

Legislative Fiscal Bureau

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February 21, 2012

TO: Senator Robert Jauch
Room 415 South, State Capitol

FROM: Sean Moran, Fiscal Analyst

SUBJECT: Proposed Changes to the Metalliferous Mining Tax

At your request, I am providing information regarding: (a) the metalliferous mining tax under current law; (b) changes to the metalliferous mining tax under Assembly Bill (AB) 426; (c) your proposed changes to the net proceeds occupational tax on state metalliferous mining operations; and (d) a hypothetical analysis of how the proposed changes might affect Gogebic Taconite's tax liability for the proposed ferrous metallic mine in northern Wisconsin.

Wisconsin Metalliferous Mining Tax -- Current Law

Wisconsin imposes a net proceeds occupational tax on state metalliferous mining operations. The mining tax is imposed using a progressive, bracket-based rate structure that is indexed to the annual change in the gross national product (GNP) deflator for June of the current year compared to June of the previous year, subject to a maximum yearly increase of 10%. The table below shows the tax rate structure that was in effect for calendar year 2011. Persons mining metalliferous minerals must file a report with, and remit taxes to, the Department of Revenue (DOR) on or before June 15 reflecting net proceeds and metalliferous mining taxes due for the prior calendar year.

2011 Mining Tax Rate Structure

Net Proceeds			Rate
\$0	to	\$527,600	0%
527,601	to	10,554,000	3
10,554,001	to	21,107,900	7
21,107,901	to	31,662,100	10
31,662,101	to	42,216,400	13
42,216,401	to	52,679,900	14
52,679,601	or more		15

The tax is determined by adding together the gross proceeds from mining and subtracting allowable deductions. Current law enumerates specific deductions, such as the actual costs of labor and supplies in mining, costs of extracting and processing the ore, costs of mining related services, federal and state taxes paid, and site reclamation and restoration costs. Current law deductions are described in the Attachment.

All revenues generated from the tax are deposited in the Investment and Local Impact Fund (ILIF), which is a segregated account administered by the Investment and Local Impact Fund Board (ILIFB). The fund was established in 1977 to provide financial assistance to local units of government experiencing social, educational, environmental, or economic impacts associated with metalliferous mining. The ILIFB is attached to DOR for administrative purposes and consists of eleven members, including: (a) the chief executive officer of the Wisconsin Economic Development Corporation or his or her designee; (b) the Secretary of DOR or his or her designee; (c) three public members; (d) five local officials consisting of two municipal officials, two county officials, and one school board member; and (e) one Native American. The public members, local officials, and Native American member must be appointed by the Governor for staggered four-year terms, subject to certain criteria enumerated in statute. It should be noted that no members are currently appointed to the Board.

The most recent mining operation in the state was the Flambeau mine in Rusk County. As a result of this mining activity, the state collected net proceeds taxes of approximately \$440,000 in 1993-94, \$6.13 million in 1994-95, \$6.41 million in 1995-96, \$1.07 million in 1996-97, and \$30,000 in 1997-98. The mine closed operations in 1997 and the mine site was reclaimed in 1998. No revenues have been generated from that mine since 1997-98.

Current law requires that net proceeds taxes deposited into the ILIF must be used for specified purposes. Eligible counties, cities, towns, villages, and tribes that are affected by mining activity must be paid a first-dollar payment from the ILIF. A first dollar payment is defined as an amount equal to \$100,000, indexed for inflation against the GNP deflator. For 2011-12, the first-dollar payment is \$211,000. Counties are also entitled to an additional payment of 20% of the tax collected, annually, from persons extracting metallic minerals in the county up to \$250,000 (indexed for inflation against the GNP deflator). For 2011-12, the additional payment to counties may not exceed \$527,500, annually. Ten percent of the tax paid by each mine to the fund, plus all accrued interest on that amount, must be retained by the Board to: (a) ensure an annual payment to

each county, city, town, village, and school district in an amount equal to the average payment for the three previous years; (b) reimburse counties, municipalities, and school districts for costs associated with the cessation of mining; and (c) indemnify counties, municipalities, and school districts for reclamation expenses.

The ILIFB may award discretionary monies to affected counties, cities, towns, villages, school districts, tribes, and local impact committees. Discretionary payments may be made to these entities to pay for certain reasonable expenses for the purposes permitted under state law. In addition, if a mine is abandoned and must be reclaimed, certain payments must be made to DNR for long-term care of mining waste sites and environmental repair for mining waste sites.

Changes to the Wisconsin Metalliferous Mining Tax Under AB 426

AB 426 would not modify the current law imposition of the net proceeds tax. However, the bill would require that 60% of the revenues collected from the tax on ferrous mining be deposited into the general fund instead of the ILIF. Therefore, the amounts available for distribution to impacted local units of government and tribes from ferrous mining activities would be reduced by 40%, as compared to current law. The current provisions regarding required distributions from the ILIF would not be changed.

Proposed Changes to AB 426

Your proposed changes to AB 426 would restore the current law provision that 100% of metalliferous mining tax revenues are deposited into the ILIF. In addition, your proposal would require that a person mining ferrous metallic minerals must calculate the amount of net proceeds tax due under current law and pay that amount or \$5 million, whichever is greater, for the first five years in which ferrous metallic minerals are mined in this state. If the person mining ferrous metallic minerals were subject to the minimum \$5 million tax during a year of production, that person would be eligible for a dollar-for-dollar credit to be used in future tax years, calculated as the difference between what would have been paid under the current law net proceeds tax and the amount that the person paid in that year. The credit could be claimed in any tax year; however, the credit could not be used in an amount that would reduce tax liability below \$5 million during the first five years of ferrous mining operations. For the first year of mining operations, the minimum payment would be prorated for the portion of the year in which ferrous metallic mining occurred. The difference between the prorated amount in the first year and the \$5 million minimum tax payment would be applied as a minimum tax liability for production that would occur in the sixth year of operation. Current law provisions regarding distribution from the ILIF would not be changed.

Potential Net Proceeds Tax Liability Under Current Law and the Proposed Changes to the Metalliferous Mining Tax

As you requested, I am providing estimates of potential net proceeds tax revenues from the proposed iron ore mining operation in the Penokee Mountain under current law and your proposal. It should be noted that changes in the assumptions used in calculating the potential tax

liability for Gogebic Taconite's proposed mine could result in significantly different estimates.

Assumptions for quantity produced and price per ton. For purposes of this analysis, it is assumed that the proposed mining operation will produce 8 million long tons (2,240 pounds per ton) of ferrous metallic minerals in each year of Phase I operation, as estimated in NorthStar Economics, Inc.'s economic impact report of Gogebic Taconite's proposed mine in the Penokee Mountain Range. It is unknown during which month the proposed mine would begin production. For purposes of this analysis, it is assumed that six months of iron ore pellets would be produced during the first year, resulting in a prorated amount of 4 million long tons of pellets during the first year of operation, and 8 million tons in each successive year of operation. According to the report, the ferrous metallic minerals would be of similar quality to taconite produced in Minnesota. Based on historical information from World Steel Dynamics, there is significant volatility in the price of iron ore pellets. Over the past ten years, the price has ranged from a low of \$31.28 per long ton in 2002 to a high of \$184.26 per long ton in 2010. For purposes of this analysis, it is assumed that Gogebic Taconite would be able to sell their product for \$100 per long ton in current dollars.

Assumptions for the first few years of production in Wisconsin. If the company began the permitting process in early 2012 and obtained a permit in early 2014, the mine would be able to begin construction in 2014. According to the Northstar analysis, it is anticipated that construction of the mine would take two years prior to the extraction of the iron ore from the mine. Under this assumption, the first year of extraction would be 2016, with Wisconsin net proceeds taxes first due in June of 2017. In the early years of operation, it is likely that the mining company would have significant deductions for depreciation of machinery and structures used in mining, and for amortization of permit fees and other pre-mining expenditures. Therefore, the mine would likely have a reduced amount of taxable net proceeds in the initial years of operation. It is unknown what portion of gross proceeds would be taxable after current law deductions were applied. For purposes of this analysis, it is assumed that the percentage of gross proceeds subject to the net proceeds tax would be: (a) 0% for the first year of operation; (b) 2.5% for the second year; (c) 5% for the third year; (d) 7.5% for the fourth year; (e) 10% for the fifth year; (f) 12.5% for the sixth year; and (g) 15% in the seventh year and for each year thereafter.

Production year. As noted earlier, Wisconsin's tax brackets are adjusted yearly in accordance with the GNP deflator. This analysis uses calendar year 2011 tax rates, which are the tax rates that have most recently been published for Wisconsin.

Estimated revenues under these assumptions. Under Wisconsin's current law net proceeds tax, the amount of net proceeds subject to tax would be determined by subtracting allowable deductions from the amount of gross proceeds generated by the sale of metallic minerals. Assuming that production would begin July, 2016, it is estimated that four million long tons of iron ore pellets would be produced in 2016 and eight million long tons of iron ore pellets would be produced in 2017 and annually thereafter. The gross proceeds, under an assumed price of \$100 per long ton of ferrous metallic product, are estimated at \$400 million in 2016 and \$800 million in 2017 and annually thereafter.

Under the proposal, a person mining ferrous metallic minerals would be required to pay \$5 million for each of the first five years, with the required payment in the first year prorated to reflect the percentage of the year for which mineral production occurred. For the sixth year, the minimum payment for production in that year would be the difference between the minimum payment required in the first year and \$5 million. Under the assumption that the proposed mine would begin production in July, 2016, the required minimum payment for production in the first year would be \$2.5 million, and the required minimum payment for the sixth year would be the same amount (\$5.0 million - \$2.5 million = \$2.5 million). The table below compares potential differences between the amounts of net proceeds tax that Gogebic Taconite would pay, based on the assumptions discussed above, under current law as compared to the proposal from 2016 through 2022.

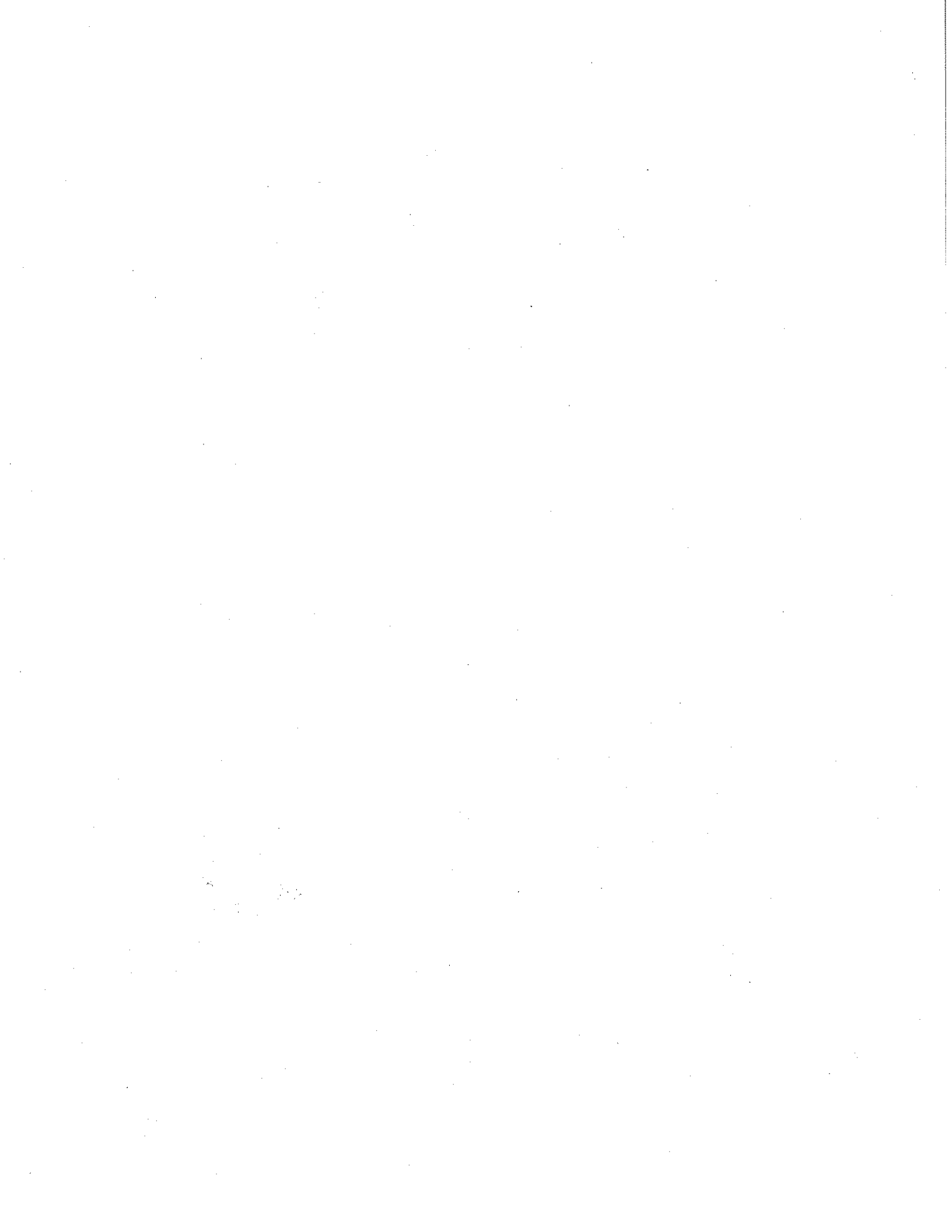
**Estimated Net Proceeds Tax Payable Under Current Law and Under the Proposal
(\$ in Millions)**

<u>Production Year</u>	<u>Gross Receipts</u>	<u>Net Proceeds Subject to Tax</u>	<u>Amount of Tax Payable Under Current Law</u>	<u>Amount of Tax Payable Under the Proposal</u>	<u>Difference</u>
2016	\$400.0	\$0.0	\$0.0	\$2.5	\$2.5
2017	800.0	20.0	1.0	5.0	4.0
2018	800.0	40.0	3.2	5.0	1.8
2019	800.0	60.0	6.0	5.0	-1.0
2020	800.0	80.0	9.0	5.0	-4.0
2021	800.0	100.0	12.0	8.7	-3.3
2022	<u>800.0</u>	<u>120.0</u>	<u>15.0</u>	<u>15.0</u>	<u>0.0</u>
Totals	\$5,200.0	\$420.0	\$46.2	\$46.2	\$0.0

As compared to current law, using the assumptions described above, it is estimated that the proposal would increase the amount of net proceeds tax paid by Gogebic Taconite by \$2.5 million for production in 2016, \$4.0 million for 2017 production, and by \$1.8 million for 2018 production. Assuming that the company would use the dollar-for-dollar credit to minimize tax liability in the first years that the credit could be used, the proposal is estimated to reduce net proceeds taxes paid by Gogebic Taconite by \$1.0 million for 2019 production, \$4.0 million for 2020 production, and \$3.3 million for 2021 production. Under these assumptions, the net tax liability would be the same under current law and the proposal over the first six years of production. As noted, that changes in the assumptions used in calculating the potential tax liability for the mine proposed by Gogebic Taconite could result in significantly different estimates.

I hope this information responds to your request, please contact me with any further questions.

SM/sas
Attachment



ATTACHMENT

Current Law Deductions from the Net Proceeds Tax

1. The actual and necessary expenses incurred during the taxable year for labor, tools, appliances, and supplies used in mining metalliferous minerals, including the labor of the lessee, the labor of the lessee's employees, and the amount expended by the lessee for tools, appliances, and supplies used by the lessee in the mining operation. The personal labor of the lessee must be computed at the prevailing wage rate.

2. The actual and necessary expenses for mining, including extracting, transporting, milling, concentrating, smelting, refining, reducing, assaying, sampling, inventorying, and handling the ore, and for further processing and transferring related to the product for which gross proceeds are received, including the cost of capital (interest and earnings) imputed to smelting and refining expenses.

3. The actual and necessary expenses for administrative, appraising, accounting, legal, medical, engineering, clerical, and technical services directly related to mining metalliferous minerals in this state, excluding salaries and expenses for corporate officers and for lobbying, as defined under laws governing the regulation of lobbying.

4. The actual and necessary expenses directly related to the repair and maintenance of any machinery, mills, reduction works, buildings, structures, other necessary improvements, tools, appliances, and supplies used in mining metalliferous minerals extracted in this state.

5. Generally all federal income taxes, state income or franchise taxes, property taxes, sales and use taxes, and other taxes paid and deductible by corporations in computing net income for corporate income tax purposes which are allocable to the mine, excluding the metalliferous mining tax. However, in the case of a mine owned by a corporation that owns other business operations or is part of an affiliated group of corporations eligible to file consolidated federal income tax returns, the determination of deductible state income or franchise taxes and federal income taxes must be made by calculating the taxable income from the mine as though the mine were a separate entity and applying the federal income tax laws and state income or franchise tax laws to this income as though the mine were filing a separate income or franchise tax return. To calculate taxable income, federal taxable income as it applies to the depletion deduction under federal laws governing percentage depletion under section 613 of the Internal Revenue Code and associated federal regulations, as amended to December 31, 1981, must be adjusted to reflect the difference between Wisconsin income or franchise tax law and federal income tax law.

6. Rents paid on personal property used in mining metalliferous minerals.

7. The cost of relocating employees within this state.

8. The cost of premiums for bonds required under laws governing bonds filed with the Department of Natural Resources.

9. The cost of premiums for insurance on persons or tangible assets relating to mining

metalliferous minerals.

10. Losses from uninsured casualty losses and the sale of personal property used in mining metalliferous minerals.

11. Depreciation or amortization on property used in connection with mining. The deduction is limited to the amount allowable as a deduction to corporations in computing net income under state corporate income tax laws. The following assets may be depreciated or amortized: (a) machinery, mills, and reduction works; (b) buildings, structures, and other improvements; (c) permit fees, license fees, and any other fees for formal written authorization required by a department or instrumentality of the state; and (d) development of the mine after the date on which extraction begins.

12. Royalties paid to owners, not including the person mining or a controlled entity or controlling entity of the person mining, of the mineral rights to the lands where the mine or an extension of the mine is located.

13. Amortization by a straight-line method over the life of the mine commencing with production of pre-mining costs, including costs for drilling, geological and engineering studies, design of facilities, pilot mines, mine testing, environmental surveys, facilities siting surveys and other exploration and development activities. Such expenses incurred after mining begins are to be expensed currently.

14. Actual and necessary reclamation and restoration costs associated with a mine in this state, including payments for future reclamation and post-mining costs required by law or by DNR order and fees and charges under DNR laws governing water and sewage, air pollution, solid waste facilities, and general environmental provisions that are not otherwise deductible. Any refunds of escrowed or reserve fund payments allowed as a deduction as specified above must be taxed as net proceeds at the average effective tax rate for the years the deduction was taken.

15. Interest determined in the following manner: (a) if the interest is specifically allocable to the development or operation of a mine or beneficiation facility from which net proceeds are derived, all of the interest is deductible; (b) if the interest is not specifically allocable to the development or operation of a mine or beneficiation facility, the proportion of the interest that equals the proportion of the capital investment in the mine and beneficiation facilities as compared to the taxpayer's total capital investment; (c) if a mine is owned by a corporation that is part of an affiliated group of corporations, "interest" means the interest paid to nonmembers of the group; and (d) the deduction for interest may not exceed 5% of the total gross proceeds for the taxable year.

16. An allowance for depletion of ores on the basis of their actual original cost in cash or the equivalent of cash.

17. Investment and Local Impact Fund administrative fees.