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February 16, 2012

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Metalliferous Mining: Taxes Under Current Law and 2011 Assembly Bill 426 (AB 426)

At your request, this memorandum provides information regarding: (a) the metalliferous mining tax under current law; (b) changes to the use of metalliferous mining tax revenue under AB 426, as passed by the Assembly; (c) Notice of Intent (NOI) fees and construction fees paid by mining companies into the Investment and Local Impact Fund (ILIF); (d) an estimated timeline under current law and under the bill for when payments into the ILIF might become available to local units of government from construction of Gogebic Taconite's proposed iron ore mine for northern Wisconsin; and (e) a description of sales taxes, corporate income taxes, and property taxes that a mining company would be subject to under both current law and under AB 426.

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 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, as passed by the Assembly, would not modify the current law imposition of the net proceeds tax. However, the bill would require that 40% 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 compared to current law. The current provisions regarding required distributions from the ILIF would not be changed.

Mining Fees Deposited Into the ILIF -- Current Law

Notice of Intent Fee. Current law requires that each person intending to submit an application for a mining permit must pay a NOI fee of $50,000 to DOR for deposit in the ILIF at the time the person notifies DNR of its intent to prospect or mine. Once the applicant is notified that the ILIFB has distributed 50% of this amount, the applicant must make a second payment to DOR of $50,000. After the applicant is notified that the Board has distributed all of the first payment and half of the second payment, the applicant must make a third payment of $50,000.

The Board may distribute NOI fees to a county, town, village, city, tribe, or a local impact committee authorized under DNR metallic mining laws governing prospecting, mining, and reclamation. The fees may only be used for the following purposes: (a) legal counsel; (b) qualified technical experts in the areas of transportation, utilities, economic and social impacts, environmental impacts, and municipal services; and (c) other reasonable and necessary expenses incurred by the recipient that directly relate to the good faith negotiation of a local agreement, as specified under DNR metallic mining laws, for the proposed mine for which the payment is being made.

Construction Fee. Under current law, each person constructing a metalliferous mine must pay to DOR for deposit in the ILIF a one-time construction fee no more than 30 days after the beginning of construction to be paid to each Native American community, county, city, town, and village that contains at least 15% of a minable ore body in respect to which construction has begun. Similar to the net proceeds tax brackets, the construction fee is indexed to the annual change in the GNP deflator for June of the current year as compared to June of the prior year. For 2011-12, the construction fee for each mining site is $211,000. The construction fee may be credited against net proceeds taxes in future years and may be carried forward; however, the credit may not reduce the

taxpayer's net proceeds tax liability below the amount needed to make first-dollar payments to eligible counties, cities, towns, villages, and tribes.

These provisions would not be changed by AB 426.

Potential Timeline for Metalliferous Mining Tax and Fee Payments from the ILIF -- Current Law and Modifications Under AB 426

This section presents a potential timeline regarding when funds might be available for local units of government, under current law and under the bill, from Gogebic Taconite's proposed iron ore mine in Ashland and Iron Counties. As noted, no members are currently appointed to the ILIFB. Under both current law and under the bill, the Governor must make appointments to the Board, with approval of the Senate. No revenues may be disbursed from the ILIF to any local governmental entity without approval by the Board.

Current Law. As noted, current law requires that each person intending to submit an application for a mining permit must pay an initial NOI fee of $50,000 to DOR for deposit in the ILIF at the time the person notifies DNR of its intent to prospect or mine. Assuming that Gogebic Taconite would begin the DNR permitting processes in January, 2012, Gogebic Taconite would pay the initial NOI fee at that time. Once the ILIFB has been reconstituted, the Board must distribute these revenues, and the two subsequent payments (up to $150,000 of total NOI fees), from the fund in the manner described above.

Under current law, no overall timeline exists for the DNR permitting process with respect to metallic mining. Primarily based upon testimony from the Department, while the timeframe may vary dramatically, the permitting process for a Wisconsin mining operation could be expected to take between three and four years, but would depend on the size, location, and complexity of the proposed project, as well as the cooperation of the mining company, local governments, and interested individuals or groups. The proposed iron ore mine for Gogebic Taconite is anticipated to be a large scale operation and is expected to receive a considerable amount of public input. Since current law does not impose a time limit on the overall DNR permitting process, it is unknown how long this process would take to approve the company's permit and begin construction of the mine. For the purposes of this memorandum, it is estimated that the permitting process would be completed and all approvals granted in four years under current law; therefore, construction is estimated to begin in 2016. The one-time construction fee must be paid no more than 30 days after the beginning of construction to eligible tribes, counties, cities, towns, and villages in the manner described above. Based upon these assumptions, it is estimated that Gogebic Taconite would pay, and eligible local governmental entities would receive, the one-time construction fee ($211,000 in 2011-12) in 2016 under current law.

According to the economic impact analysis published by Northstar Economics, Inc., construction of Gogebic Taconite's proposed mine would take approximately two years. If ore production began in 2018, net proceeds tax revenues would be first payable into the fund in June, 2019. All tax revenues would accrue to the ILIF. Revenues would be used to make first dollar payments, additional county payments, and discretionary payments to eligible local units of

government. 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.

Timeline under AB 426. Under the bill, the DNR permitting process would be reduced to approximately two years. It is possible that the permit could be issued in a shorter amount of time under the bill; however, approval of the federal environmental impact statement and other federal permits may delay the beginning of mine construction. For purposes of this memorandum, it is estimated that the DNR permitting process would be completed in two years and that federal permits would not delay mine construction. As compared to the timeline of payments described above, and assuming that Gogebic Taconite would begin the permitting process in January 2012 (and assuming DNR would approve the permit), it is estimated that once the Board were reconstituted: (a) the NOI fees would be collected and distributed in 2012; (b) construction of the mine would begin and the construction fee would be collected and distributed in 2014; and (c) the first year of production would be 2016, with net proceeds taxes first due and payable June, 2017. Similar to current law, 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 in the early years of operation. Therefore, the mine would likely have a reduced amount of taxable net proceeds in the initial years of operation. As noted, the amount of net proceeds tax revenues that would be available to eligible local units of government would be reduced by 40% under the bill as compared to current law.

According to testimony from the Army Corps of Engineers, federal approval of the proposed mine's environmental impact statement and approval of wetland and other navigable water permits are often performed in conjunction with state agencies. Limiting the time DNR may review the application for a permit may result in the applicant paying for duplicative work for the state and federal review process, and may result in the federal permitting process taking longer than two years. If that were to occur, the permitting process could be delayed longer than is contemplated under the bill. Under this circumstance, construction of the mine would be delayed pending federal permit decisions.

Sales and Use Taxes -- Current Law

Under current law, manufacturing is defined for the purposes of state sales and use taxes as the production by machinery of a new article of tangible personal property, item, or property with a different form, use, and name from existing materials, by a process popularly regarded as manufacturing. Manufacturing begins with conveying raw materials and supplies from plant inventory to the place where work is performed in the same plant, and ends with conveying finished units of tangible personal property, items, or property to the point of first storage in the same plant. Manufacturing specifically includes: (a) crushing, washing, grading, and blending sand, rock, gravel, and other minerals; (b) ore dressing, including the mechanical preparation, by crushing and other processes, and the concentration, by flotation and other processes, of ore, and beneficiation, including the preparation of ore for smelting; (c) conveying work in progress directly from one manufacturing process to another in the same plant; (d) testing and inspecting, throughout the

manufacturing process, the new article of tangible personal property, item, or property that is being manufactured; (e) storing work in progress in the same plant where the manufacturing occurs; (f) assembling finished units of tangible personal property, items, or property; and (g) packaging a new article of tangible personal property, items, or property if the manufacturer, or another person on the manufacturer's behalf, performs the packaging and if the packaging becomes part of the new article as it is customarily offered for sale by the manufacturer.

The definition of manufacturing specifically excludes: (a) storing raw materials or finished units of tangible personal property, items, or property; (b) research or development; (c) delivery to or from the plant; and (d) repairing or maintaining plant facilities.

Based on the current law definition of manufacturing, a company engaged in mining activities is generally entitled to the same state sales and use tax exemptions provided to other manufacturers. Current law provides the following sales tax exemptions for purchases by manufacturers:

a. Property that becomes an ingredient or component that is used exclusively and directly by a manufacturer in manufacturing an article of tangible personal property, that becomes an ingredient or component part of an article of property, or that is consumed or destroyed or loses its identity in the process of manufacturing tangible personal property that is subsequently sold.

b. Fuel and electricity consumed in manufacturing tangible personal property in Wisconsin.

c. Mobile units used for mixing and processing.

d. Machinery and equipment, including safety attachments and repair parts, used exclusively and directly by a manufacturer in manufacturing.

e. Motor vehicles not required to be licensed and used for recycling or waste reduction activities.

f. Property that becomes a component part of a waste treatment facility.

g. Equipment and parts used exclusively for waste reduction or recycling.

AB 426 does not modify current law sales and use tax exemptions. Therefore, the exemptions listed above would likely be provided for Gogebic Taconite's proposed iron ore mining operation in the Penokee Mountain Range. In addition to these exemptions, most services such as legal services, geological consulting services, water quality consulting services, and other professional services are not subject to sales tax.

It should be noted that other types of business inputs, such as stationary, office furniture, and tangible personal property, items, and property that are not used in a manner that qualifies for the manufacturing exemption, would be subject to tax. For example, under current law, machinery used to physically extract mineral ore from the ground, as well as fuel, accessories, and parts of

such machinery, does not qualify as machinery used in manufacturing and is subject to sales and use tax both under current law and under the bill.

Corporate Income/Franchise Tax -- Current Law

In general, a corporation determines state corporate income/franchise tax liability by computing gross or total income, subtracting deductions, apportioning the net income to the state (if necessary), adjusting for nonapportionable income and net operating losses (if applicable), applying the 7.9% state tax rate, and subtracting tax credits. Corporations that operate entirely in Wisconsin do not apportion net income. However, multistate corporations must apportion part of their income to the state. If the corporation is a member of a combined group of corporations, an individual corporation's income/franchise tax liability is based on the group's combined income computed in a combined report that must be completed by each such group.

Gross business income is income that is generated by a taxpayer in the active conduct of a trade or business. For tax purposes, total income includes gross profit, dividends, interest, rents, royalties, capital gains or losses, and other income.

Deductions are subtracted from gross income in determining net or taxable income. Deductions are provided for compensation of officers and employees, repairs, taxes, interest, charitable contributions, depreciation and amortization, expensing certain depreciable assets (Section 179 expensing), bad debts, rents, depletion, insurance, retirement plans, employee benefit programs, advertising, and other ordinary and necessary business expenses. The state net proceeds tax on metallic mineral mining is deductible.

Generally, state definitions of income and deductions are referenced to federal law. For corporate income tax purposes, state provisions are referenced to the federal Internal Revenue Code (IRC) in effect on December 31, 2010, with numerous exceptions. Included in these exceptions are state depreciation deductions, which are referenced to federal IRC provisions in effect on January 31, 2000. Also, Wisconsin has different maximum expense and phase-out thresholds for expensing certain depreciable assets (section 179 expensing), and does not provide the federal domestic production activities deduction.

For state tax purposes, specified rules and laws are used to allocate or assign income of a particular corporate taxpayer to the state for tax purposes.

A corporation that conducts all of its business and owns property only in Wisconsin has all of its income subject to taxation in Wisconsin. Usually, such firms are incorporated in Wisconsin. These types of firms are often referred to as 100% Wisconsin firms, and they compute their taxes very much like a Wisconsin resident does under the individual income tax.

A corporation which conducts its business operations and owns property both within and outside of the state is subject to a different corporate income tax treatment than is a 100% Wisconsin firm. Wisconsin generally employs one of three methods of assigning the income of a

multistate corporation to the state--separate accounting, apportionment, or specific allocation.

Under Wisconsin law, a multijurisdictional corporation must use separate accounting when the corporation's business activities in the state are not an integral part of a unitary business. Separate accounting implies that the income and expenses of each specific business function or activity of a multijurisdictional corporation can be accounted for individually and independently. The corporation must determine the income attributable to Wisconsin using separate records of the sales and expenses for the Wisconsin business. Currently, few multijurisdictional corporations in the state use separate accounting to determine their net tax liability.

Under apportionment, the corporation adds its total gross income from its in-state and out-of-state unitary business activities, subtracts its deductions, and multiplies the amount of net income by its apportionment ratio, or percentage, as determined by the Wisconsin apportionment factor. The apportionment percentage is used to approximate how much of a corporation's total net income is generated by activities in Wisconsin. Most multistate corporations, apportion income to Wisconsin using single sales factor apportionment.

The statutes and administrative rules include provisions for determining if certain sales are considered to be in Wisconsin, and therefore included in the numerator of the sales factor. (In general, all the corporation's sales or gross receipts are included in the denominator.) For the purposes of the sales factor, sales of tangible personal property are considered in the state, regardless of the f.o.b. point (where responsibility for goods is transferred) or other conditions of the sale, if: (a) the property is delivered or shipped to a purchaser, other than the federal government, within the state; or (b) the property is shipped from an office, store, warehouse, factory, or other place of storage in Wisconsin and delivered to the federal government within the state.

In addition, certain sales of personal property in states where a taxpayer has no nexus are treated as being in Wisconsin. These sales are known as "throwback sales", and include the following:

a. Sales of tangible personal property that is shipped from an office, store, warehouse, factory, or other place of storage in Wisconsin and delivered to the federal government outside the state, and the taxpayer is not within the jurisdiction, for income tax purposes, of the destination state.

b. Sales of tangible personal property that is shipped from an office, store, warehouse, factory, or other place of storage in Wisconsin to a purchaser, other than the federal government, and the taxpayer is not in the jurisdiction, for income tax purposes, of the destination state.

c. Sales of tangible personal property by an office in Wisconsin to a purchaser in another state, that are not shipped or delivered from Wisconsin, if the taxpayer is not within the jurisdiction, for income tax purposes, of either the state from which the property is delivered or shipped, or the destination state.

Generally, for individual multijurisdictional corporations, the sales factor is a percentage determined by dividing the total sales or receipts of the corporation in Wisconsin by the total sales or receipts of the corporation everywhere. Sales are generally all gross receipts from the course of the taxpayer's regular trade or business operations which produce apportionable business income. Specific provisions apply regarding receipts of interstate financial institutions, brokerages, and other investment businesses.

Allocation of nonapportionable income traces the income to the state of its supposed source and includes the income in that state's tax base. For state income and franchise tax purposes, nonapportionable income includes income, gain, or loss from: (a) the sale of nonbusiness real property or nonbusiness tangible personal property; (b) rental of nonbusiness real property or nonbusiness tangible personal property; and (c) royalties from nonbusiness real property or nonbusiness tangible personal property.

Under state tax provisions, net business losses, if any, are used to offset state taxable income before the state tax rate is applied to net income. The state corporate income tax rate is 7.9%, and is applied to all income subject to the state corporate income tax. The resulting amount is the corporation's gross tax liability.

State tax credits can then be used to offset gross tax liability to determine the corporation's net tax liability. Wisconsin provides both refundable and nonrefundable tax credits under the corporate income tax. Corporate nonrefundable tax credits include qualified production activities, research and research facilities, super research and development, early stage seed investment, economic development, post-secondary education, dairy and livestock investment, manufacturing investment, electronic medical records, Health Insurance Risk-Sharing Plan (HIRSP), community rehabilitation program, ethanol and biodiesel fuel pump, biodiesel fuel production, water consumption, internet equipment, supplement to the federal historic rehabilitation, relocated businesses and community development tax credits. State refundable tax credits include enterprise zone, jobs, dairy manufacturing facility, meat processing facility investment, food processing plant and food warehouse investment, film production, woody biomass, beginning farmer and farm asset owner, and farmland preservation tax credits.

Corporations that are engaged in a unitary business with one or more other corporations are required to file a combined return. Specific provisions govern which corporations must file a combined return, and the manner in which combined net tax liability is determined. Wisconsin's combined reporting law requires a corporation to use combined reporting if it satisfies all of the following conditions: (a) the corporation is a member of a "commonly controlled group;"(b) the corporation is engaged in a "unitary business" with one or more other corporations in its commonly controlled group, or the commonly controlled group makes a controlled group election; or (c) the corporation is not excluded from the combined group under "water's edge" rules.

The general process of computing a combined group's net tax liability includes computing the combined unitary income of the group, determining each member's income and tax, and computing the group's tax liability. In general, member level data is computed separately, and then

aggregated on the combined return. Combined groups are required to aggregate and reconcile federal taxable income from the federal consolidated return or from federal separate returns, and to make certain adjustments related to intercompany transactions and limitations that apply on the combined group level, and report it on a combined return. Following these adjustments, the group computes the aggregate Wisconsin addition and subtraction modifications to federal taxable income for each member that are generally required of all corporations to reflect the differences between Wisconsin and federal tax law provisions.

After aggregate additions and subtractions are made to the combined group's income, the nonapportionable and separately apportionable income (income subject to water's edge rules, lottery prizes, and separate entity income/loss) of each group member is subtracted. As previously noted, these amounts are generally allocated to the state where the property that produced the income, gain, or loss is located. Amounts that are allocable or apportionable to Wisconsin are included in the group's combined unitary income, following apportionment. The specific combined group adjustments and state additions and subtractions are used to determine the combined unitary income of the group.

The individual member's share of combined unitary income is apportioned by using the percentage calculated by dividing the member's sales in Wisconsin by the group's total sales. The group's unitary combined income is then multiplied by this percentage to determine the member's combined unitary income.

A corporation that is a member of a combined group can have income that is required to be apportioned separately from the group's combined unitary income. This can occur when a member has income or loss that is excluded from combined unitary income under "water's edge" rules. In addition, each member's combined unitary income is adjusted by adding nonapportionable income (rents and royalties from nonbusiness property, lottery prizes) and separately apportionable income (water's edge and separate unitary business income).

Individual combined group members that show a positive income amount can offset the income with net business loss carryforwards. A net business loss carryforward is an attribute of the separate corporation that generated the loss. However, the combined group member may share all or a portion of its business loss carryforward with other members of the combined group, if certain conditions are met.

After a group member offsets its income with any net business loss carryforwards, the individual corporation determines its gross tax by applying the 7.9% state corporate income/franchise tax rate to the resulting measure of income. The corporate income/franchise tax liability computed separately for each group member and separately computed components including business loss carryforwards and nonrefundable tax credits, are aggregated and included on the group's combined return to determine the combined group's tax liability.

Tax credits are attributes of the separate corporation rather than of the combined group, and credits are computed separately for each corporation. A combined group member's nonrefundable credits, other than research credits (but not the super research and development tax credit),

including carryforwards of those credits, may only be used by the combined group member to offset the tax liability attributable to its own taxable income. The total amount of nonrefundable tax credits claimed by group members is reported on the combined return. However, a combined group member that computes a research and/or research facilities tax credit, or that has an unused carryforward of a research or research facilities tax credit, may share a portion of the credit with other members of the combined group.

Each combined group member also separately reports its refundable tax credits. However, any refundable tax credits computed by combined group members are aggregated and used to offset the combined group's tax liability reported on the combined return. Any refundable amount not used is refunded to the group's designated agent. The combined group's designated agent files the combined return and pays any tax due for the group.

The qualified production activities income (QPAI) tax credit was enacted under 2011 Wisconsin Act 32 (the 2011-13 biennial budget act) and is provided under the state individual income and corporate income and franchise taxes, and will be phased in over a four-year period, starting with tax years beginning on or after January 1, 2013.

Under the individual income tax, the credit equals a specified percentage of the claimant's qualified production activities income (QPAI), as defined under the Internal Revenue Code (IRC), that is derived from property assessed as manufacturing or agricultural property in Wisconsin, as defined under state property tax law. Under the corporate income and franchise tax and for insurance companies, the credit is the lesser of a specified percentage of the claimant's: (a) qualified production activities income, as defined under the IRC, derived from manufacturing or agricultural property in Wisconsin, as defined under state property tax law; (b) income apportioned to Wisconsin for state corporate income and franchise tax purposes; or (c) income determined as taxable under state combined reporting provisions. The specified tax credit percentage is as follows:

a. 1.875% for tax years beginning after December 31, 2012, and before January 1, 2014;

b. 3.75% for tax years beginning after December 31, 2013, and before January 1, 2015;

c. 5.526% for tax years beginning after December 31, 2014, and before January 1, 2016;

d. 7.5% for tax years beginning after December 31, 2015.

Unused tax credit amounts can be carried forward up to 15 years to offset future tax liabilities.

As noted, the credit is based on qualified production activities income derived from manufacturing property in Wisconsin, as defined under state property tax law. The definition of manufacturing property under state law includes any property in the Metal Mining major group classification of the Standard Industrial Classification (SIC) Manual, 1987 edition, published by the U.S. Office on Management and Budget (OMB).

None of the corporate tax provisions outlined above would be modified by AB 426.

Whether the Gogebic mine would pay corporate income and franchise taxes to the State of Wisconsin, and the amount of any taxes paid, would depend upon a number of factors that are not certain at this time. For example, if most or all of the mine's output were sold outside of Wisconsin, then little or none of the mine's operating profits would be apportioned to Wisconsin under the single-sales apportionment formula. Also, it appears that the mine would be eligible to claim the qualified production activities credit. Starting in tax year 2016, when mining operations are expected to begin under AB 426, that credit will equal 7.5% of the income attributable to mining operations in Wisconsin, which would eliminate most of any tax liability the mine would otherwise incur. It is also unknown whether the mine will be operating as a member of a combined group of corporations conducting a unitary business, and thus be subject to the combined reporting requirements. Finally, if the mining company were organized as a pass-through entity [limited liability company (LLC), partnership, or tax option corporation], the mine's profits would be passed through to its owners and taxed under the individual income tax. In that case, the apportionment provisions and the qualified production activities credit would still affect any tax liability. Information on the Gogebic Taconite website indicates that the firm is currently organized as an LLC.

Property Taxation -- Current Law

All real and personal property located in Wisconsin is subject to property taxation under Chapter 70 of the state statutes, unless the property has been exempted from taxation. The property tax is the largest source of local government tax revenue, and the tax is administered primarily by local governments. The first step in this process is the discovery and valuation of taxable property, which is generally performed by municipal assessors. The state statutes provide an exception for manufacturing property, which is valued by DOR. The statutes include "metal mining" in the list of activities classified as manufacturing.

To be included as manufacturing property, a manufacturing activity must take place on the property. For mining property, the Department indicates that mining activity begins when the overburden is stripped from the land, thereby providing access to the minerals to be mined. DOR makes this determination on a parcel-by-parcel basis. Therefore, if mining activity occurs on only one of two adjoining parcels of land owned by the same individual, DOR would assess the parcel where mining activity is occurring, and the municipal assessor would value the other parcel. In addition, DOR employs a "substantial use" test based on a provision in s. 70.995(4) of the statutes. Under this test, mining activity must occur on 50% or more of the parcel in order for DOR to assess the property. Otherwise, the property's value is determined by the municipal assessor.

State law directs DOR to value mining property differently than the property of other manufacturers by excluding the value of the metalliferous mineral content of land where metalliferous minerals are being extracted and the net proceeds occupation tax (described above) is being imposed. Like other manufacturers, owners of mining property are required to file manufacturing report forms with DOR. On these forms, manufacturers report the original cost of their real and personal property by year of acquisition and report any additions to or deletions from that property. The Department considers that data, as well as other factors, such as appreciation,

depreciation, and obsolescence, in valuing the property.

As a manufacturer, property used in mining could receive the exemption for manufacturing machinery and equipment. To qualify for the exemption, machinery and specific processing equipment must be used exclusively and directly in the manufacturing production process. As noted above, the production process for mining property begins when the overburden is stripped away from the earth. State law provides that the production process ends when the finished product is conveyed to the point of first storage on the plant premises. Mining property could also receive other exemptions available to manufacturers, such as for pollution abatement equipment, computers, and certain motor vehicles.

Manufacturers and municipalities containing manufacturing property may appeal manufacturing assessed values to DOR, where objections are heard by the state Board of Assessors. A $45 fee must accompany the objection. Determinations of the Board may be appealed to the Tax Appeals Commission (TAC), and TAC decisions may be appealed to the circuit court for Dane County.

After DOR determines the value of manufacturing property, the value is incorporated into the corresponding municipality's assessment roll, with the DOR values being "equated" to the municipally determined values to ensure that all properties are taxed at the same level of market value. At that time, manufacturing property, including mining property, is taxed at the same tax rate as similarly located property.

Under the preceding procedures, municipal assessors would value parcels where mining activity may be imminent, but is not yet occurring. In valuing these parcels, municipal assessors should follow the same principles and guidelines used to value other taxable real estate. These principles and guidelines are explained in the Wisconsin Property Assessment Manual published by DOR and reflect constitutional and statutory provisions, as interpreted in case law, and property appraisal practices and procedures. For example, the Manual indicates that values should reflect a property's "bundle of rights," which "consist of use, possession, enjoyment, disposition, exclusion, or the right not to exercise any of these rights," and "highest and best use"' which is "that use which over a period of time produces the greatest net return to the property owner." In applying these principles and guidelines, the courts have consistently held that the sale of the subject property or of comparable properties is the best indicator of value. However, in the absence of sales data, the courts have endorsed other valuation approaches. While state law directs DOR to exclude the value of the metalliferous content of land where metalliferous minerals are being extracted, the statutes do not provide a comparable exclusion when property is valued by the municipal assessor.

These provisions would not be changed by AB 426.

Prepared by: Sean Moran

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.