COMMONWEALTH OF KENTUCKY STATE FISCAL NOTE STATEMENT
LEGISLATIVE RESEARCH COMMISSION
2017 REGULAR SESSION

MEASURE

2017 BR NUMBER **0184** **HOUSE** BILL NUMBER **37**

RESOLUTION NUMBER_____ AMENDMENT NUMBER _____

SUBJECT/TITLE An ACT relating to the property tax on unmined coal.

SPONSOR Representative Tim Couch

NOTE SUMMARY

FISCAL ANALYSIS: ☒ IMPACT ☐ NO IMPACT ☐ INDETERMINABLE IMPACT

LEVEL(S) OF IMPACT: ☒ STATE ☒ LOCAL ☐ FEDERAL

BUDGET UNIT(S) IMPACT: **Energy & Environment Cabinet- KY Heritage Land Conservation Fund and Department for Energy Development and Independence**

FUND(S) IMPACT: ☐ GENERAL ☐ ROAD ☐ FEDERAL ☒ RESTRICTED AGENCY _____ ☐ OTHER

FISCAL SUMMARY

FISCAL ESTIMATES	2016-2017	2017-2018	ANNUAL IMPACT AT FULL IMPLEMENTATION
REVENUES			State ($278,000) Local ($2.9 Million)
EXPENDITURES			Minimal
NET EFFECT			State ($278,000) Local ($2.9 Million)

( ) indicates a decrease/negative

MEASURE'S PURPOSE: HB 37 will exempt unmined coal reserves from state and local property taxation if, on January 1 of the tax year, the owner or lessee did not hold a state and federal permit to mine the coal and did not anticipate the coal would be mined during that tax year.

PROVISIONS/MECHANICS: HB 37 amends KRS 132.820 by adding a new subsection to limit the unmined coal that can be subject to state and local property taxes. The bill states that unmined coal is only taxable when the owner or lessee of the reserve holds a valid permit from both the state and federal government to mine the coal and anticipates that the coal will be mined during the tax year. It further exempts coal reserves that do not meet these standards from state and local property taxes for that year.

Pursuant to the ruling of the Kentucky Supreme Court in *Gillis v. Yount*, 748 S.W.2d 357 (Ky. 1988), unmined coal is a form of real property. Section 172 of the Kentucky Constitution requires all property not exempted from taxation by the Constitution to be assessed at fair cash value. Currently, unmined coal is not considered exempt property under the Constitution. HB 37 proposes a statutory exemption, but does not amend the Constitution. Therefore, it is possible that HB 37 could be challenged in court.

The valuation method currently used by the Department of Revenue to centrally assess the fair cash value of unmined coal was developed as a result of a settlement reached in 2005 and approved by order of the Franklin Circuit Court in the *Kentuckians for the Commonwealth v. Blanton* case, No. 88-CI-0407. The method takes into account numerous factors impacting the market for unmined coal. It uses an income-based approach that seeks to estimate and assign a present value to the future income to be derived from the ownership of the property, which is complicated due to the volatile nature of the market for coal. One of the many factors is whether the reserve is actively being mined or is idle. Idle reserves are either not being mined currently or are not projected to be mined for some time. If a coal reserve is classified as idle, its present assessed value is reduced. This is because it is not worth as much in a fair voluntary sale in today's market, due to the distant and/or uncertain time period before it will likely be mined to generate income for its owner.

In 2016, the Department of Revenue reviewed their valuation methods of idled unmined coal reserves and adjusted the inputs in their valuation formula to compensate for the economic downturn in the coal industry. These adjustments resulted in a significantly lower valuation for idled unmined coal reserves in Kentucky for tax year 2016.

FISCAL EXPLANATION: HB 37 has an effective date of January 1, 2018. If enacted, the impact of the bill will not be seen until the 2018 unmined coal property tax is due, which is December 31, 2018.

State Impact

The bill would have a negative impact on state property tax revenues. The impact will not be borne by the general fund. KRS 132.020(5) provides that $400,000 in state revenues from the property tax on unmined coal is reserved for use by the Department for Energy Development and Independence for the purpose of public education of coal-related issues. All remaining state revenues are deposited into the Kentucky Heritage Land Conservation Fund for the purchase and management of natural areas and wetlands by various state agencies and private entities.

The assessment of unmined coal does not impact the annual calculation of the state real property tax rate. Therefore, the tax rate would not be adjusted to account for the exemption and the result would be a reduction in receipts to the educational and environmental programs. The amount of currently taxable unmined coal reserves that are not permitted for extraction cannot be identified. However, the valuation method for this class of property already takes into account whether a particular reserve is idle. As a result of this assessment method, the current assessed value of all coal resources not projected to be mined within the next year is ascertainable and serves as a reasonable estimate of the amount of unmined coal that would become exempt under this bill. According to figures provided by the Department of Revenue for tax year 2016, the assessed value of unmined coal resources statewide is $976,119,063 and idled unmined coal is $228,024,800. When applying the state real property tax rate of 12.2 cents per $100 to the idled unmined coal base, the estimated negative impact of HB 37 would be approximately ($278,000) in state revenues.

Minimal expenditures may occur for the Kentucky Department of Revenue in order to administer the new unmined coal requirements created under KRS 132.820.

Local impact
At the local level, unmined coal assessments are figured into the annual computation of property tax rates (performed as a result of "House Bill 44"). Local taxing jurisdictions are allowed to impose a compensating tax rate on real property, which is the rate that will generate approximately the same amount of revenue as was collected in the prior year. The effect of this rate calculation is that if the total assessment of taxable property within a jurisdiction is reduced, a local taxing jurisdiction may impose a higher compensating tax rate, which would be applied to all taxable property. Therefore, a locality could possibly mitigate a reduction in revenues by levying the compensating tax rate, effectively shifting the tax burden to other properties.

Using the average tax rates levied by local taxing jurisdictions, the expected negative impact of HB 37 would be approximately ($2.9 million), collectively, for the local jurisdictions where the idled unmined coal reserves are located (which are within the 43 counties of the eastern and western coal fields).

Local school funding and the SEEK formula
Local school districts are funded with a mix of state and local tax dollars, in amounts determined by the SEEK funding formula and based in large part upon the total assessed value of taxable property in each district. If a district's local assessment base is reduced, as would occur in some districts due to HB 37, it is considered less wealthy and the amount of required local tax effort is reduced. The amount of state SEEK funding provided to that district would also likely change. The change in state funding would differ among districts, due to the many other factors in the formula.

Collectively, the school districts receiving revenues from unmined coal property already tend to be less wealthy than the state average because their per-pupil assessment is substantially lower than the state per-pupil average. As a result, these districts, as a group, already have a larger share of their funding provided by the state than the other districts do. HB 37 would reduce the district's local assessment base and therefore further reduce the already below average per-pupil assessment base in these counties. This could result in an even greater share of their funding coming from state SEEK dollars, which would have an impact on the state general fund.

DATA SOURCE(S): **LRC Staff, Kentucky Department of Revenue**
PREPARER: **Cynthia Brown** **NOTE NUMBER**: **10** **REVIEW**: **JRS** **DATE**: **1/11/2017**