F I S C A L   I M P A C T   R E P O R T

ORIGINAL DATE 2/26/07
SPONSOR Harrison **LAST UPDATED** **HB** 1198

SHORT TITLE Eliminate Coal Surtax & Surtax Exemption **SB**

ANALYST Francis

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY07	FY08	FY09		
	($6,876.0)	($6,876.0)	Recurring	Severance Tax Bonding Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

Duplicates SB220

SOURCES OF INFORMATION
LFC Files
NM Taxation and Revenue Department (TRD)

Responses Received From
NM Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

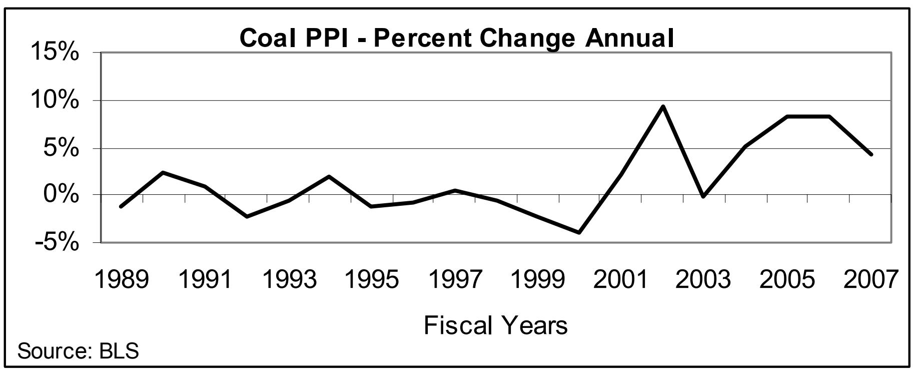
House Bill 1198 would repeal the surtax currently levied on the extraction of coal, effectively cutting the effective severance tax rate on coal in half. Under current law, the base severance tax rate is $0.57 per short ton for coal mined on the surface and $0.55 per short ton for coal mined underground. The surtax is $0.71 per short ton for surface mined and $0.73 per short ton for underground mined. The surtax is subject to annual increases base on the producer price index for coal. The exemption to the surtax is also repealed as it is no longer necessary.

The effective date is July 1, 2007.

FISCAL IMPLICATIONS

According to consensus revenue estimates, the total amount generated by severance taxes on coal in FY08 is $18.3 million including intergovernmental credits for extraction on tribal lands from a production of 26.6 million tons. Of this, over half, or $9.9 million, is generated by the surtax. Of this amount, $2.9 million is offset by the Intergovernmental Tax Credit, which allows a credit of up to 75 percent of taxes levied by an Indian nation, tribe or pueblo. The net impact, $6.9 million, would negatively impact future severance tax bonding capacity as the severance tax is distributed to the severance tax bonding fund.

The severance tax rate on coal extraction is $0.57 per short ton on surface-mined coal and $0.55 per short ton on underground-mined coal. This rate has been the same since the early eighties. In 1989, a surcharge was imposed on coal extraction equal to $0.60 and $0.55 on surface and underground respectively per ton to be increased by the consumer price index beginning in 1993. In 1993, the surcharge rate on underground coal was increased to $0.58 and the index used for increasing the rate was changed to the producer price index (PPI). During most of the 90s, the cost of coal was flat or declining. In 2001, the price shot up by almost 10 percent and has been positive since then, triggering rises in the surcharge up to $0.69 for surface and $0.67 for underground. In FY07, those values will rise again to $0.73 and $0.71.



HB 1198 repeals the surcharge on coal extraction that is in effect for contracts signed prior to 1990 or coal sold on contracts signed prior to 1990 in excess of the average delivery in 1987, 1988 and 1989. The argument for repealing the surtax is that it was inequitable to companies who have signed long term agreements with electricity generators. About seventy-five percent of coal mining is “non-exempt” or subject to the surcharge. There is no indication in the data that exempt mining has been increasing at a rate indicative of a competitive advantage. In fact, most of the coal is under long term contract with the severance tax presumably built into the contract price. BHP Billington reported in a presentation to the Legislative Finance Committee in support of the repeal that they have extended their contracts with local power providers through 2016.

SIGNIFICANT ISSUES

The surcharge has not impeded the production of coal and has provided significant revenues to the state, all of which are distributed to the severance tax bonding fund. The total rate, base plus surcharge, of the tax on coal is equivalent to a 5.4 percent rate ($1.30 combined rate divided by $24 price equals 5.4 percent) which compares favorably to the top three coal producing states.

Wyoming	7% on value
West Virginia	5% on value
Kentucky	4.5% on value before credits (minimum $0.50 per ton)

The repeal or continuation of this surcharge will have no effect on production since current expansions are not subject to the surcharge. The repeal of the surcharge will also not have any effect on the price of coal since the surcharge is only applied to existing long term contracts where the price has already, presumably, been established.

TRD:

Under present law, the Severance Surtax rate is "indexed," meaning that the rate is increased periodically if the average price of coal increases. This provision was adopted to insure that severance tax revenues would increase along with any significant increase in the sales value of coal. In contrast, the Severance Tax on coal is not indexed, it is set at a fixed rate of $0.57 per ton for surface-mined coal and $0.55 per ton for underground mined coal. Thus, one implication of the proposal is that total collections of severance taxes and surtaxes would no longer increase along with increases in the value of coal. If the value of coal increases in the future, this will have the effect of reducing the average effective tax rate on the coal when the latter is measured as a percent of value.

ADMINISTRATIVE IMPLICATIONS

TRD reports that the provisions of this legislation could be implemented with available resources.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

This bill provides tax relief to coal mining companies based on existing contracts for delivery and price. Continuing to levy the surcharge keeps the severance tax rate competitive and provides funds to support the state's infrastructure investments financed by severance tax bond proceeds.

NF/nt