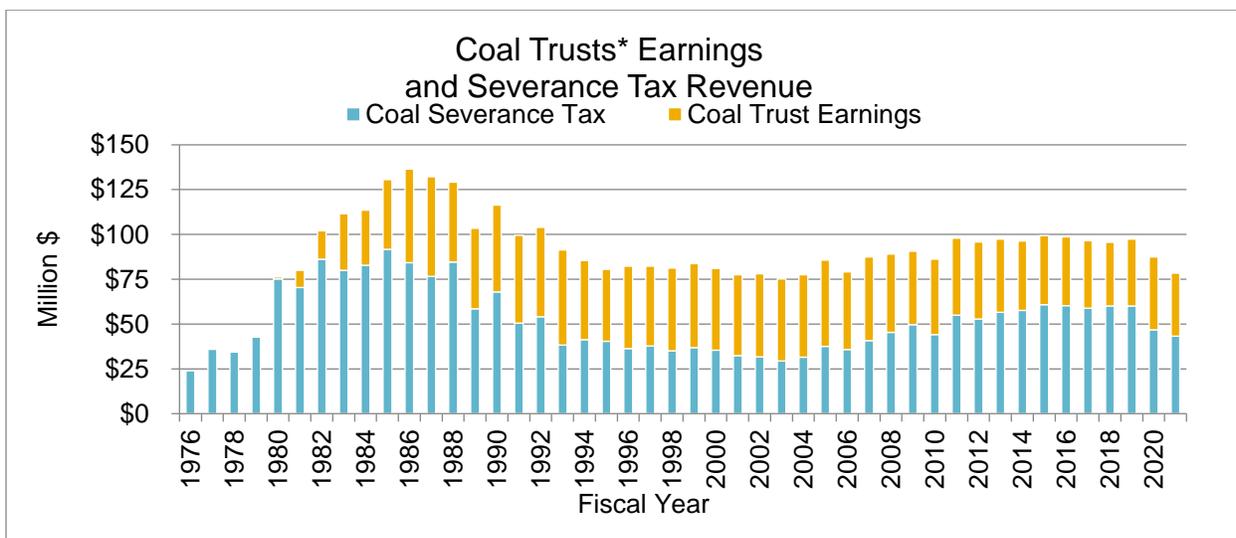
Section [15-35-108](#) provides for the distribution of the revenue not dedicated to the coal severance tax trust fund. The funds are allocated as follows:

- 12% to the major repair long-range building program account;
- 5.8% to the coal natural resource account (reduced to 2.9% beginning July 1, 2023);
- 3.71% to the conservation district account;
- 1.27% to the permanent fund account for parks acquisition and management;
- 0.95% for renewable resource loan debt service;
- 0.93% to the basic library services account;
- 0.82% to the growth through agriculture account;
- 0.63% to a trust fund for protection of art and cultural and aesthetic project in the capitol;
- \$250,000 to the coal and uranium mine permitting and reclamation program account; and
- the remainder to the general fund.

## Coal Severance Tax and Trust Fund Forecasts

Two panel discussions in September 2021 provided information on possible future coal severance tax revenue. Representatives of Spring Creek Mine, Westmoreland, and Westmoreland's Rosebud Mine discussed coal extraction forecasts. Navajo Transitional Energy Company, which owns Spring Creek Mine, [predicts](#) increased demand for coal on the international market.

Coal severance tax forecasters from the [Legislative Fiscal Division](#) and the [Office of Budget and Program Planning](#) and a representative of the [Bureau of Business and Economic Research](#) addressed coal tax revenue forecasts and trust fund earnings forecasts. They expect the coal production decline over the last decade to continue, resulting in less coal severance tax revenue.



Source: Sam Schaefer, Legislative Fiscal Division

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Trust fund interest earnings are also expected to be less than in previous years. Less coal severance tax revenue means smaller increases in principal and low interest rates since the Great Recession result in lower interest earnings.

## EXPANDING THE TRUST FUND

The coal severance tax trust fund is the only trust fund for natural resource revenue. However, Montana also levies taxes on oil and natural gas production, metal mines, electrical energy generation, energy transmission, bentonite, and cement and gypsum. As part of the HJ 6 study, the committee considered whether to [increase the principal of the trust fund](#) by adding other natural resource revenue.

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Natural Resource Historical and Projected Values in HJ 2					
(\$ Millions)					
	Actual FY 2019	Actual FY 2020	Actual FY 2021	Estimated FY 2022	Estimated FY 2023
Oil & Natural Gas Production Tax	118.9	84.6	87.4	97.3	89.6
Coal Severance Tax	60.0	46.8	43.3	35.9	31.7
US Mineral Royalties	28.8	24.7	16.1	21.6	19.4
Coal Gross Proceeds	20.3	23.3	20.8	15.4	14.0
Federal Forest Receipts	15.1	14.2	13.8	3.8	3.9
Metal Mines Tax	14.7	18.6	25.8	17.1	17.5
Electrical Energy Generation	7.0	5.8	5.2	3.8	3.7
Wholesale Energy Transmission Tax	3.5	3.4	3.0	3.5	3.5
Resource Indemnity Tax	2.9	2.3	2.0	1.9	1.7
Bentonite Production Tax	0.9	0.9	0.4	0.7	0.7
Cement & Gypsum Tax	<u>0.1</u>	<u>0.1</u>	<u>0.2</u>	<u>0.1</u>	<u>0.1</u>
Total	272.1	224.6	217.9	201.1	185.8

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Source: Sam Schaefer, Legislative Fiscal Division

A Legislative Fiscal Division [analysis](#) estimated the principal and interest that could be generated from depositing additional coal severance tax revenue in the trust fund and adding some metal mines tax revenue and oil and natural gas tax revenue.

The committee did not make any recommendations to change the revenue deposited in the trust fund.

## INVESTMENT OF THE TRUST FUND

The Board of Investments manages coal severance tax [trust fund investments](#). However, the trust fund's investments are limited in two ways. [Article VIII, Section 13](#) of the Montana Constitution prohibits investment of most public funds, including the coal severance tax trust fund, in private corporate capital stock.

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In addition, [17-6-308](#) authorizes loan programs to utilize specified amounts of trust fund principal. These programs affect coal trust earnings because some interest rates are set in state law rather than by the market. As of Sept. 30, 2021, \$113 million of the trust fund was designated for these programs.

Trust fund investments are limited by a constitutional prohibition on investment in corporate stock and by use of trust funds for loan programs.

The coal severance tax trust fund is part of the Trust Fund Investment Pool (TFIP). The TFIP asset portfolio includes corporate bonds, commercial mortgage-backed securities, asset backed securities, treasuries, mortgage-backed securities, high-yield bonds, and real estate.

## Prohibition on Investment in Corporate Stock

Of 17 severance and royalty [trust funds in 12 states](#), the Montana coal severance tax trust fund is the only one that may not be invested in corporate stocks.

## Five States Specify Maximum Stock Investments

Among the states included in the analysis, five states specify a maximum percentage of the trust fund that may be invested in stocks. The percentages range from a low of 35% in Louisiana to 80% in Utah. The other three states have limits closer to Utah's than Louisiana's: Arizona, 60%; New Mexico, 65%; and Wyoming, 70%. In addition, North Dakota sets a target of 10% of investment in stocks for one of its trust funds.

## Many State Distributions Based on Multi-Year Fund Value Averages

The distributions for seven of the 12 royalty trusts are based on a percentage of the average value of the trust over a number of years ranging from 2 years to 6 years. Three states – Arizona, Oregon, and Utah – set distribution percentages based on the current year value of the fund, and Colorado and Louisiana distribute a certain dollar amount.

Half of the states with severance tax trust funds distribute a percentage of the 5-year average value of the trust: New Mexico, North Dakota, and Wyoming. Colorado's trust is available for legislative appropriation, but half is reserved for loans. Montana and Utah distribute current year earnings rather than a percentage of the trust's total value.

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## APPENDIX A: REVENUE INTERIM COMMITTEE MEMBERS

Before the close of each legislative session, the House and Senate leadership appoint lawmakers to interim committees. The members of the Revenue Interim Committee, like most other interim committees, serve one 20-month term. Members who are reelected to the Legislature, subject to overall term limits and if appointed, may serve again on an interim committee. This information is included in order to comply with 2-15-155, MCA.

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