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Installment Payments for Gross Revenues Utilities
(General Fund Taxes -- Excise Taxes and Other Taxes)

CURRENT LAW

Under current law, private and municipal light, heat, and power companies (LHPs) and electric cooperatives are subject to a gross revenues tax (license fee) on revenues from sales of electricity and gas services. Gross revenues are taxed at a rate of 3.19%, except that sales of gas services are taxed at 0.97% and wholesale sales of electricity are taxed at 1.59%.

LHPs and electric cooperatives make semiannual installment payments (prepayments) on May 10 and November 10, in the calendar year preceding the receipt of their current year assessment, equal to either 55% of the previous year's assessment or 50% of the estimated assessment for the current year. On May 1 of the following year, these utilities receive an assessment from the Department of Revenue (DOR) notifying them of the license fee due on their gross revenues earned in the previous year. On May 10 of that year, a final adjustment payment is made, or a refund is issued, to reconcile the two prior installment payments with the actual assessment. Refunds are made in the form of credits applied to the May 10 installment payments owed by utility companies, thereby decreasing the amount owed.

In contrast, car line companies, which are also assessed based on their gross revenues from the previous year, only make one installment payment of 50% of the previous assessment on September 10, then pay their remaining liability the following April 15, once their actual tax liability is known.

Conservation and regulation, municipal electric, pipeline, and telephone companies are subject to the state's ad valorem utility tax, which is based on the assessed value of a company's property within the state. These utilities also make semiannual payments on May 10 (prepayment) and November 10 (final payment). On May 10, ad valorem utilities must pay either 50% of their previous year's net utility tax liability or 40% of its estimated current year's liability. However, these companies are notified of their current year tax liability (based on property values as of January 1 of the current year) by October 1 (November 1 for telephone companies). Therefore, by November 10, the current year tax liability is known, and the utility companies pay the remainder of their tax liability at that time.

DISCUSSION POINTS

1. Given the current installment payment structure, DOR reports that most LHPs and electric cooperatives choose to make installment payments of 55% of the previous year's assessment, resulting in annual payments that are 110% of the previous year's assessment. Since most companies do not owe a 10% increase in utility tax liability from year to year, many companies overpay their utility tax liability each year and carry a credit forward into the next year. DOR indicates that these credit balances can build up for certain companies over time, until the balance equals the amount needed for an installment payment. When this occurs, the taxpayer would not make a payment for that installment, allowing the credit to cover the entire amount due, and would start over again from little or no credit. This process creates accounting complexities due to credits and payments that occur over different assessment years and state fiscal years. In addition, these companies are essentially providing "interest-free loans" to the Department of Revenue for making prepayments each year that exceed their tax liability.

2. A few options can be considered to address the continual overpayment of utility taxes by LHPs and electric cooperatives. One option is to, beginning in May of 2024, eliminate the May 10 installment payment and instead require just one installment payment, on November 10, of 50% of the previous year's assessment [Alternative 1]. If the May 10 installment payment were eliminated beginning in May, 2024, only companies that received a 2024 assessment (for revenues earned in 2023) greater than the sum of their May and November, 2023, installment payments would make a payment at that time. All other companies would receive a credit for their overpayment of their tax liability. Under Alternative 1, that credit would be applied to the November, 2024, installment payment. On May 10 of 2025, once actual assessments are received, the companies would make a final payment equal to their actual assessment less the installment payment made the previous November.

3. Eliminating the May installment payments for LHPs and electric cooperatives and changing the November 10 installment payment requirement to 50% (rather than 55% under current law) of the previous year's assessment would bring the payment structure for these taxpayers more in line with the payment structure of other utility companies. Other utility taxpayers make one 50% installment payment during the year, then make a final payment once their actual tax liability for that assessment year is known. This change would simplify the payment process, making it more easily understood by taxpayers and other relevant parties. Eliminating the May installment payment would reduce (or eliminate) credits for overpayments, provide a one-time cash-flow benefit to utility taxpayers, and simplify administration of the tax for DOR.

4. The Annual Comprehensive Fiscal Report (ACFR) calculates the state's general fund balance using Generally Accepted Accounting Principles (GAAP). A negative adjustment is made

each year to account for gross revenues utility tax collections that are received in the current fiscal year, but that are attributable to tax amounts owed in a future fiscal year. Using GAAP, the state has determined that the May 10 prepayment is fully attributable to taxes owed in future fiscal years. For example, the May 10, 2022, prepayment is reported in 2021-22, but is attributable to taxes owed in 2022-23 (50%) and 2023-24 (50%). Additionally, 50% of the November 10 prepayment and the following May 10 final payment are attributable to the current fiscal year, while the remaining 50% of each payment is attributable to the next fiscal year. According to the ACFR for 2021-22, deferred revenues for gross public utility taxes were the sixth largest negative basis adjustment to the year-end general fund balance under GAAP (-$260.5 million).

5. Alternative 1 is estimated to decrease utility tax revenues by $127.7 million in 2023-24 and $29.5 million in 2024-25, for a total one-time reduction of $157.2 million in the 2023-25 biennium. It is important to note that this option would not reduce the utility tax liability of these companies. It would only incur a one-time reduction in utility tax collections as a way to refund prior overpayments of tax and shift back the timing of future tax payments. Eliminating the May installment payment would reduce the negative adjustment made in the ACFR each year under GAAP accounting, on an ongoing basis, by the amount that the May installment payment would have been under current law.

6. One consideration of Alternative 1 is whether the required 50% payment of the previous year's assessment is the appropriate percentage payment requirement for the November installment payment. If the Committee desires to set the November payment to reflect that the payment would occur when approximately 85% of the calendar year is complete, it could set the November prepayment at 85% of the previous assessment [Alternative 2], rather than the proposed 50% requirement under Alternative 1. Therefore, by November 10, utilities would have paid 85% of their previous year's assessment toward their current year's liability, rather than 110% under current law. It is estimated that Alternative 2 would result in the same one-time revenue reduction and have the same effect on the State's GAAP balance as in Alternative 1. The only difference would be that a larger payment would be required in November, reducing the cash-flow benefit to utility taxpayers.

7. However, because LHPs and electric cooperatives would not be making a May installment payment, they would be holding on to money during the year that would otherwise have been paid to DOR under current law.

8. If the Committee is concerned about not requiring LHPs and electric cooperatives to make a payment towards their current year's tax liability until November, it could keep both the May 10 and November 10 installment payments and the May 10 final payment, but adjust the required installment payment amounts [Alternative 3]. Under this alternative, the Committee could require that these companies make an installment payment of 50% of the previous assessment in May and 50% of the previous assessment in November, to ensure that the utilities are paying estimated taxes in line with when their gross revenues are earned. This would result in a required prepayment of 100% (rather than 110%) of the previous year's assessment during the year in which the revenues are earned. Alternative 3 would result in an estimated one-time reduction in general fund tax revenue of $14.2 million in 2023-24 and $0.1 million in 2024-25 (a one-time revenue reduction of $14.3 million in the biennium).

9. An argument could be made that Alternative 3 would establish a payment schedule for LHP and electric cooperative utilities that is similar to the installment payments required for individuals, partnerships, and certain tax-option (S) corporations (those with net income of less than $250,000) under the individual income tax and the corporate income/franchise tax. These taxpayers have the safeharbor option of making four estimated payments throughout the year towards their current year's tax liability, based on 100% of their previous year's liability. Alternative 3 would provide the same option (although with only two installment payments) to LHP and electric cooperative utility taxpayers. However, while individual and corporate income taxpayers receive a refund if they overpay their current year's liability, utility taxpayers would not. Instead, under Alternative 3, some utility taxpayers may still receive a credit for their overpayment, which would be applied to the next May 10 installment payment (as under current law).

10. The net effect on utility ratepayers under Alternatives 1 through 3 is not clear at this time. In general, large investor-owned utilities petition the Public Service Commission (PSC) for rate increases approximately every two years, while municipal utilities may seek rate changes on cycles that are more irregular. The Commission approves rates based on estimated utility operating and fuel costs, including tax obligations, as well as an allowed rate of return the utility can realize on capital expenditures. It is conceivable that a significant reduction in utility tax payments over the course of a rate cycle could result in some amount of credits issued to ratepayers if a utility would otherwise exceed its rate of return. However, many factors influence a utility's cost of operations, and it is possible that tax savings would be subsumed by other costs, or utilities could seek to allocate cost savings in different ways. For instance, PSC could authorize a utility to apply savings to other deferred costs that a utility may be carrying; this would tend not to lead to direct credits to ratepayers.

11. Although each of these alternatives would result in a one-time reduction in general fund tax revenue without reducing revenues in future biennia, the Committee may want to consider whether it believes this is the best use of one-time funds. Rather than providing a benefit to LHP and electric cooperative utility companies (which may or may not result in a credit to ratepayers), the Committee could instead use these monies for another purpose, or to benefit other individuals, businesses, or local governments.

12. Further, the current law payment schedule and structure for LHP and electric cooperative utility companies has been in place since 1986. Therefore, since the structure has not been altered in 37 years, it is possible that the affected utility companies are not concerned about their continual overpayment of their tax liability. The Committee might decide that the current payment structure is sufficient, and therefore take no action [Alternative 4].

ALTERNATIVES

1. Eliminate the May prepayment of utility taxes for LHPs and electric cooperatives, and require that such companies make one prepayment of 50% of the previous assessment (or the estimated assessment for the current year) in November. Maintain the existing May final payment under current law. Estimate a one-time reduction in state utility tax revenues of $127,700,000 in 2023-24 and $29,500,000 in 2024-25. Specify that any credit companies would receive for overpayment of their tax liability be applied to the November installment payment. Specify that the provisions first

apply to utility tax prepayments that would be made in May, 2024, under current law.

ALT 1	**Change to Base**
GPR-Tax	- $157,200,000

2. Eliminate the May prepayment of utility taxes for LHPs and electric cooperatives, and require that such companies make one prepayment of 85% of the previous assessment (or the estimated assessment for the current year) in November. Maintain the existing May final payment under current law. Specify that any credit companies would receive for overpayment of their tax liability be applied to the November installment payment. Estimate a one-time reduction in state utility tax revenues of $127,700,000 in 2023-24 and $29,500,000 in 2024-25. Specify that the provisions first apply to utility tax prepayments that would be made in May, 2024, under current law.

ALT 2	**Change to Base**
GPR-Tax	- $157,200,000

3. Modify the current May and November prepayments of utility taxes for LHPs and electric cooperatives to specify that companies would be required to make an installment payment of 50% of the previous assessment (or the estimated assessment for the current year) in May and 50% of the previous assessment (or the estimated assessment for the current year) in November. Maintain the existing May final payment under current law. Estimate a one-time reduction in general fund tax revenue of $14,200,000 in 2023-24 and $100,000 in 2024-25. Specify that the provisions first apply to utility tax prepayments that would be made in May, 2024, under current law.

ALT 3	**Change to Base**
GPR-Tax	- $14,300,000

4. Take no action.

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