HB 487

Department of Legislative Services

Maryland General Assembly
2006 Session

FISCAL AND POLICY NOTE
Revised

House Bill 487 (Garrett County Delegation and Allegany County Delegation)
Ways and Means Budget and Taxation

Tax Credit for Maryland-Mined Coal

This bill phases out the Maryland-mined coal credits. The maximum amount of credits that can be claimed in each year is: (1) $9 million in 2007 through 2010; (2) $6 million in 2011 through 2014; and (3) $3 million in 2015 through 2020. The credit is completely phased out in 2021.

The bill takes effect July 1, 2006 and applies to tax year 2007 and beyond.

Fiscal Summary

State Effect: General fund revenues could increase by approximately $7.3 million in FY 2008 due to a reduction in credits claimed against the public service company franchise (PSF) tax. Future years reflect estimated savings from phase out in each year. Expenditures would not be affected.

($ in millions)	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
GF Revenue	$0	$7.3	$7.7	$7.9	$8.1
Expenditure	$0	$0	$0	$0	$0
Net Effect	$0	$7.3	$7.7	$7.9	$8.1

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: None.

Small Business Effect: Minimal.

Analysis

Bill Summary: The bill alters the existing coal-mine credits by limiting the number of credits that can be claimed under current law. Beginning in calendar 2007, a cogenerator or public service company that claims the credit under existing law must apply to the State Department of Assessments and Taxation (SDAT) for credit approval by January 15 of the following year in which the Maryland-mined coal was purchased. The maximum amount of credits that SDAT can approve in each tax year is:

- $9 million in calendar 2007 through 2010;
- $6 million in calendar 2011 through 2014;
- $3 million in calendar 2015 through 2020; and
- none in calendar 2021 and beyond.

If the amount of credits applied for exceeds the maximum amounts that can be approved in any tax year, the value of the credit is reduced by the proportional amount of excess credits sought. Of the total credits allowed in calendar 2007 through 2020, $2,250,000 are reserved annually for a facility that uses Maryland-mined coal in a Maryland facility (approximately 750,000 tons of coal).

Current Law: Public service companies in Maryland can claim a $3 per ton credit for the amount of Maryland-mined coal purchased in a calendar year. This nonrefundable tax credit can be claimed against the PSF tax and cannot exceed the State tax liability for that tax year. Cogenerators and electricity suppliers that are not subject to the public service franchise tax can also claim a $3 per ton credit for the amount of Maryland-mined coal purchased in a calendar year. The credit is restricted to the electricity suppliers that were defined before July 1, 1999 as an electricity company under the Public Utility Companies Article. This restriction does not apply if an electricity supplier is an affiliate of one of the suppliers that were defined as an electricity company prior to July 1, 1999. This nonrefundable credit can be claimed against the State income tax.

Chapter 792 of 1988 established the tax credit for Maryland-mined coal purchased by public service companies, with a sunset provision of June 30, 1991. The credit allowed was $3 per ton of coal purchased by a public service company in excess of the coal purchased by the public service company in 1986. Chapter 832 of 1989 established the Maryland-mined coal tax credit for cogenerators and electricity producers not subject to the PSF tax.

Chapter 700 of 2000 allowed the credit to be claimed for all amounts of coal purchased for both tax credits, not just the amount in excess of the amount purchased in 1986. This change was effective beginning in tax year 2001. Chapter 700 also repealed the sunset provision originally established for public service companies under Chapter 792 of 1988. Chapter 700 of 2000 was not approved by the Attorney General's Office for constitutionality and legal sufficiency, in that it was determined that a court is likely to have serious problems under the Commerce Clause of the U.S. Constitution.

From the enactment of the credit, SDAT had asserted that the credit was only available for public service companies that purchased and consumed Maryland-mined coal. However, in reviewing the law in 1995, the Attorney General concluded that an underlying purpose of the legislation was to aid the struggling Maryland coal industry and advised that consumption was not a requirement for claiming the credit. This ruling allowed companies to claim the credit for Maryland coal that was purchased and resold or otherwise used by another company.

Background:

The Coal Industry

Maryland coal production began in the 1780s, when small amounts were mined for Fort Cumberland. State coal production increased to over 1 million tons in 1865, exceeded 4 million tons by the turn of the century, and reached a peak of approximately 6 million tons in 1907. Coal production declined sharply after 1920, reflecting economic downturns, recurrent labor problems, and the extensive replacement of coal by petroleum. Production fell below 1 million tons during the 1950s and early 1960s before trending upwards, due mostly to an increasing use of coal to generate electricity (the electricity sector consumed approximately 90% of all coal consumed in the United States in 2004).

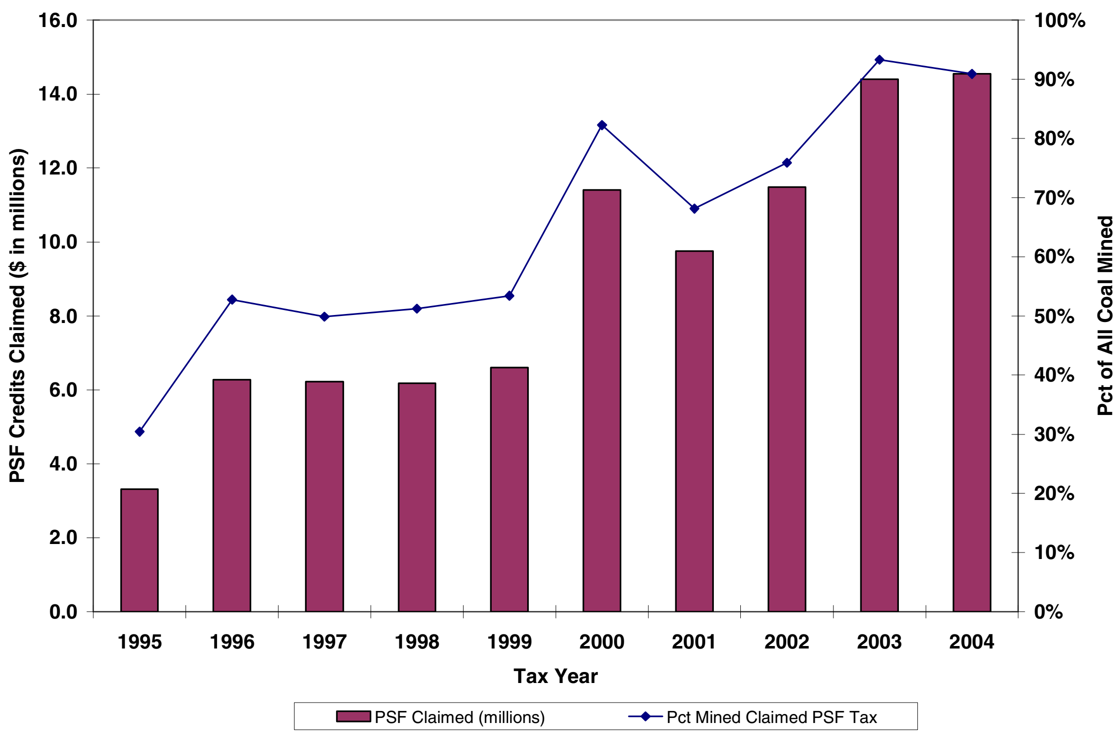
Garrett County produces approximately 80% of total State coal production with Allegany County accounting for the remaining. Production is from two adjoining coal basins, Georges Creek and Potomac, located in the North Appalachian coal region. Although 14 coal beds were mined in 2003, nearly three-fourths of the 5.1 million tons in total State production was from the Freeport coal bed. Coal production in 2004 increased by approximately 3.7% totaling approximately 5.3 million tons. Maryland's coal industry is relatively modest relative to other states. Maryland ranked twentieth of the 26 coal-producing states and accounts for less than 0.5% of total U.S. production. In 2004, surrounding states mined: West Virginia (the second largest coal producer, 148 million tons); Pennsylvania (66 million tons); and Virginia (31.4 million tons). In 2004 the average ton of coal produced per employee per hour in each state was: Maryland (5.11); West Virginia (4.03); Pennsylvania (3.99); and Virginia (2.95).

According to the Bureau of Mines, the coal industry employed 428 coal miners in 2003. This employment figure does not include office, supervisor personnel, or independent truck haulers. The U.S. Energy Information Administration reports that the Maryland coal industry employed a total of 497 individuals in 2004, which includes office and supervisor personnel. According to the Department of Labor, Licensing, and Regulation, in Quarter 1 of 2005 the mining (not just coal) industry in Allegany and Garrett counties employed 627 individuals, had a total payroll of approximately $7.4 million, and an average annual wage of $47,000 ($34,320 in Allegany and $50,444 in Garrett). These wages compare with an annual average wage of $24,440 in Garrett County and $28,285 in Allegany in 2004. Following the Attorney General's opinion that the intent of the tax credit is to aid the coal industry, the tax credit amounted to approximately $30,000 per coal industry employee in 2004.

Fiscal Impact of the Credits

Prior to 1995, the amount of credits claimed against the PSF tax was limited, averaging approximately $590,500 annually. After the Attorney General's opinion and increase in the value of the credit enacted by Chapter 700 of 2000, the amount of credits claimed has increased from approximately $3.3 million in tax year 1995 to approximately $14.6 million in 2004. Virtually all of the coal mined in Maryland is currently being claimed against the PSF tax. In tax year 2004, 91% of all Maryland coal mined was claimed against the PSF tax. **Exhibit 1** lists the amount of credits claimed against the PSF tax in tax years 1995 through 2004 and percent of all coal mined in Maryland that is claimed against the PSF tax.

Exhibit 1
PSF Credits Claimed
Tax Year 1995-2004



Source: Maryland Bureau of Mines, State Department of Assessments and Taxation

According to SDAT, four public service companies claimed the credit in tax year 2004. Based on federal and State data, Legislative Services estimates that none of the public service companies that claimed the credit consumed the coal and instead brokered it (indirectly or otherwise) to the ultimate consumer. Maryland coal has relatively high ash content and moderate levels of sulfur as compared to other types of coal. As a result of the 1990 amendments to the federal Clean Air Act, public service companies in Maryland significantly decreased their consumption of Maryland-mined coal in order to reduce emissions in the absence of installing pollution control equipment. In addition to these companies, AES Warrior Run uses Maryland-mined coal to fire its Cumberland cogeneration plant. According to the Federal Energy Regulatory Commission, the company purchased 706,605 tons of Maryland-mined coal in 2003 and 687,586 tons in 2003. The Comptroller's Office advises that, to date, it can identify $1.5 million in credits claimed in tax year 2000 and $1.0 million in tax year 2002. Industry representatives advise Legislative Services that AES Warrior Run is purchasing coal from a public service company that claims the credit on its behalf.

Several bills proposing to phase out the coal credits were introduced in the 2005 session. The 2005 Budget Reconciliation and Financing Act (BRFA), as amended and passed by the House, proposed a deliberate phase out of the credit whereby the credit would be eliminated beginning in tax year 2021. The credit against the State income tax would have been eliminated, but $2.1 million in credits from tax year 2007 through 2020 would have been reserved for a facility that uses Maryland-mined coal. The 2005 BRFA, as enacted, contained nonbinding intent language that the General Assembly pass legislation in 2006 providing for a phase out and repeal of the Maryland-mined coal tax credits.

Coal Industry Subsidies in Other States

Other states allow companies to claim credits for the purchase of state coal, including Virginia, Kentucky, and Ohio. Pennsylvania has supported efforts to construct new power plants that can use high sulfur content coal typically found in Eastern coal.

Kentucky

Kentucky electricity producers are allowed to claim a credit equal to $2 per ton of qualifying Kentucky coal in excess of those consumed in a base year. For companies in existence by July 14, 2000 the base year is 1999; otherwise the base amount of coal is zero. The coal must be subject to the state's coal severance tax and the credit can be claimed against the State income tax and public service company property tax.

Ohio

Earlier this year, the Ohio legislature extended the state coal tax credit for electric companies that burn Ohio coal to generate electricity. In extending the credit, however, the legislature reduced the value of the credit from $3 per ton to $1 per ton in tax years 2006 through 2008. The credit can be claimed against the state corporate income tax and is scheduled to terminate January 1, 2008. In order to qualify for the credit, the generating facility at which the coal is burned must employ qualified pollution control devices. A total of $36.8 million in coal credits were claimed in tax year 2004.

Virginia

Virginia has two credits designed to subsidize the state coal industry; the Virginia Coal Employment and Production Incentive and the Coalfield Employment Enhancement. Under the production incentive credit, electricity producers can claim a credit equal to $3 per ton of state coal purchased and *consumed*. The Virginia legislature in 2000 added the requirement that consumption was necessary in order to claim the credit in response to a local utility claiming the credit for coal it brokered to other entities.

Generally, coal producers can qualify for a credit of between $1 and $2 per ton for coal that is mined underground while surface-mined coal can qualify for a credit of $0.40 per ton. The credit is scheduled to expire on January 1, 2008. The producer credit cannot be claimed for any coal that is sold to an electricity generator that claims the purchase of the coal against the production incentive credit.

Pennsylvania

In late November 2005, Governor Rendell introduced a proposal to provide for state-backed financing to transform older electricity power plants into ones that can burn synthetic natural gas through the gasification of coal. This is in addition to a joint state-federal initiative for construction of an early entry co-production energy plant designed to convert some of the state's 250 million tons of waste coal, which is estimated to foul approximately 250,000 acres of land, into synthetic diesel fuel. The state has pledged $47 million in tax credits while the federal government has provided $100 million in financing. Morgan Stanley is coordinating the private financing of an additional $465 million.

State Revenues:

Phase-out of Tax Credit

As a result of the phase-out of the Maryland-mined coal tax credits beginning in tax year 2007, general fund revenues would increase by approximately $7.3 million in fiscal 2008, $7.7 million in fiscal 2009, $7.9 million in fiscal 2010, and $8.1 million in fiscal 2011. The estimated revenue gains, and out-year projections, are based on the following facts and assumptions:

- According to the Maryland Bureau of Mines, approximately 5.8 million tons of coal was mined in 2005. From 1994 to 2005 the amount of coal mined increased on average by 4.6% annually.
- The average amount of coal mined from 2006 through 2010 is estimated to increase by approximately 2%.
- Approximately 92% of all coal mined in 2003 and 2004 was claimed against the public service franchise tax.
- No credits will be claimed against the State income tax.

Officials of the largest coal producer in Maryland have indicated that it has nearly exhausted its Maryland coal reserves and production from its Maryland mines is likely to decrease substantially after 2006. This producer accounted for a little less than one-half of total State production in 2005. To the extent that production from these mines decreases without a corresponding increase in production in other mines located in the State, the increase in revenues from repealing the credit would be less than estimated. However, according to the U.S. Energy Information Administration (EIA), there are approximately 17 million tons of recoverable coal reserves at Maryland-producing mines in addition to 366 tons of estimated total recoverable reserves of Maryland coal. An EIA coal analyst contacted by Legislative Services does not foresee a significant reduction in the amount of coal mined in the State in the near future.

Further, the amount of coal mined by this coal producer has decreased by a total of 17% from 2003 to 2005. Notwithstanding this decrease, the total amount of coal mined in the State during this time has increased by a total of 13%.

Small Business Effect: The overall impact of the bill on small businesses is expected to be minimal. To the extent that any small businesses are currently involved in brokering coal on behalf of public service companies, these small businesses that benefit under current law from the brokering of coal could be negatively impacted by the bill.

Additional Information

Prior Introductions: None.

Cross File: SB 335 (Senator Hafer) – Budget and Taxation.

Information Source(s): State Department of Assessments and Taxation, Comptroller's Office, Department of Legislative Services

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