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Primer on Minnesota's Property Taxation of Electric Utilities

Updated to include laws enacted in 2003 legislative sessions

This information brief summarizes the current structure of electric utility property taxation. The brief discusses the various types of electric utilities, how they are valued, and how much property tax they pay. It provides a summary of the various exemptions granted by the legislature, most of which are for the utility's personal property. The brief describes the taxation of wind energy conversion systems used as an electric power source. Lastly, it summarizes the provisions in the 2003 Xcel Energy's Prairie Island law that have implications for issues discussed in this brief.

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Introduction

Changes in the regulation and economics of the electric utility industry make state and local utility taxes more important. These changes also raise policy questions about the way state and local governments tax utilities.

For most of the 20th century, utilities operated as regulated monopolies: they were stable businesses that earned regulated and, more or less, guaranteed rates of return. Because regulations typically allowed property taxes to be recovered through the utility's rates, the level of taxes had little effect on the rate of return earned by the utility. Furthermore, utility taxes provided a convenient and stable way for state and local governments to raise generous amounts of revenue.

However, the economics of the industry are changing with the competition for wholesale supply allowed by federal regulations. Some states have also begun to allow retail competition. If competitive market forces set utility prices, state and local taxes can affect the rate of return on and viability of utility investments. Utility consumers (especially large commercial and industrial customers) have become more aware of the effect of taxes on their utility bills and, along with the utilities, are seeking to reduce utility taxes, including property taxes.

In recent years, the Minnesota Legislature has made a variety of utility property tax changes in response to this changing environment. This information brief:

- Describes the various types of utilities and how Minnesota taxes utility property
- Discusses the methods of valuing utility property
- Provides data on the total property taxes paid by utilities
- Lists exemptions and special provisions granted by the legislature over the last decade
- Describes the taxation of wind energy conversion systems through payable 2003 (property tax) and effective in calendar year 2004 and subsequent years (production tax)
- Describes those aspects of Xcel Energy's Prairie Island law enacted in 2003 that impact the taxation of electric utilities

Types of Electric Utilities

Investor-owned utilities (IOUs) are private, for-profit corporations whose rates are regulated by the Minnesota Public Utilities Commission (PUC). The five IOUs that serve Minnesota (Xcel, Allete, Alliant, Ottertail, and Northwestern Wisconsin Electric) are vertically integrated utilities; the IOUs generate, transmit, and distribute their own electricity. Property owned by these utilities is subject to property tax, unless specifically exempted.

Rural electric associations (co-ops) are nonprofit organizations whose rates are overseen by a board composed of co-op members.¹ Co-ops are not vertically integrated. There are two basic types of co-ops:

- **Distribution cooperatives** provide retail electric service directly to Minnesota consumers. There are 40 distribution co-ops in Minnesota. The distribution co-ops pay a fee of 10 cents per customer in lieu of the property tax on their distribution lines located outside of incorporated areas. (This fee is collected by the Department of Revenue (DOR) and deposited in the general fund. For 2002, the statewide total was \$51,800.) However, co-op-owned substations are subject to property tax. Any distribution lines that they have located within incorporated areas are also subject to property tax; however, the majority of them are outside of incorporated areas and pay the in lieu fee mentioned above.
- **Generation and transmission cooperatives** generate and transmit electricity to distribution co-ops. There are six generation and transmission cooperatives that serve Minnesota distribution co-ops.² Generation and transmission cooperatives are generally subject to property taxation, unless specifically exempted.

Municipal utilities (Munis) are public, nonprofit utilities overseen by local public utilities commissions or city councils. Munis are generally not vertically integrated. As with co-ops, there are two kinds of municipal utilities.

- **Distribution Munis**, like their cooperative counterparts, provide retail electric services to Minnesota consumers. There are 126 distribution Munis in Minnesota.
- **Municipal power agencies (MPAs)** provide distribution Munis with generation and transmission services. There are six MPAs operating in Minnesota.³

Both distribution Munis and MPAs are generally exempt from property tax, but an MPA pays in lieu payments to each taxing authority within whose taxing jurisdiction its property is situated. These in lieu payments equal the amounts of taxes which would have been payable if its property were owned by a private person. *Minn. Stat. § 453.54, subd. 20.*

Distribution Munis, while not subject to a specific statutory requirement to pay in lieu taxes to taxing jurisdictions in which they operate, often do make contributions (monetary and otherwise) to their host city.

Independent power producers (IPPs) are nonutility power producers that generate electricity solely for sale at wholesale (e.g., NRG). IPPs are generally private corporations and are subject to property taxation unless specifically exempted.

¹ One distribution cooperative, Dakota Electric Association, has elected to be rate-regulated by the PUC.

² The six "G&T" co-ops are: Basin Electric Power Association, Dairyland Power Cooperative, East River Electric Power Cooperative, L&O Power Cooperative, Minnkota Power Cooperative, and Great River.

³ The six MPAs are: Missouri River Energy Services, Heartland Consumer Power District, Southern Minnesota MPA, Central Minnesota MPA, Northern Minnesota MPA, and Minnesota MPA.

Determining a Utility's Value

Utilities are valued and assessed under a "dual" property tax system:

- 1) The DOR values the property that constitutes the utility's operating property using the unit value system. The "unit value" method estimates the market value for the entity as an integrated whole, rather than valuing each part and parcel separately. The unit value is then apportioned among the jurisdictions where the property is located, based on a formula.
- 2) Local assessors value the utility's nonoperating property which consists of all offices, garages, warehouses, and land.

There are three approaches to valuing property—cost, income, and sales. However, in the case of valuing utilities, only cost and income are used by the DOR in establishing market value. Sales are considered, but are not used due to lack of data and other concerns. Prior to January 1, 2000, cost was the only factor used in determining the value of co-ops. However, beginning with the 2000 assessment, a co-op can elect to be valued on the unit-value basis or continue to be valued using only cost as the factor.^{4, 5} DOR periodically reviews the rules and revises them as necessary, following the appropriate rulemaking process.

The DOR uses the unit-value method in determining the market value of the utility. The current formula is:

$$0.75 \times (\text{the original cost}^6 \text{ of the utility property less allowable depreciation}^7), \text{ plus} \\ 0.25 \times (\text{the utility's capitalized income during the most recent three years}^8)$$

Given this approach, the property values of Minnesota electric utilities have remained relatively stable for property-tax purposes. Some states rely more heavily on utilities' income-producing ability to determine property values and consequently experience wider variations in their property valuations.

⁴ [Minnesota Rules, part 8100.0300](#), subpart 6, allows co-ops this option.

⁵ Cost is used as the factor in determining the market value of MPAs, since no MPA has elected the unit-value option.

⁶ In determining property values, DOR also includes improvements and the cost of construction in progress on the date of the assessment.

⁷ [Minnesota Rules, part 8100.0300](#), subpart 3, limits electric companies' allowable depreciation for property-tax purposes to 20 percent of the cost of the property, plus 50 percent of the excess amount (over the 20 percent).

⁸ The income component of the equation uses the utility's net income for the most recent three years weighted consecutively at 40 percent, 35 percent, and 25 percent, respectively, and applies at a capitalization rate. [Minnesota Rules, part 8100.0100](#), subpart 5, defines the capitalization rate as the relationship of income to capital investment or value, expressed as a percentage.

DOR then determines what portion of an electric company's total property value is allocated to Minnesota using the following formula:

$$\begin{aligned} \text{Minnesota's share of total value} &= 0.90 \times (\text{original cost of utility property in} \\ &\quad \text{Minnesota/total original cost of utility} \\ &\quad \text{property in all states of operation) plus} \\ &\quad 0.10 \times (\text{gross operating revenue from Minnesota} \\ &\quad \text{operations/gross operating revenue from all} \\ &\quad \text{states)} \end{aligned}$$

The Commissioner of Revenue then deducts utility nonoperating property (i.e., land, offices, garages, warehouses, etc.) and rights-of-way from the Minnesota allocation, since these items are valued by local assessors. Lastly, the Minnesota portion of utility property is adjusted to exclude property that is statutorily exempt from Minnesota property taxes (e.g., pollution control equipment).

Property Tax

After DOR determines the market value of the utility's operating property, it then certifies the value to the county auditor where the property is located. The county auditor applies the appropriate class rates to the market value. A listing of the major property classes and their respective class rates for taxes payable in 2003 is shown in the table on the following page. These class rates apply statewide and are set by the legislature.

The 2001 Legislature provided for major restructuring of the property tax system. [*Laws 2001, 1st spec. sess., ch. 5, art. 3.*](#) As part of that reform, the class rates of the various property types were compressed so there are smaller differences between the lowest class rates (agricultural and residential) and the highest class rates (commercial/industrial/public utility—C/I/PU). Numerous other changes were made to prevent these compressed class rates from shifting the tax burden to agricultural and residential property. A state general property tax was also established on C/I/PU property and on seasonal recreational residential (e.g., cabins). However, the public utility attached machinery of electric generation systems is exempted from this new state general tax.

Following the 2001 property tax restructuring, in certain geographic areas of the state, the class rate decreases on utility property had a much more significant effect on the local tax base than had originally been anticipated. In response, the 2002 Legislature provided supplemental property tax aid for any county in which public utility property constituted over 40 percent of the county's tax base for taxes payable in 2001. The only three counties that qualified for the supplemental aid were Clearwater, Kittson, and Red Lake. The supplemental aid was added to each county's homestead and agricultural credit aid (HACA) base amount beginning in 2003. It is equal to 83 percent of the county tax revenues attributable to the reduction in tax capacity of public utility property for taxes payable in 2002. The total annual aid amount is \$1.45 million.

The 2003 Legislature, as part of its county aid restructuring, incorporated HACA, including the supplemental pipeline aid, into the general county aid formula. Therefore, beginning in 2004, the supplemental pipeline aid is no longer identifiable as a separate aid amount, but is part of the county's total aid.

Class Rate Schedule — Major Property Types by Class			
Taxes Payable 2003⁹			
	Class Rate	Subject to State Tax	Subject to Operating (Excess Levy) Referenda¹⁰
Residential Homestead:			
Up to \$500,000 market value	1.0%	no	yes
Over \$500,000 market value	1.25	no	yes
Apartment:			
Regular	1.5 ¹¹	no	yes
Low-income	1.0 ¹²	no	yes
Commercial-Industrial-Public Utility:¹³			
Up to \$150,000	1.5	yes	yes
Over \$150,000	2.0	yes	yes
Electric generation machinery	2.0	no	yes
Agricultural Land & Buildings			
Homestead:¹⁴			
Up to \$600,000 market value	0.55	no	no
Over \$600,000 market value	1.0	no	no
Nonhomestead	1.0	no	no

House Research Department

After the appropriate class rate is applied to the utility's market value, the result is the utility's net tax capacity. The utility's property tax is determined by multiplying its net tax capacity times:

- a) the total local tax rate (i.e., the county, city/town, school district, and special taxing districts), plus
- b) the statewide general tax rate (where applicable; see table above)

⁹ The table is a very abbreviated listing of the class rates. There are numerous subclasses of property and minor exceptions within the major classes.

¹⁰ School operating referendum levies (sometimes called "excess levy" referenda) and all county, city, and town referendum levies are levied on referendum market value. School debt levies are levied against *all* property based on net tax capacity.

¹¹ Rate reduced to 1.25 percent in pay 2004 and thereafter.

¹² Classification abolished in pay 2004; rate increased to 1.25 percent, which is the same as regular apartments.

¹³ A utility is allowed to receive the first-tier class rate (up to the \$150,000 market value limit) on only one property per county.

¹⁴ House, garage, and one acre treated the same as residential homestead.

For property taxes payable in 2003, the statewide utility market value by type of property and estimated property tax is shown in the table below. Note that utility personal property is taxable even though other business personal property (including both inventories and attached machinery) have been exempt since the early 1970s.

Statewide Utility Market Value and Property Taxes by Type of Property Taxes Payable in 2003 (all figures in millions)				
Type of Property	Market Value Amount	Market Value % of Total	Net Tax Amount	Net Tax % of Total
Land and buildings ¹⁵	\$800	12.2%	\$28.6	13.1%
Electric generation machinery	1,545	23.5	40.0	18.3
Other machinery ¹⁶	1,003	15.3	35.0	16.0
Transmission lines ¹⁶	1,402	21.4	51.3	23.5
Distribution lines ¹⁷	175	2.7	6.6	3.0
Pipelines	1,636	24.9	57.0	26.1
Total	\$6,561	100.0%	\$218.5	100.0%

House Research Department

To put this in context with all property on a statewide basis:

- The total taxable market value of utility property (\$6.6 billion) is about 2 percent of the total taxable market value of all property for taxes payable in 2003 (\$325.2 billion).
- The total utility property tax of \$218 million is about 4.4 percent of the total tax on all property for taxes payable in 2003 (\$5,018 million).

Thus, utility property taxes (4.4 percent) are more than twice the utility's property share of market value (2 percent).

¹⁵ The market value and taxes in this category are for all utilities. Due to data constraints, it is not easy to separate the values and taxes by type of utility. However, electric utilities constitute almost 69 percent of the total value of all utility property (2002 assessment).

¹⁶ The market value in this table excludes the value of the transmission and distribution lines that are excluded from the general tax base in determining tax rates. For taxes payable in 2003, this market value was over \$195 million. That value is then subject to the countywide tax rate. *Minn. Stat. § 273.37, subd. 2.*

Utility property is not uniformly distributed throughout the state. Therefore, the proportion of utility market value and tax within any particular taxing district to its total market value and tax varies dramatically within the state.

Power line credit. Incentives for landowners to accept transmission lines on their property will likely be a legislative issue in the near term. A property tax credit enacted in 1980 to address this issue is worth noting, even though the total dollar amount of credits paid now are small. The power line credit was established to reduce the property tax burden of those taxpayers whose properties have high-voltage electrical lines on them, as an incentive for taxpayers to accept these power lines. In order to qualify for the credit, the property must be crossed by a transmission line of 200KV or more constructed after June 30, 1974.

In 1981, utility companies made direct payments to qualifying property owners to compensate them for having these high voltage lines pass over their property. However, the direct payments were changed to property tax credits beginning with taxes payable in 1982/1983. For taxes payable in 2003, the total statewide power line property tax credit was only \$97,000. *Minn. Stat. § 273.42.*

Pass-through of Property Tax Savings under 2001 Tax Reform

The 2001 Legislature enacted a provision requiring the PUC to reduce utility rates in order to pass through to customers the savings from the tax reductions on personal property resulting from the 2001 legislation. *Laws 2001, 1st spec. sess., ch. 5, art. 3, sec. 11.* As a result, utility property taxes on real and personal property decreased between 17 percent and 18 percent from taxes payable 2001 to 2002. However, the legislature required only the tax savings on personal property to be immediately passed through to customers. For purposes of this adjustment, “personal property” means tools, implements, and machinery of the generating plant.¹⁷

The 2002 Legislature clarified that the electric utility rate reductions mandated by the 2001 omnibus tax law resulting from the personal property tax reductions are to be permanent rate reductions. The law further clarified that a utility may voluntarily reduce rates by more than the mandated amount, but specified that if the utility does voluntarily pass on any additional property tax savings, it must be “allocated” in the same manner as approved by the public utility commission for the mandatory reduction. *Laws 2002, ch. 377, art. 4, sec. 3, and Laws 2002, ch. 400, sec. 12.*

¹⁷ If a utility later files for a rate case at the PUC, the rates will reflect all of the utility's property tax savings, including the tax savings on their tools, implements, and machinery.

Exemptions

In Minnesota, a utility's attached machinery and other personal property is taxable (i.e., transformers, turbines, etc.).^{18, 19, 20} In recent years the legislature has granted many property tax exemptions for attached machinery and other personal property for *newly constructed facilities*.²¹ These exemptions (listed below) have been adopted in response to requests from companies proposing to build new electric generating plants in Minnesota. These companies argue that they will build in neighboring states with lower or no property tax on attached machinery if the tax on attached machinery is not exempted. With the precedent for these exemptions so well established, it is likely that this trend will continue for future proposed facilities.²²

Electric Utilities

The following is a list of the proposed facilities for which attached machinery and other personal property have been exempted from property taxation.

- 1994** **L.S. Power Plant:** Exemption for a cogeneration system that used natural gas as a primary fuel. The exemption required that the plant be constructed before July 1, 1997. The plant was constructed in Cottage Grove and is operational. *Laws 1994, ch. 513.*
- 1996** **Market Value Exclusion for Electric Power Generation Efficiency:** Exemption for facility that produces electricity at very high efficiency levels and which has significantly lower pollution emissions than conventional power production facilities. It provides for a subtraction equal to 5 percent of market value of qualifying property for each percentage point that the facility is operating above 35 percent efficiency. Although this is a general exemption, it was designed for a specific company (Koch Refinery; now called Flint Hills Resources) and project, which was to be a cogeneration facility. The required efficiency level could only be met by existing power production facilities in Minnesota by implementing significant and expensive changes to the facility. This provision is often referred to as the "cogeneration" provision, since at that time those were the only types of facilities which could achieve the required efficiency. *Laws 1996, ch. 444.*

¹⁸ Personal property of nonutility commercial and industrial businesses are exempt.

¹⁹ Companies in Minnesota which generate electric power for their own use, and not for resale, are exempt from taxation on the personal property used to generate the power. *Minn. Stat. § 272.027 (Supp. 1999).*

²⁰ Personal property used primarily for the abatement and control of air, water, or land pollution is exempt from property tax. *Minn. Stat. § 272.01, subd. 10.*

²¹ Class rate compressions enacted by the legislature apply to both the existing and newly constructed facilities.

²² Many assume that even if electric restructuring occurs, transmissions and distribution lines will remain taxable because they are not subject to competition as are the actual generation facilities.

As of 2003, the DOR has granted market value exclusions for a few facilities under this law. They are Xcel's Black Dog plant (Burnsville), Minnesota Power's plant at Potlatch, and two natural-gas fired peaking plants that Dakota Electric is building (one in Hastings and the other in Lakeville).

1997 Biomass, Waste Wood: Exemption for equipment that is part of a system that generates biomass electric energy and satisfies a portion of the Prairie Island biomass mandate on Xcel Energy in section [216B.2424](#), or a system which produces energy using waste wood.

An exemption for a plant is not effective without the approval of the governing bodies of each affected county, city/town, and school district. That approval may be rescinded by a later referendum if a petition is signed by 10 percent of the voters in the county voting in the last general election. No facilities currently qualify for this exemption. Property exempted under this provision is limited to a maximum of five assessment years, beginning with the assessment year immediately following when the personal property is put into operation. The St. Paul District Energy facility began generating electricity in May 2003 and qualifies for the exemption under this provision. *Laws 1997, ch. 231, art. 2, sec. 8.*

1997 Laskin Plant: Exemption for equipment of a facility with a capacity of 110 megawatts, whose operation is integral to the development and operation of a new, adjacent industrial park.

The governing bodies of the county, city/town, and school district must each approve, by resolution, the personal property exemption. Approval may be rescinded by a later referendum if a petition is signed by at least 10 percent of the number of persons voting in the county in the last general election. Exemption may not exceed five years beginning with the assessment year immediately following when the property is put into operation, and expires thereafter. If the industrial park is not built by July 1, 2001, this exemption expires. This exemption was enacted for a plant proposed for St. Louis County. However, no exemption was granted under this provision and it has expired. *Laws 1997, ch. 231, art. 2, sec. 57.*

1999 Lakefield Junction: Exemption for equipment of a peaking facility proposed to be constructed in Martin County that is part of a simple-cycle combustion-turbine electric generation facility that exceeds 250 megawatts of installed capacity.

The exemption required that construction of the facility has to begin after July 1, 1999, and before July 1, 2003. The plant is in operation. *Laws 1999, ch. 243, art. 5, sec. 4.*

1999 Rapids Energy Center, Grand Rapids: Exemption for equipment of a facility if the electric generating facility was operational on January 2, 1999, and sold to a Minnesota electric utility. This was enacted for a plant proposed to be sold to

Minnesota Power and expanded from 30 megawatts to 250 megawatts. Plans to build this facility were cancelled in August 2002. *Laws 1999, ch. 243, art. 5, sec. 4.*

1999 **Direct-reduction steel mill:** Exemption for equipment of an electric generating facility if the facility, when completed, has a capacity of at least 450 megawatts; is adjacent to a taconite mine direct-reduction steel mill; and supplies over 60 percent of its electricity generated in the prior year to the adjacent direct-reduction plant and steel mill. No construction has begun on this facility. *Laws 1999, ch. 243, art. 5, sec. 4.*

2000 **Pleasant Valley Station:** Exemption for equipment of an electric generation peaking facility, proposed to be constructed in Mower County by Great River Energy, that is a simple-cycle combustion-turbine electric generation facility that exceeds 250 megawatts of installed capacity.

Construction of this facility had to begin after January 1, 2000, and before January 1, 2004. This facility has been constructed and is in operation. *Laws 2000, ch. 490, art. 5, sec. 4.*

2001/2003 **Fibro Minn**

2001: Exemption for equipment of an electric generating facility designed to use poultry litter as a primary fuel source and constructed for the purpose of generating power to satisfy a portion of power sold under the Prairie Island biomass mandate under section [216B.2424](#).

Construction of the facility must begin after January 1, 2000, and before December 31, 2002. This exemption was enacted for a facility proposed to be located in the city of Benson (Swift County). *Laws 2001, 1st spec. sess., ch. 5, art. 3, sec. 18.*

2003: The 2003 Legislature extended the date that the construction must begin by one year to December 31, 2003. Construction on this plant has not yet begun. It received its air permit from the Minnesota Pollution Control Agency (MPCA) in October 2002. Under PUC order and control of facility by Xcel, Fibro Minn must either achieve financial closing or begin continuous construction by October 2003. *Laws 2003, ch. 127, art. 2, sec. 6.*

2001 **Preston Waste tire cogeneration facility:** Exemption for equipment of an electric generating facility designed to use waste tires as a primary source and is a cogeneration electric generating facility of 15 to 25 megawatts of installed capacity.

Construction of the facility must begin after January 1, 2000, and before January 1, 2004. This exemption was enacted for a facility proposed to be located in the

city of Preston (Fillmore County). *Laws 2001, 1st spec. sess., ch. 5, art. 3, sec. 19.* This facility received its air permit from the MPCA in July 2003.

2001 Biomass electrical generating facility: Exemption for equipment of an electric generating facility that is designed to utilize biomass as a primary fuel source. It must also be constructed for the purpose of generating power that will be sold under a contract approved by the PUC, in accordance with a biomass mandate imposed under section [216B.2424](#).

Although this exemption was written broadly to apply to any facility which meets the criteria and for which construction begins after January 1, 2000, and before December 31, 2002, it may be that only the St. Paul district energy facility may qualify. *Laws 2001, 1st spec. sess., ch. 5, art. 3, sec. 21.*

2001/2003 Northom; Itasca Power Company

2001: Exemption for equipment of a new wood-burning biomass generation facility eligible to satisfy a portion of the biomass mandate imposed on Xcel Energy (Northern States Power) in the Prairie Island legislation (1994 and 2003) if the facility:

- has a generation capacity of between 10 and 20 megawatts;
- is located north of constitutional Route No. 8 (this area includes Duluth, Floodwood, Swan River, Grand Rapids, Cass Lake, Bemidji, Bagley, Erskine, Crookston, East Grand Forks, and intervening and adjacent communities);
- utilizes biomass residue wood, sawdust, bark, chipped wood, or brush as a primary fuel source; and
- is operational by December 31, 2002. *Laws 2001, 1st spec. sess., ch. 5, art. 3, sec. 13.*²³

2003: The 2003 Legislature extended the operational date by an additional three years to December 31, 2005. *Laws 2003, ch. 127, art. 2, sec. 31.* Additionally, the legislature required Xcel Energy to purchase the output of the facility if certain criteria are met. See page 19 for details.

2002 Waseca County: Exemption for equipment of a combined-cycle natural-gas turbine electric generation facility of between 43 and 46 megawatts of installed capacity, that:

- utilizes a combined-cycle gas turbine generator fueled by natural gas;
- is connected to an existing 115-kilovolt high-voltage electric transmission line that is within one mile of the facility;
- is located on an underground natural gas storage aquifer;

²³ The exemption granted under this section is effective regardless of whether the facility is needed or selected to fulfill some portion of the biomass mandate.

- is designed as an intermediate load facility; and
- has received, by resolution, the approval from the governing body of the county for the exemption of personal property under this subdivision.

Provides that construction of the facility must be commenced after January 1, 2002, and before January 1, 2004. *Laws 2002, ch. 377, art. 4, sec. 7.*

2002

Beltrami County: Exemption for equipment of a simple-cycle combustion-turbine electric generation facility of more than 40 megawatts and less than 50 megawatts of installed capacity, that:

- utilizes natural gas as a primary fuel;
- is located within two miles of parallel existing 36-inch natural gas pipelines and a 115-kilovolt high voltage electric transmission line;
- is designed to provide peaking, emergency backup, or contingency services; and
- satisfies a resource deficiency identified in an approved integrated resource plan filed under section [216B.2422](#).

Construction of the facility must be commenced after January 1, 2001, and before January 1, 2005. *Laws 2002, ch. 377, art. 4, sec. 8.*

2002/2003

Crown Hydro (Minneapolis)

2002: Exemption for equipment of a 3.2 megawatt run-of-the-river hydroelectric generation facility that:

- utilizes two turbine generators at a dam site existing on March 31, 1994;
- is located on publicly owned land and within 1,500 feet of a 13.8 kilovolt distribution substation; and
- is eligible to receive a renewable energy production incentive payment under section 216C.41.

Construction of the facility must be commenced after January 1, 2002, and before January 1, 2004. *Laws 2002, ch. 377, art. 4, sec. 9.*

2003: The 2003 Legislature extended the date construction must begin by one year to January 1, 2005. *Laws 2003, ch. 127, art. 2, sec. 7.*

2002

Rahr Malting (Shakopee): Exemption for equipment of an electric generation facility that:

- has a generation capacity of less than 25 megawatts;
- provides process heating needs in addition to electrical generation; and
- utilizes agricultural by-products from the malting process and other biomass fuels as its primary fuel source.

Construction of the facility must be commenced after January 1, 2002, and before January 1, 2006. *Laws 2002, ch. 377, art. 4, sec. 10.*

2002 **Mesaba Energy Project:** Exemption for equipment of an electric generation facility sited on an energy park and that:

- is located on an active or former mining or industrial site;
- is within the taconite tax relief area;
- has on-site access to existing railroad infrastructure;
- has direct rail access to a Great Lakes port;
- has sufficient private water resources on site; and
- is designed to host at least 500 megawatts of electric generation.

Construction of the first 250 megawatts at the facility must be commenced after January 1, 2002, and before January 1, 2005. This exemption was enacted for a facility proposed to be located in St. Louis County (the old LTV plant site). Construction of up to an additional 750 megawatts must be commenced before January 1, 2010. *Laws 2002, ch. 377, art. 4, sec. 11.*

Legislation was enacted in 2003 that provided for a number of regulatory incentives for this project. See [page 18](#) for details.

2003 **Calpine (Mankato-Blue Earth County):** Exemption is for equipment of a combined-cycle combustion-turbine electric generation facility that exceeds 550 megawatts of installed capacity and that:

- is designed to utilize natural gas as a primary fuel;
- is not owned by a public utility as defined in section 216B.02, subdivision 4;
- is located within five miles of an existing natural gas pipeline and within four miles of an existing electrical transmission substation;
- is located outside the seven-county metro area; and
- is designed to provide energy and ancillary services and has received a certificate of need under section [216B.243](#).

Construction of the facility must be commenced after January 1, 2004, and before January 1, 2007. *Laws 2003, ch. 127, art. 2, sec. 8.*

2003 **Dakota Electric (Rosemount-Dakota County):** Exemption is for equipment of a combined-cycle combustion-turbine electric generation facility that exceeds 150 megawatts of installed capacity and that:

- utilizes natural gas as a primary fuel;
- is owned by an electric generation and transmission cooperative;
- is located within ten miles of parallel existing 24-inch and 30-inch natural gas pipelines and a 345-kilovolt high-voltage electric transmission line;

- is designed to provide intermediate energy and ancillary services, and has received a certificate of need under section [216B.243](#), demonstrating demand for its capacity; and
- has received local approval from the county and city in which the site is located.

Construction of the facility must be commenced after January 1, 2004, and before January 1, 2009.

The exemption will take effect only if the owner of the facility enters into agreements with the governing bodies of the county and the city where the facility is located. The agreements may include a requirement that the facility must pay a host fee to compensate the county and the city for hosting the facility. [Laws 2003, ch. 127, art. 2, sec. 9.](#)

Energy and Pollution Control Property

In addition to the above exemptions, Minnesota also exempts some energy and pollution control equipment from property tax located at facilities which are otherwise subject to property taxes. The estimated market value exempted under [Minnesota Statutes, section 272.02](#), subdivisions 10, 24, 41, and 43 for these property types for the 2000 assessment was about \$550 million. This exemption amount has remained relatively stable in recent years since no major generating facilities have been built. Most of the exemption is for pollution control equipment (some structures are also exempted).

Wind Energy Conversion Systems

The taxation of wind in Minnesota has been an important policy question as technology advanced to make wind systems more economic to install. On the one hand, policymakers wanted to keep the tax on this source of energy low to promote this renewable resource. On the other hand, the areas of the state in which the wind resource is abundant are relatively poor in terms of tax capacity (little industry, etc.). The local government units in these areas want to tax wind energy systems as a means of raising local revenues.

Responding to this tension, the legislature enacted numerous changes to the taxation of wind energy conversion systems, imposing a tiered property tax structure with graduated tax rates according to the capacity of the wind facility. Then in 2002, the legislature exempted these systems from property taxation and enacted a production tax beginning in 2004.

The Past: 1991 through 2003, Property Tax

The original law, enacted in 1991, exempted all wind energy conversion systems installed after January 1, 1991, which are used as an electric power source. *Laws 1991, ch. 316, sec. 2*. In the years that followed, numerous changes were made to the taxation of these systems. The property of wind energy conversion systems is taxable and/or exempt based on the size of the system. The table below summarizes the tax status of each type of wind energy conversion system for taxes payable in 2003. *Minn. Stat. § 272.02, subd. 22 (2001 Suppl.)*. Prior to the 2000 assessment, the county assessors were responsible for valuing wind conversion systems. However, beginning with the 2000 assessment, the responsibility was transferred to the DOR. *Laws 2000, ch. 490, art. 5, sec. 15*.

Taxation of Wind Energy Conversion Systems				
Size of System	Land	Foundations and Support Pads	Structures	Turbines, Blades, Transformers, and Equipment
Small (less than 2 megawatts)	Taxable	Exempt	Exempt	Exempt
Medium (more than 2 megawatts, but less than 12 megawatts)	Taxable	Taxable	Exempt for 5 years; 30% taxable thereafter	Exempt
Large (more than 12 megawatts)	Taxable	25% taxable	25% taxable	25% taxable

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Currently there are 20 private wind energy projects in the state; ten are categorized as small scale, six are medium scale, and four are large scale. There are also two municipal wind energy systems (cities of Marshall and Moorhead) which are small-scale systems (these two are exempt because they are publicly owned). Nineteen of the systems are located in southwest Minnesota (Lincoln, Lyon, Pipestone, and Murray counties), one in Clay County, one in Sherburne County, and one in Dodge County. The total estimated market value of wind energy conversion systems exempted for the 2002 assessment year is over \$100 million.

An important issue arose on how to define the size of the system since the different sizes were taxed differently. Wind developers attempted to make these projects seem smaller than they actually were to qualify for more beneficial tax treatment. The 2001 Legislature reacted by defining how the total size of wind energy conversion systems is to be determined for purposes of property taxation. They provided that the nameplate capacity of all wind energy conversion systems located within five miles of each other, constructed in the same calendar year, and under the same ownership be combined in determining if the system is a small-, medium-, or large-scale system for wind energy systems installed after January 1, 2001. *Laws 2001, 1st spec. sess., ch. 5, art. 3, sec. 16*.

The 2001 Legislature also allowed a developer of a new or existing medium- or large-scale wind energy conversion system to negotiate with the city or town and the county where the system is located to establish a payment in lieu of property taxes on the property. The payment is to provide fees or compensation to the host jurisdictions to maintain public infrastructure and

services. The payment in lieu agreement must be signed by the parties and filed with the Commissioner of Revenue and the county recorder. Upon execution and filing of the agreement, the personal property of the system is exempt from property tax. The exemption is effective for the same duration as the in lieu payments are in effect. *Laws 2001, 1st spec. sess., ch. 5, art. 3, sec. 22.* For taxes payable in 2003, no known negotiations under this provision are in effect.

The Future: 2004 and Thereafter, Production Tax

The local governments remained unhappy with the changes made by the 2001 Legislature. They argued that an acceptable in lieu payment would not be agreed upon and that the taxes based on property were not sufficient. After numerous meetings, the affected counties and wind developers agreed upon a production tax, which the legislature enacted in 2002.

The new law imposes a production tax on the production of electricity from wind energy conversion systems in lieu of the property tax installed after January 1, 1991. The land upon which the system is located remains taxable for purposes of property taxation. Rates of tax are based on the size of the wind energy conversion system.

- A large-scale system (nameplate capacity of more than 12 megawatts) will pay 0.12 cents per kilowatt-hour.
- A medium-scale system (nameplate capacity between two and 12 megawatts) will pay 0.036 cents per kilowatt-hour.
- A small-scale system (nameplate capacity of two megawatts or less) will pay 0.012 cents per kilowatt-hour.
- Exempt from the production tax: Very small conversion systems with a nameplate capacity of 0.25 megawatts or less and small-scale systems (two megawatts or less) owned by a political subdivision.

Annually on or before March 1, beginning in 2004, the owner of the wind energy conversion system will file a report to the DOR detailing the amount of electricity produced in the previous calendar year. The tax, based on the above rate schedule, will be paid to the county at the time and in the manner in which personal property taxes are due. The revenues will be distributed among the taxing jurisdictions in proportion to their tax rates. The payment in lieu of property tax (enacted in 2001), which could be negotiated with the host community was changed to a payment in lieu of the production tax by the 2002 Legislature. *Laws 2002, ch. 377, art. 4, sec. 12.*

The amount of the initial year's production tax will not be known until March 2004. That tax will be based on the calendar year 2003 production. However, the DOR is estimating that the tax will be about \$1 million. A county-by-county breakdown of the total estimated tax amount for all taxing jurisdictions is shown on the following page. This estimate may be low since it does not include the production from any new systems which may "come on line" during the latter part of calendar year 2003.

The 2003 Legislature appropriated dollars for production incentives for the small scale wind systems. It also required Xcel Energy to deploy additional megawatts of wind energy by 2010 (see [page 19](#)).

**Total Estimated Wind Production Tax by County
Based on 2003 Production Tax, Due in 2004
(Total All Taxing Jurisdictions)**

Lincoln	\$520,781
Pipestone	451,577
Murray	2,672
Rock	791
Sherburne	122
Dodge	2,208
Clay	643
Total	\$978,794

Since the production tax is in lieu of property tax, the law exempts wind energy conversion systems from property tax. However, the land on which the systems are located remains subject to property tax. *Laws 2002, ch. 377, art. 4, sec. 6; further amended by Laws 2002, ch. 400, sec. 9.*

Xcel Energy's Prairie Island 2003 Law; Tax Implications

A few provisions affecting the issues discussed in this brief were included in the 2003 legislation authorizing additional storage capacity for the spent nuclear fuel generated by Xcel Energy's Prairie Island nuclear generation facility. *Laws 2003, 1st spec. sess., ch. 11.* Those provisions are as follows:

- **Mesaba energy project:** Provides for a number of regulatory incentives for an “innovative energy project on the Iron Range,” which generates electricity by utilizing “coal as a primary fuel in a highly efficient combined cycle configuration with significantly reduced sulfur dioxide, nitrogen oxide, particulate, and mercury emissions” when compared with traditional technologies (see [page 14](#)). The regulatory incentives include:
 - an exemption from demonstrating need for the facility or associated transmission facilities;
 - a grant of eminent domain authority for transmission routes approved by the Environmental Quality Board; and

- an entitlement to enter into a power purchase agreement with Xcel Energy to provide 450 megawatts of capacity and energy, subject to the approval of the PUC.
- **Northom biomass facility:** Requires Xcel Energy to enter into a power purchase agreement with this facility by January 1, 2004, for 10 to 20 megawatts of biomass energy and capacity at a price not to exceed \$55 per megawatt-hour. The project must be operational by June 30, 2005 (see [page 12](#)).
- **Wind energy:** Provides \$4.5 million dollars a year for production incentives of 1.5 cents per kilowatt-hour produced by wind facilities under 2 megawatts. Proponents contend these incentives should result in another 100 megawatts of small wind energy capacity in the state. The legislation also requires Xcel Energy to deploy 300 megawatts of wind energy capacity in the state by 2010, in addition to the 825 megawatts the utility is already committed to deploy.

For a complete summary of this energy legislation, see www.house.mn/hrd/as/83/2003-1/as011.html.

For more information about property taxes and electric utilities, visit our web site, www.house.mn/hrd/issinfo/tx_prop.htm.