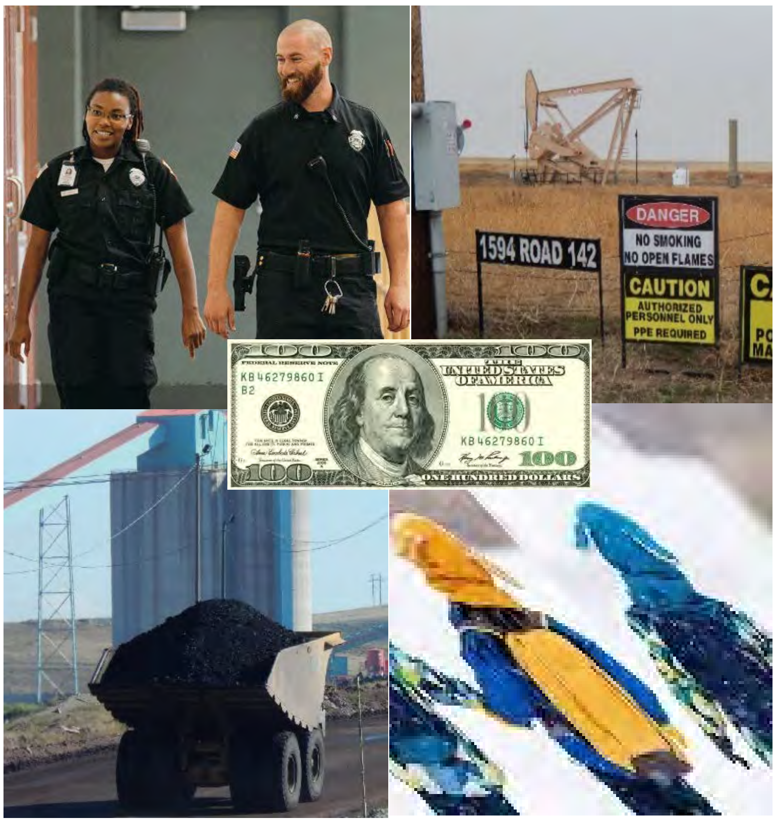
Ad Valorem Taxes in Wyoming:

Proposed Improvements



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Powder River Basin Resource Council

Updated, August 2018

POWDER RIVER BASIN
Resource Council

Executive Summary

Our original report detailed Wyoming's heavy dependence on mineral taxes to fund state and local government services. We discussed the fact that Wyoming gets more than 70% of our total revenue from taxes on mineral extraction and the impacts to county services that occur when mineral production taxes cannot be collected.

The Wyoming Legislative Revenue Committee (committee) has responded to the problem facing counties in collecting these debts by taking up the topic of reforming administration and imposition of ad valorem *taxes for exploration during the interim session.*

To assist in the committee's process, Powder River has maintained communication with participating counties in order to provide updated information on tax status. While there is positive news to report in this update, the cumulative debt owed to counties has continued to rise since information was originally published in January. Mineral production debts reported by participating counties has climbed from just over <u>$42 million to almost $55 million.</u>

While it may be difficult - if not impossible - for counties to collect these back taxes because many companies are bankrupt or long gone, the policy changes being considered by the committee can prevent a similar problem from occurring in the future.

One consideration before the committee is the synchronization and streamlining of the payment of ad valorem *and severance taxes. This is the policy change that would provide the greatest benefit to counties regarding the collection of* ad valorem *debt. At the state level, severance taxes (collected when minerals are severed from the ground) are collected on a regular, monthly basis, as minerals are produced. At the county level, however,* ad valorem *taxes (taxes on mineral production) are collected only annually, with an average lag time of around 18 months from the time of mineral extraction to tax collection. And a lot can happen in 18 months.*

Changes made now will help counties smooth out the boom and bust cycle they have endured for too long. The current lag time in collections means that when companies declare bankruptcy counties are left with debts that can be years old. Along with other solutions being considered, synchronizing tax collection schedules at county and state levels will help to ensure that counties are no longer at the mercy of the rise and fall of the global energy market.

Powder River applauds the Wyoming Joint Interim Revenue Committee for addressing this important issue.

Who We Are

Founded in 1973, Powder River Basin Resource Council is a citizen-based organization of individuals and affiliate groups dedicated to the stewardship of Wyoming's natural resources. Through member empowerment, strategic alliances, and a dedicated staff, we work to preserve Wyoming's unique quality of life and our precious air, land, and water quality.

Our mission is to preserve and enrich our agricultural heritage and rural lifestyle; conserve Wyoming's unique land, minerals, water, and clean air consistent with the responsible use of these resources to sustain the livelihoods of present and future generations; and educate and empower Wyoming's citizens to raise a coherent voice to affect the decisions that will impact our environment and lifestyle.

We are a non-profit, 501(c)(3) tax-exempt organization.

The 2018 Joint Interim Revenue Committee is Considering the Following Topics Related to Administration and Imposition of Ad Valorem Tax Debt:

1) **The establishment of perpetual liens on mineral property when change of ownership occurs.**
2) **The synchronization and streamlining of the payment of *ad valorem* and severance taxes.**
3) **Other administrative changes to ease the burden on taxpayers and reduce delinquency.**

Benefit of Perpetual Liens: *If liens automatically attach to mineral production taxes owed to counties upon sale or transfer of assets, counties will be placed higher in the order of collections in bankruptcy proceedings. This will not ensure that counties will be able to recoup all debts owed to them, but it will make counties secured lenders and put them at the bargaining table with other secured lenders such as banks. When determinations are made on what debts will be paid fully or partially, counties will stand a better chance of collecting on at least some of the debts industries owe them.*

Benefit of Synchronization and Streamlining of *Ad Valorem* and Severance Taxes: *If counties switch to a monthly, rather than annual, collection schedule for* ad valorem *taxes the amount of taxes left delinquent in the event of a bust or a bankruptcy will be dramatically reduced. Counties will benefit by having a smaller deficit, and companies will benefit by maintaining good standing with counties.*

Powder River's Recommendations for "other administrative changes:"

- **A state funding pool should be established to assist counties during bankruptcy proceedings. Hiring specialized legal counsel experienced enough to represent a county in these complex and lengthy cases can be cost prohibitive to small counties, but it is critical that counties have the expertise to engage in the process and protect their interests. Having a fund held at the state level or allowing counties to access the Federal Natural Resource Policy Account (an account managed by the state to fund state and local government involvement in matters of natural resource policy) would help counties pay legal fees and ensure that they have the means to secure effective representation.**

Benefit: *Establishing a funding pool at the state level that counties can draw from when they need representation will help ensure that our poorest counties are able to collect taxes they desperately need for operations.*

- **Legislation is needed to allow the Wyoming Oil and Gas Conservation Commission (WOGCC) and the Wyoming Department of Environmental Quality (WDEQ) to check the status of a company's state and county tax debt in Wyoming before allowing sale or transfer of assets. The WOGCC has regulations to ensure adequate bonding is in place prior to sale or transfer of wells from one operator to another,[1] and WDEQ has similar regulations for coal asset transfers, requiring licensing, bonding, and insurance of the new operator prior to transfer.[2] These agencies should also be required to check the tax status of companies to ensure that all debts to the state and Wyoming counties are paid prior to transfer of assets.**

Benefit: *If companies are barred from selling assets, changing lease ownership, or otherwise operating within Wyoming until they have paid all debts owed to the state and Wyoming counties, operators will have a strong incentive to pay their public debts as quickly as possible, and counties will have greater access to outstanding funds. Since* ad valorem *tax revenues from recapture counties are redistributed to all Wyoming schools, the state's public school districts will also benefit.*

The Immediacy of Need:

Looming Bankruptcies

At the time of this update, Westmoreland Coal is facing financial difficulties and is widely presumed to be heading toward bankruptcy. According to Lincoln County Treasurer Jerry Greenfield, Westmoreland's annual *ad valorem* taxes average around $9 million. If the company declares bankruptcy, it will likely leave Lincoln County with around $11 million dollars in *ad valorem* taxes that the county may or may not be able to collect. Regarding the looming possibility of bankruptcy, Treasurer Greenfield expressed deep concern.

Sublette County is also facing outstanding *ad valorem* debts. At this time, Sublette County has spent around $100,000 in bankruptcy proceedings for Vanguard Natural Resources. So far, they have secured $2 million of the outstanding mineral tax debts, but they are still attempting to collect over $2 million that Vanguard still owes. While Sublette County Clerk Mary Lankford was not optimistic about the chances of collecting that money in full, she said, "With that kind of money on the table, you at least have to try."

The examples of Westmoreland and Vanguard show that the immediacy of need for county protection is not over. In the past three years, several "too big to fail" companies operating within Wyoming have sought bankruptcy protection. Vanguard is just the latest, and Westmoreland may be next in line. In an economy already weakened by national and global downturns in demand for coal, Wyoming cannot afford to continue policies that allow precious tax revenue to go uncollected. If implemented, the legislation being considered by the committee will radically change the rate of county collection and help to turn the tide in favor of Wyoming citizens.

Impact on Education

The percent of *ad valorem* taxes earmarked for education varies from county to county. It can also vary from year to year depending on the mill rate for education and the mill rate allocated for other purposes. According to Carol Seeger, deputy attorney for Campbell County, the percent of *ad valorem* taxes that goes to schools in Wyoming is high in all counties. In Campbell County, for example, about 75% of *ad valorem* tax collected goes toward education.[3]

Statewide, Wyoming schools are facing a projected $400 million dollar shortfall in 2019-2020.[4] These numbers do not take into account capital construction or major maintenance shortfalls, current and predicted, which are also primarily funded by mineral production[5] and lease revenues. An additional $400 million deficit is predicted for 2021-2022. Because so much of our school funding comes from mineral production taxes and severance taxes, bust cycles cause significant harm to Wyoming schools and weaken our entire state.

In addition to reductions in the amount of funding allocated per student, Wyoming school districts may be impacted by loss of special programs. These may include instructional facilitator programs in which exceptional teachers mentor colleagues, and programs for education outside of regular school hours, as well as new construction and large maintenance projects. Wyoming schools provide citizens with excellent educational opportunities. The legislation being considered could provide schools with much needed funding consistency and ensure that Wyoming's ability to provide high-quality education is not compromised.

Cumulative Debts Owed to Counties

During the past ten years, counties around Wyoming have experienced several bust cycles. The recent coalbed methane (CBM) and oil & gas downturn, and the subsequent coal downturn, were particularly severe.

The cumulative impact of these busts has been substantial, leaving counties across the state with significant deficits. Counties with active mineral extraction have been affected by loss of local jobs, loss of ongoing tax collection, and, in many cases, uncollectable taxes that were previously assessed.

Some have been hit harder than others, but during the last ten years most Wyoming counties have been affected. We collected records of delinquent mineral production taxes for the past decade (2006-2016) from 13 counties. Mineral tax delinquencies were found in every county from which data was obtained.

When this report was first published, the 12 counties that reported tax delinquencies had collectively lost out on more than $42 million. At the time of this update, one additional county has reported back, and several counties have accumulated additional tax debts. The total amount of tax debt reported has grown to almost $55 million (this figure does not include money written off as uncollectable by several counties). For small counties, even a few hundred thousand dollars can make a significant difference in operating budgets, and some are dealing with delinquencies in millions or tens of millions of dollars.

DELINQUENT MINERAL PRODUCTION TAXES BY COUNTY UPDATED JULY 2018

Campbell------$32,740,475.11

Carbon---------$10,386,688.94

Sheridan---------$7,457,659.00

Natrona------------$926,682.79

Sweetwater-------$910,792.09

Johnson------------$779,723.93

Crook---------------$500,352.57

Fremont------------$124,449.62

Converse-----------$297,331.00

Sublette------------$214,180.00

Hot Springs--------$392,268.00

Laramie-------------$116,882.43

Weston---------------$75,957.99

Total-------$54,923,443.47

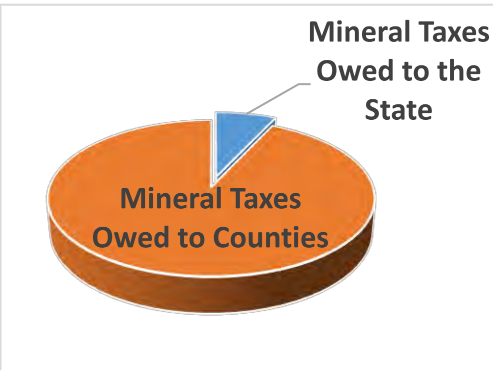
The deficits faced by counties are significant and, given current laws, are certain to grow. If left unchecked, these debts are likely to mount to crisis level. Simple legislative changes can tip the scales in favor of Wyoming citizens, increasing counties' level of financial security.

Legislation Under Consideration

Standardizing Tax Collection Schedules at State and County Levels

In order to avoid the adversity caused to counties during bust years, it is essential that changes be made to the collection schedule of *ad valorem* taxes. Currently, the state and counties collect mineral taxes on different schedules. The state collects severance tax when minerals are severed from the ground. Counties collect *ad valorem* property taxes long after extraction.

According to the Administrator of the Mineral Tax Division of the Wyoming Department of Revenue, Craig Grenvik, severance taxes are paid monthly at the state level. Because of this regular payment structure, the state today is owed less than $3 million from the last bust. According to Mr. Grenvik, a full 99.977% of all assessed taxes were paid as owed.



At the county level, however, *ad valorem* property taxes are reported to the Department of Revenue by February 28th of the year AFTER the year of production or sale. Debts are due in full the following December, according to Converse County Assessor Dixie Huxtable. Payments are not due until an average of 18 months after the mineral is produced and sold. A lot can happen in a volatile economy in 18 months, and counties lose a lot more than the state when a downturn hits and a company is unable to pay its taxes.

In 2016, HB64, sponsored by The Joint Interim Revenue Committee, would have changed the way counties collect mineral *ad valorem* taxes. The proposed law would have structured payment of *ad valorem* taxes more like severance taxes, changing payments to a monthly, rather than yearly, schedule.[6] While the bill may require some amendments, it is a good template for the committee to work from when addressing the collection schedule of *ad valorem* taxes in Wyoming.

"Much of the reason for the differences in amounts collected [by the state and counties] has to do with…differences between when payments are due to the state for severance taxes and when payments are due to counties for *ad valorem* taxes."

-Campbell County Commissioner
Mark Christensen
82717 January/February 2018

Changing the collection schedule would also assist companies seeking to transfer assets. When Contura decided to sell Belle Ayr and Eagle Butte mines to Blackjewel after acquiring them from Alpha Natural Resources,[7] they had outstanding tax debts to Campbell County. As a result, instead of receiving payment for the transfer, Contura had to pay Blackjewel $20 million to take the mines so that Blackjewel could pay those taxes.[8] If taxes were paid on a monthly basis, Contura would have been in a position to benefit from the sale of those mines, instead of paying another company to take them.

Importance of Liens

Establishing perpetual liens on mineral property when change of ownership occurs will ensure that outstanding tax debts are collectable at the time of sale or transfer of assets. Currently, when sales of mineral property occur, liens are not automatic. This places counties in a position of potentially losing out on assessed tax money.

HB242, introduced in 2017, attempted to attach perpetual liens on *ad valorem* taxes.[9] The bill did not pass, due in part to a provision that would have made mineral production liens superior to all other liens. The Revenue Committee has decided to take up the topic of automatic and perpetual liens, without addressing lien superiority. HB242 provides a starting place for the committee as they work on new legislation.

Powder River believes that counties' liens should have superiority to other liens. Tax revenue collected by counties directly serves Wyoming citizens, while other liens represent private interests. Taxes generated from mineral production belong to the people of Wyoming, and all methods for ensuring their collection should be prioritized. Nonetheless, Powder River supports the legislation being considered as a step in the right direction.

Additional Suggestions for Legislation

Implementing a Pre-Sale Tax Status Check

The provision of a pre-sale status check is complementary to ongoing liens. If perpetual liens are automatically attached to mineral production taxes, a pre-sale tax check will be essential for those liens to have any real meaning. The WOGCC and WDEQ already ensure that companies have adequate bonding, licensing, and insurance prior to sale. A tax check is a logical addition to this list. This provision will assist counties in collection efforts and help to ensure timely payment of tax debts.

Legislation allowing the WOGCC and the WDEQ to check the status of tax debt prior to sale or transfer of assets would assist in collection of delinquent *ad valorem* taxes. If companies know their tax status will be checked prior to approval of sale or transfer, payment of those debts will become company priority when considering changes in asset ownership.

The sale of Eagle Butte and Belle Ayr mines from Contura to Blackjewel (mentioned earlier) is a prime example of why a pre-sale tax check is necessary. Had automatic liens and mandatory pre-sale tax checks been in place, Contura would not have been allowed to sell those assets to Blackjewel without first addressing their tax debts to Campbell County.

Establishing a Funding Pool for Counties

Most counties do not have dedicated funding to engage in bankruptcy proceedings. This means they have no recourse when companies declare bankruptcy and they find themselves low on the debt collections list. Without money to engage in bankruptcy proceedings, counties simply have to cut their losses and move on. The Federal Natural Resource Policy Account (FNRPA), a fund Wyoming holds at the state level to cover costs associated with participating in federal natural resource policy decisions, with a current balance estimated at over $2 million,[10] could potentially be used to assist counties during bankruptcies.

Language in current statute allows for the governor, "with permission," to provide funds to counties to "retain qualified practicing attorneys...including providing representation in other forums with the federal government or other state or county governments that may preclude or resolve any outstanding issues."[11] This language could be broad enough to apply to bankruptcies, which are litigated in a federal forum. However, additional clarifying legislation may be required to explicitly allow counties to access this fund during bankruptcies.

Campbell County Update

Coal company bankruptcies that affected Campbell County featured prominently in our original report. In the eight months since that report was published, debts owed to Campbell County have grown from $26 million to over $32 million, despite the county's recent settlement with Alpha Natural Resources. At this time, Campbell County's bankruptcy proceedings with Alpha have concluded. When Alpha and its subsidiary Alpha Coal West declared bankruptcy in 2015, Campbell County was left with over $19 million in unpaid *ad valorem* taxes. In the end, the county was able to secure all but $4 million of the taxes owed to them by Alpha. According to Campbell County Deputy Attorney Carol Seeger, the county's attempts to collect taxes from Alpha cost the county around $1 million, leaving the county out a total of $5 million.

While it is unfortunate that the county had to write off $4 million, Campbell County is fortunate to have been able to engage in bankruptcy proceedings at all. The county has money available to pursue unpaid taxes through litigation. It cannot be overstated, however, that many counties in Wyoming do not have the funds required to even enter into the bankruptcy process.

> **"The mines themselves can no longer say, 'We've always paid our taxes.' It's a terrible thing to have to happen that we lose 4 to 5 million dollars before someone wakes up and says, 'Oh, wait a minute.' And there's potential to lose quite a bit more."**
>
> **-Senator Michael Von Flatern**
> ***Wyoming Public Media – June 29, 2018***

As mentioned previously, establishing a funding pool that counties could utilize during tax and bankruptcy proceedings would empower counties to pursue large debts, rather than having to cut their losses. The revenue this would recapture would enrich the entire state. Since much of the *ad valorem* tax is redistributed across the state for education, all Wyoming citizens suffer when counties are left without recourse to pursue unpaid debts.

Currently, the interim committee is considering automatic and ongoing county liens on mineral property so that tax debts will have to be paid prior to sale or transfer of mineral assets. Had this legislation existed prior to the recent spate of coal company bankruptcies, the sale of Belle Ayr and Eagle Butte mines would not have been allowed until Campbell County was first paid the debts owed them by Alpha. The company would have had sufficient motivation to pay their debts in full and the county could have avoided much of the expenditure of bankruptcy court and collections procedures. Instead, Alpha was able to delay the process and sell the mines to its subsidiary, Contura,[7] leaving Campbell County with no real assets to hold as collateral.

Conclusion

Taking on the topic of *ad valorem* tax reform displays an understanding of the depth of the problem Wyoming counties face. The fact that past attempts to fix this problem did not become law underscores an aspect of the problem. We are facing funding deficits at all levels, and in all counties. Yet Wyoming does not want to accept that an economy over-reliant on the mineral sector will always suffer bust cycles. Changes in the global energy economy present ever greater risk of instability within the energy sector and indicate how dangerous the situation really is.

Minerals are commodities with global markets, and prices of oil, gas and coal are dictated by outside forces. Busts can come on very suddenly, leaving little time for Wyoming to prepare. Boom-cycle spending must be reined in quickly. At the state and county level, budgets must be cut in all areas. School funds shrink rapidly. The number of programs offered may contract, schools may have to shut down and building and maintenance tasks are delayed.

As noted in the original version of this report, counties are particularly hard hit during mineral downturns. Most Wyoming counties operate on tight budgets normally, so shortfalls are felt immediately. To make matters worse, counties collect taxes long after they are accrued, unlike the state, which collects severance taxes on a monthly basis. Due to these differences, the state may be left with a few months of uncollectable back taxes, but counties can be owed years of delinquent tax debt.

The fact that we have not passed laws that would strengthen government's financial standing and hold operators accountable reflects a philosophy that places industry needs above the needs of Wyoming counties and citizens. Continuing down this path is not an option. We must pass legislation to minimize the damage done to essential government services during busts. There may not be many booms left for Wyoming, and we need to ensure that citizens benefit from minerals that, once severed, will never be replenished.

The financial problems Wyoming faces today are not new. Neither are some of the solutions being considered by the Revenue Committee. Some options being considered mirror past proposed legislation that was not enacted. Examining that prior legislation and determining what factors led to its rejection may provide a good starting point for crafting legislation that will be able to become law.

The Revenue Committee and state legislators hold the fate of Wyoming in their hands. The simple, elegant solutions being considered by the committee have the potential to change the picture of economic stability for Wyoming counties. If enacted into law, these solutions will generate greater prosperity on the county level while improving the larger Wyoming economy. Now is the time to enact legislation to support county collection of *ad valorem* taxes.

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11. WY Stat § 9-4-218 (1997 through Reg Sess)

Personal Communications

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