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OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

EVALUATION REPORT

Mineral Taxation

APRIL 2015

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STATE OF MINNESOTA • James Nobles, Legislative Auditor

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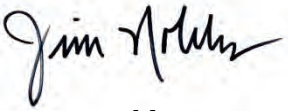
Members of the Legislative Audit Commission:

Taconite and iron ore mining in Minnesota has its own tax system. Mining companies pay a "production" tax instead of the customary property tax on their mining land and operations. They pay an "occupation" tax instead of the customary corporate franchise tax. In northeastern Minnesota, where the mining occurs, the funding of local government services and school districts differs from elsewhere in the state.

This report explains the state's system for taxing mining and distributing tax revenues. It also contains our assessment of how the system should be improved.

Our evaluation was conducted by Jody Hauer (project manager) and Laura Logsdon. The Department of Revenue and Iron Range Resources and Rehabilitation Board cooperated with our evaluation, and we thank them for their assistance.

Sincerely,



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- To smooth out effects of high and low years of taconite production, the annual production tax is based on a three-year average of taconite tonnage, but it does not produce predictable revenue amounts, and it creates problems for companies paying the tax. (pp. 29, 31-32)
- Production tax revenue goes into 27 accounts to be distributed to local taxing jurisdictions and others in northeastern Minnesota. In 2014, 46 percent went directly to local jurisdictions, 41 percent to the Iron Range Resources and Rehabilitation Board, 12.5 percent to a Taconite Property Tax Relief account, and less than 1 percent to other accounts. (p. 37)
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- State law prevents use of the Taconite Economic Development Fund to buy mobile equipment, such as ore trucks. (pp. 87-88)
- The mineral tax system can be complex, hard to understand, and can lack transparency. Confusing legal provisions, outdated statutes, and errors are factors. (p. 98)

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- The Legislature should establish a process to improve the use of production tax revenue for one-time grants to local jurisdictions. (p. 84)
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- The Legislature should ensure that outdated mineral tax statutes are deleted. The Department of Revenue should maintain accurate historical mineral tax data. (pp. 102, 103)

Report Summary

Iron ore mining in northeastern Minnesota dates back to the 1880s. Today's mining companies mine taconite, a rock with low-iron content, because the natural iron ore deposit has been largely depleted. Aggregate is also mined in the state, but iron ore mining has been far more valuable.

Minnesota law authorizes 12 taxes on mining taconite, however 3 taxes would become active only if applicable producers began operating. Another 5 are ad valorem taxes that apply to specific property, such as lands adjacent to mining facilities.

The largest portion of mining tax revenue comes from Minnesota's production tax, which is imposed instead of a property tax on taconite production. In 2014, it generated nearly $110 million. The tax rate is applied to the taxable tonnage of taconite, which is calculated as a three-year average of tons produced. Thus, taxes in 2014 were paid on an average of taconite produced in 2013 and the preceding two years.

State statutes define how to distribute production tax revenue. Most revenues flow to (1) local taxing jurisdictions located within a statutorily defined Taconite Assistance Area in northeastern Minnesota and (2) the Iron Range Resources and Rehabilitation Board (IRRRB). The board, comprised of legislators from the Iron Range, is a state agency that promotes and invests in that region's businesses and communities.

Another significant mining tax is the occupation tax, imposed on mining companies' taxable income in lieu of the corporate franchise tax. It generated $15.8 million in 2014. This tax's revenue is deposited into the state's General Fund; 40 percent is to support elementary and secondary schools, and 10 percent is credited to the University of Minnesota.

Legislators have distributed some production tax revenue as one-time grants to local governments, but the process lacks sufficient safeguards.

A portion of production tax revenue is allocated to the Taconite Property Tax Relief account. This account pays for taconite homestead credits going to qualified property owners on the Iron Range. In recent years when the account received more money than was needed to pay for homestead credits, legislators appropriated remaining dollars as one-time grants, mostly for city projects.

The process legislators followed had shortcomings when compared against best practices for administering state grants. For example, it had no application process and offered no widespread notice on fund availability. The process lacked adequate oversight; it did not use grant agreements, and no one was formally in charge of following up as projects were completed. The Legislature should establish a formal process to make these one-time grants.

Production tax revenue is allocated into 27 separate accounts and then distributed to municipalities, counties, school districts, and IRRRB, among others.

In 2014, 41 percent of production tax revenue was allocated to accounts under IRRRB; 19.5 percent went to school districts; 13.6 percent to municipalities; 13.2 percent to counties; and 12.5 percent to the Taconite Property Tax Relief account.

Allocations of less than 1 percent went to two smaller entities. From 2009 through 2014, total production tax revenue increased 12 percent, compared with an 11 percent increase in inflation.

The calculation of production taxes does not produce predictable amounts of revenue.

Because the production tax base is an average of taconite production over three years, it lessens the impact of downturns in taconite production. It does not, however, produce predictable amounts of revenue for local taxing jurisdictions.

The averaging cannot eliminate the ebb and flow in taxes generated. For instance, using dollars adjusted for inflation, the production tax generated $108.8 million in 2009 but only $87.6 million in 2010. Local government officials interviewed for this evaluation said volatility in taconite production is ill suited for their budgetary needs. Further, mining company representatives said the three-year averaging is difficult because the tax does not consider whether the company makes money.

Statutes do not make clear why only some accounts receiving production taxes have guaranteed allocations or allocations tied to inflation.

State law guarantees that 10 of the 27 accounts receiving production tax revenue will receive at least minimum amounts of funding. A guaranteed allocation is based on amounts received in 1983 or 1999, when two now-closed plants still operated. Calculating the allocations involves comparing one amount based on formulas in law and a second on the guaranteed amounts. The higher of the two amounts is allocated.

In addition, allocations into four accounts are tied to inflation. For only these four accounts, allocations increase automatically with inflation each year.

The Legislature should review the accounts with guarantees and automatic increases to determine whether these mechanisms meet their objectives. Further, the Legislature should take steps to make allocations of production taxes more predictable.

One option to increase predictability is to (1) establish a new base year of allocations into most or some of the 27 accounts and (2) guarantee those allocations into the future. In years with high levels of taconite produced, the tax would be sufficient to pay for more than the guaranteed allocation amounts. In years with low taconite tonnage, the new guarantees would be paid using other funds that receive production tax revenue. Under current law, existing guarantees are paid with production tax revenue from two funds: the Douglas J. Johnson Economic Protection Trust Fund and the Taconite Environmental Protection Fund. We recommend continuing reliance on those funds, although other options exist.

As part of the recommendation, the Legislature should determine which accounts will receive guaranteed allocations. The fewer accounts with a guarantee, the less production tax revenue has to be reserved to pay for the guarantees. A reasonable possibility is to focus on accounts that distribute production tax revenue directly to local taxing jurisdictions. In such an approach, accounts managed by IRRRB and others, such as the Range Association of Municipalities and Schools, would still receive allocations, but they would not receive guaranteed

allocations in years with low taconite production.

Guaranteed allocations would produce more predictable amounts of revenue and could remove the need to use three-year averages of taconite production when calculating taxable tons. Removing such averaging would also benefit the taxpaying mining companies in years of low production. Without the three-year averages, however, the funds paying the guarantees would likely pay more following low-production years.

Production taxes in the Taconite Economic Development Fund, originally intended to pay for mining company projects, have been allocated for other uses, leaving the fund's purpose unclear.

The Taconite Economic Development Fund receives a production tax allocation that is held by IRRRB and distributed to mining companies after IRRRB approval of company proposals. The proposals are typically projects to improve plants and stationary mining equipment. To qualify, companies must review their proposals with representatives of their nonsalaried employees, and they must provide matching funds. Mobile equipment, such as an ore haulage truck, is ineligible.

Law changes in 2007 and 2009 required money not approved for company use by IRRRB to be deposited instead into the Taconite Environmental Protection Fund, which IRRRB controls. But the purpose of the Taconite Economic Development Fund expressed in law did not change.

The Legislature should clarify the intended uses of the Taconite Economic Development Fund. How to use the fund is a policy decision for the Legislature. If it chooses to continue using the fund for multiple purposes, the Legislature should explicitly state these purposes in law. If, instead, the Legislature chooses to use the fund in line with the fund's original intent, it should delete the provision that requires money from the fund to be deposited elsewhere.

Further, the Legislature should remove the prohibition against using the fund to pay for mobile mining equipment. Representatives of nonsalaried employees and companies suggested such a change would be beneficial.

The mining tax system can be complex and difficult to understand and can lack transparency.

Confusing legal provisions, outdated statutory references, and errors in documents are factors that reduce the tax system's understandability and transparency. The Legislature should ensure that outdated mineral taxation statutes are deleted.

The Department of Revenue should maintain accurate historical information on mineral taxation that is broadly accessible to users and corrected in real time as errors are found. The department is currently developing a proposal to accomplish this. It would create on its website a single source of updated historical data on mineral taxation. Future updates or errors would be automatically communicated to interested users. If such a proposal is not developed, the department should explore alternate methods for maintaining accurate mining tax data.

Introduction

Northeastern Minnesota has been a home to iron ore mining since the 1880s. Currently, the state has nine active mining operations and one under construction. Taxation of mining iron ore is grounded in Article X of the *Constitution of the State of Minnesota*. Exploration of minerals other than iron ore is also underway in the northeastern part of the state.

In April 2014, the Legislative Audit Commission directed the Office of the Legislative Auditor to evaluate mineral taxation in Minnesota. Our evaluation addressed the following questions:

- **What are Minnesota's mineral taxes and royalties, and how has this changed over time?**

- **How are revenues from mineral taxes and royalties distributed? How has the tax distribution changed over time?**

- **How effectively and transparently are mineral taxes administered and distributed? To what extent are mechanisms in place to ensure oversight?**

- **What impacts do the mineral tax system and its distribution have on the state and Iron Range local governments?**

To answer these questions, we used a variety of research methods. We analyzed legal requirements, including the constitution, numerous statutes and laws, and court cases. We studied documents from the Minnesota Department of Revenue, in particular, past issues of the department's annual *Mining Tax Guide*. Past studies of mineral taxation in Minnesota were also helpful.

We collected data from the Department of Revenue to analyze changes in the tax system's structure and revenues it generates. The Iron Range Resources and Rehabilitation Board (IRRRB) provided data on expenditures funded with mining tax proceeds. Counties in northeastern Minnesota also submitted data on mining taxes they administer.

To obtain perspectives of the local jurisdictions that receive revenues generated by mineral taxes, we interviewed representatives from 13 Iron Range jurisdictions. They represented six cities, three counties, three school districts, and one township. We interviewed northeastern Minnesota organizations whose work is related to mining taxes, including IRRRB, Arrowhead Regional Computing Consortium, and Range Association of Municipalities and Schools.

We obtained information from people who work in and manage mining facilities. This included interviews with representatives from three U.S. Steelworker union locals as well as from three mining companies. We toured one of the company's mining pits and processing plants.

In addition to interviewing IRRRB, we conducted interviews with staff from three other state agencies: Department of Revenue, Department of Natural Resources, and Department of Commerce's Weights and Measures Division. Throughout the evaluation, we had numerous communications with staff from the Department of Revenue.

We did not evaluate all aspects related to mineral taxation. For instance, we did not evaluate IRRRB or its effectiveness. Nor did we evaluate issues related to funds such as the School Trust Fund, although we collected certain data on royalties that go into the fund.

Chapter 1 provides background information on mineral taxation in Minnesota. Chapter 2 explains the "production" tax, which generates the most revenue among all of Minnesota's mineral taxes. Chapter 3 examines issues connected to the production tax. A supplement to the report that compares mineral taxation in Minnesota with other states will be published separately.

Chapter 1: Background

Minnesota has a unique history of mining and a system of mineral taxation that consists of multiple taxes on different types of minerals. In this chapter, we describe why mining has its own tax structure, the history of mining in Minnesota, and the different taxes that make up the state's mineral tax system. We also explain the significance of royalties in mining and how taxation of mining companies differs from that of other industries. Finally, we summarize the role of the Minnesota Department of Revenue, which is the principle agency administering mining taxes.

MINING'S SINGULAR TAX STRUCTURE

In Minnesota and many other states, mining has its own unique tax structure, unlike that for most other industries. Mining taxes also differ from more commonly known taxes on income and property. Most states with mineral deposits (and other natural-resource based industries) use a "severance" tax, which is imposed distinctively on removing natural products from the Earth's land or water.

Economists describe two main reasons why states tax mining with severance taxes instead of property taxes.[1] First, property taxes depend on the value of the property one owns. Estimating the true value of a mineral deposit, however, is difficult due to unknowns about the extent of the deposit, volatility of mineral prices, unpredictability of future extraction costs, and dependence of a mine's output on further capital investments. By contrast, a severance tax uses a mine's output as a proxy for its value.

Second, a property tax comes due whether a mine is producing great quantities or not operating, which creates an adverse economic effect. It creates incentives to accelerate the depletion of the mineral deposit. Accelerated depletion occurs because to minimize the total tax over a mine's lifetime, companies have an incentive to recover more mineral from a mine than would ordinarily be the case under a more neutral tax. The increased supply of mined product lowers its market price, leading to increased consumption of the lower-priced product. In addition, lower prices concentrate production on higher-grade iron ore, as the economic feasibility of mining lower-grade ores is reduced.

By contrast, a severance tax, such as Minnesota's taconite production tax, has the advantages of simplicity and neutrality. Severance taxation is relatively simple because the only data needed are the taxable tons produced in a given year. Severance taxes are considered neutral because they are based on the amount of production, which avoids the incentive to accelerate "mining out" the minerals.

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[1] This discussion comes from two primary resources: Thomas F. Stinson and George S. Temple, *State Mineral Taxes* (Washington, DC: U.S. Department of Agriculture, 1982), 6-16; and Robert Ebel and Therese McGuire, editors, *The Final Report of the Minnesota Tax Study Commission* (St. Paul: Butterworths, 1986), 245-253.

MINING IN MINNESOTA

Minnesota has had mining operations that recover iron ore, sand and gravel, and stone, but the state's most valuable mining has been of iron ore. The state also has deposits of nonferrous precious metals, including copper and nickel; exploration of such metals has commenced but mining has not.

Iron ore mining began in northeast Minnesota in 1884. Since then, iron ore has been mined on three iron ranges: the Vermillion Range (northeast St. Louis County), the Mesabi Range (stretching from eastern Cass County through Itasca County and to the eastern border of St. Louis County), and the Cuyuna Range (Crow Wing and Aitkin counties). Natural iron ore deposits have been mostly depleted, and much of the rock now mined in northeastern Minnesota is "taconite," a compact rock of low iron content with finely disseminated iron ore particles. Minnesota is the nation's leading producer of taconite ore, which is used in the production of steel.

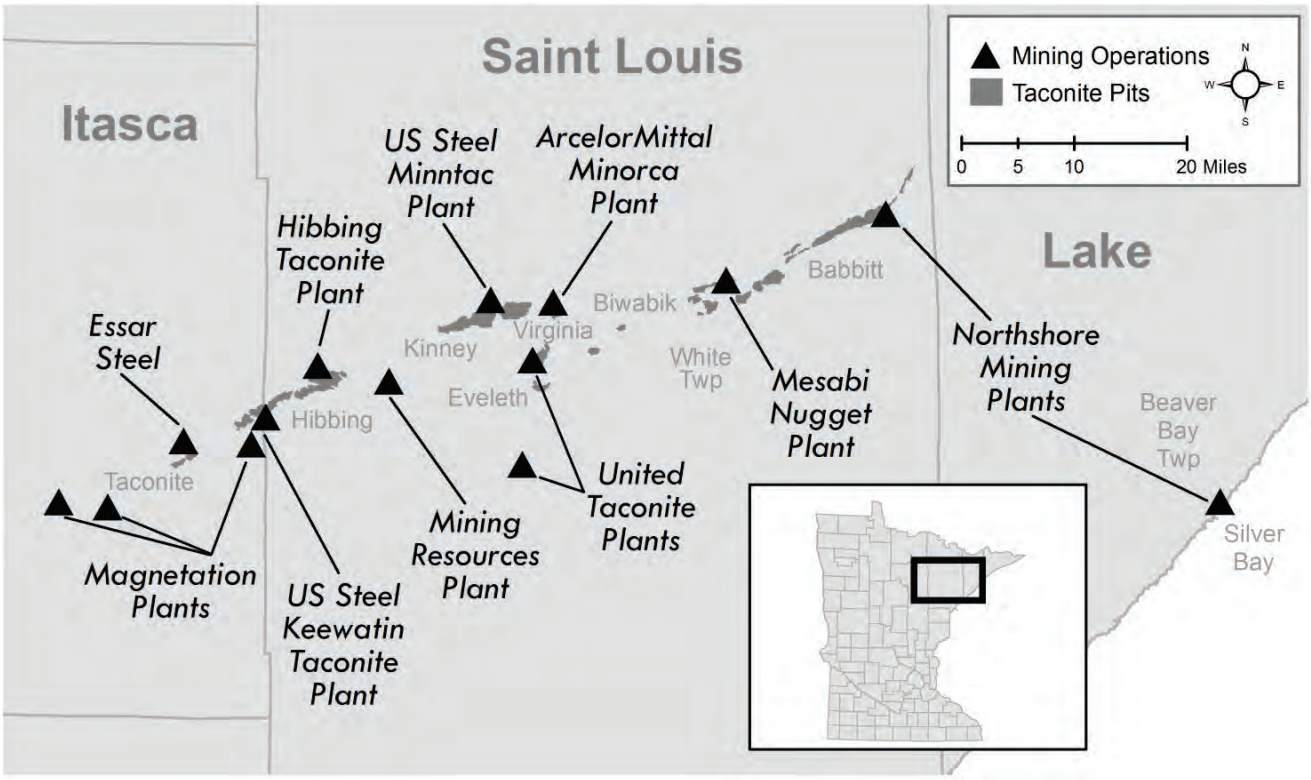
The majority of taconite mined in Minnesota from 2008 to 2013 came from privately owned lands (excluding lands owned by mining companies). From 2008 to 2013, on average 66 percent of total tons of crude ore were mined from privately owned land, 23 percent from state-owned land, and 11 percent from lands owned by mining companies.

As of 2014, five companies had nine active taconite and iron ore mine operations (which includes mines and plants), located chiefly in St. Louis County but also in Itasca and Lake counties. These companies were: ArcelorMittal, Cliffs Natural Resources, Magnetation, Steel Dynamics, and U.S. Steel. A sixth company, Essar Steel Minnesota, has been constructing a taconite mine and plant since 2008. Exhibit 1.1 depicts the mine and plant locations.

In its natural state, taconite is not suitable for sale as iron ore. The customary method of mining and processing taconite involves extracting iron-bearing rock from the ground through drilling and blasting, then crushing the rock and separating iron particles with magnets. This is done to create pellets that contain over 65 percent iron and are suitable for sale. Processing of iron ore is known as "beneficiation," which includes the stages of magnetic separation and conversion of concentrate into pellets.

During the stages of crushing, grinding, and concentrating taconite into pellets, the rocks that contain little or no iron are separated and deposited into large basins. These rocks are known as tailings. Some companies in Minnesota, such as Magnetation, use new technology to create iron ore concentrate by removing iron from the previously mined tailings.

Exhibit 1.1: Taconite Mining Pits and Plant Locations, 2014



NOTE: Essar Steel remained under construction as of March 2015.

SOURCE: Office of the Legislative Auditor, analysis of Department of Natural Resources data.

MINERAL TAXES IN MINNESOTA

This section describes taxes that apply to different minerals. It starts with taxes that apply to taconite and iron ore, then describes taxes that apply to aggregates, and ends explaining taxes on nonferrous minerals, such as copper and nickel.

In Minnesota, different sets of taxes apply to the mining of taconite and iron ore, sand and other aggregates, and nonferrous minerals.

Minnesota's multiple mining taxes vary by the type of mineral being extracted. Exhibit 1.2 lists all taxes that apply to mining each type of mineral.

Taconite and Iron Ore

This section describes the taxes currently imposed on taconite and iron ore mining. A few of the taxes generate significant portions of total taconite and iron ore taxes, while other taxes do not currently generate revenue.

Exhibit 1.2: Mineral Taxes by Type of Mineral, 2014

	Iron Ore and Taconite	Aggregates[a]	Nonferrous[b]
Tax			
Aggregate Material Production Tax		√	
Income Tax Withholding on Mining and Exploration Royalties	√		√
Occupation Tax	√		√
Sales and Use Tax	√	√	√
Taconite and Iron Sulphides Production Tax[c]	√		
Ad Valorem Taxes[d]			
Auxiliary Mining Lands	√		√
Commercial-Industrial		√	
Severed Mineral Interests[e]	√	√	√
Taconite Railroads	√		
Unmined Natural Iron Ore	√		
Unmined Taconite and Iron Sulphides	√		
Taxes Not Currently Generating Revenue			
Agglomerating Facilities Production Tax[f]	√		
Net Proceeds Tax			√
Semitaconite Tax[g]	√		
Tailings Tax[h]	√		

[a] Aggregates are nonmetallic natural minerals including sand, silica sand, gravel, crushed rock, limestone, and granite. Aggregates are also taconite tailings and architectural or dimension stone that is removed from a taconite mine or previously operated taconite mine.

[b] As of March 2015, nonferrous minerals, such as copper and nickel, were under exploration but had not been mined in Minnesota.

[c] Producers of "other iron-bearing material" are also taxed under the taconite and iron sulphides production tax, although the tax applies only to current year production, not a three-year average of production.

[d] Ad valorem taxes are property taxes.

[e] The severed mineral interests tax is levied on any minerals owned separately from the surface of real property.

[f] Agglomerating facilities are plants other than taconite or semitaconite facilities that produce sellable iron ore aggregates for shipment and use in a blast furnace.

[g] Semitaconite deposits are altered iron formations, taconite, or composites of iron-bearing and other minerals that exist in a mass and must undergo processing to produce taxable concentrates. It is not sellable as iron ore in its natural state.

[h] Tailings are the solid and liquid waste materials that result from processing taconite.

SOURCES: Office of the Legislative Auditor, analysis of Minnesota Department of Revenue data; and *Minnesota Statutes* 2014, chapters 270, 273, 290, 298.

Minnesota law defines 12 different taxes on taconite and iron ore, but several of the taxes do not generate revenue.

The two primary taxes imposed on companies mining taconite and iron ore are the (1) taconite and iron sulphides production tax and (2) occupation tax.[2] Taconite mining companies pay sales and use tax, but certain items are exempt and others refundable. In addition, mining companies pay several ad valorem taxes on operations connected to mining and processing taconite.[3] Minnesota does not have a specific tax on mining royalties, but to the extent mining companies pay royalties, they are required under certain circumstances to withhold income tax from those payments. Tax withheld on royalties is discussed at the end of this chapter. Exhibit 1.3 summarizes features of the major taxes on taconite and iron ore: the production tax, occupation tax, sales and use tax, and income tax withholding on royalties.

Exhibit 1.3: Summary Features of Major Iron Ore and Taconite Taxes, 2014

Feature	Production Tax[a]	Occupation Tax	Sales and Use Tax	Income Tax Withholding on Royalties
Tax Rate	$2.56 per ton, adjusted annually with the implicit price deflator[b]	2.45 percent of taxable income	6.875 percent of gross receipts from retail sales	6.25 percent of royalties
Tax Base	Taxable tons of sellable iron ore concentrate	Company's income, as determined by the mine value or selling price of taconite	Gross receipts from retail sales; exemptions apply	Total royalties paid from which income tax is withheld
Revenue Paid in 2014	$109.9 million	$15.8 million	$10.9 million	$191,216
Revenue Recipients	Iron Range local taxing jurisdictions, property tax relief, IRRRB, RAMS[c]	General Fund, Elementary and Secondary Schools, University of Minnesota	General Fund, Outdoor Heritage Fund, Clean Water Fund, Parks and Trails Fund, Arts and Cultural Heritage Fund	General Fund

[a] Producers of "other iron-bearing material" are also taxed under the taconite and iron sulphides production tax, although the tax applies only to current year production, not a three-year average of production.

[b] The production tax rate is adjusted annually with the implicit price deflator for gross domestic product, a measure of inflation in the economy.

[c] IRRRB is the Iron Range Resources and Rehabilitation Board; RAMS is the Range Association of Municipalities and Schools.

SOURCES: Office of the Legislative Auditor, analysis of Minnesota Department of Revenue data; and *Minnesota Statutes* 2014, chapters 290, 297, and 298.

[2] Iron sulphides are chemical combinations of iron and sulphur that are not sellable as iron ore in their natural state.

[3] Ad valorem taxes are property taxes.

Taconite and Iron Sulphides Production Tax

The production tax is a severance tax on the total taxable tons of taconite or iron ore.[4] It generates the most revenue of all the taxes on taconite and iron ore. Statutes currently establish a production tax rate of $2.56 per gross ton of sellable iron ore concentrate.[5] Concentrates are finely ground iron particles that remain after impurities are removed. The statutory tax rate is adjusted annually based on the implicit price deflator for the gross domestic product.[6] The tax is levied on a three-year average of taconite production, described in detail in Chapter 2.[7]

The Legislature enacted the production tax in 1941 in lieu of property taxes on taconite and the lands in which it is contained.[8] A 1984 Minnesota Supreme Court case affirmed that the production tax is a substituted method of property taxation, because mining companies are not subject to property taxes on active mine lands.[9] The court explained that taconite producers utilize a unique type of property and remove a valuable natural resource; because they are not subject to property taxes on that property, the production tax is a means of replacing lost property tax revenue. In 1964, voters amended the *Minnesota Constitution* to include language that prevented modification or repeal of taconite tax laws for 25 years, providing a period of stability for taconite tax laws.[10]

The production tax generated $109.9 million in 2014.[11] Revenues were distributed to northeastern Minnesota local taxing jurisdictions, the Iron Range Resources and Rehabilitation Board (IRRRB), the Range Association of Municipalities and Schools, and for property tax relief. IRRRB is a state agency that promotes and invests in business, community, and workforce development in northeastern Minnesota. Its board has statutory authority to approve all expenditures and projects made by the agency; board members are nine legislators, eight of whom are, by law, from northeastern Minnesota legislative districts.[12] The agency provides loans, grants, and loan guarantees for businesses relocating or expanding in the region and provides grants to local governments, educational institutions, and nonprofits for workforce and community development. IRRRB administers a

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[4] The tax also applies to producers of "other iron-bearing material," although there are some differences. Other iron-bearing material is material other than taconite or semitaconite that (1) contains less than an average 46.5 percent natural iron, (2) is of a certain granularity, and (3) is treated to separate iron particles from other compounds.

[5] *Minnesota Statutes* 2014, 298.24, subd. 1(a).

[6] The gross domestic product measures the growth in the economy using a "market basket" of goods and services that changes over time based on actual production or purchases. An implicit price deflator is a ratio of nominal gross domestic product to real gross domestic product, which adjusts growth in the economy for changes in prices and output of goods and services over time.

[7] The tax is levied on only current year production of other iron-bearing material.

[8] *Law of Minnesota* 1941, chapter 375, secs. 2 and 3.

[9] Erie Mining Company v. Commissioner of Revenue, 343 N.W.2d 261, 265 (Minn. 1984).

[10] *Minnesota Constitution*, art. X, sec. 6.

[11] Taxes levied on taconite are paid in the year following the year the taconite is produced. Therefore, revenues collected and distributed in 2014 were levied on taconite produced in 2013.

[12] *Minnesota Statutes* 2014, 298.22, subd. 1a.

significant portion of production tax revenues. Chapter 2 describes in detail the structure and distribution of the production tax.

Occupation Tax

The occupation tax is akin to an income tax levied on mining companies in lieu of the corporate franchise tax. The current occupation tax rate is 2.45 percent of mining companies' taxable income. Taxable income is a company's gross income, which is determined using the mine value of the ore mined in Minnesota, less certain deductions. Mine value is the value of a mine's taconite after processing but before incurring costs associated with stockpiling, transportation, marketing or marine insurance, or loading and unloading.

The calculation of mine value is based on two factors related to the value of taconite products and follows a process determined by the Department of Revenue.[13] First, 75 percent of the change in the product value is based on the change in a steel index from June of the previous year to June of the current year. Second, the price of taconite sold in arms-length transactions (where buyers and sellers are independent of one another) is the basis for the remaining 25 percent. When companies first sell products in arms-length transactions, they may choose to use actual sales prices to determine mine value or the taconite product values set by the department. Once they select an option, however, they must continue to use that option in the future.[14] Companies without arms-length transactions may use only the taconite product values set by the department.

The Legislature imposed the occupation tax in 1921 at a rate of 6 percent of the value of all ores mined or produced in Minnesota.[15] The *Minnesota Constitution* and statutes specify that the tax applies to any person engaged in the business of mining or producing iron ore or other ores, metals, or minerals in the state.[16]

Occupation tax revenues are primarily distributed statewide. Under the *Minnesota Constitution,* revenues from the occupation tax are distributed to the state's General Fund, elementary and secondary education, and the University of Minnesota.[17] Statutes establish three specific uses for General Fund revenue generated by the occupation tax.[18] These uses currently are: (1) the mining environmental and regulatory account, (2) a new account to benefit northeastern Minnesota schools, and (3) a distribution to certain northeast Minnesota counties that do not receive taconite property tax relief. Exhibit 1.4 details the statutory distribution of the

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[13] Separate values are calculated for different taconite products; for example, the value of pellet chips and concentrates differs from that of direct reduced iron. Direct reduced iron is defined in statute as a product that contains 75 percent or more iron. See *Minnesota Statutes* 2014, 298.24, subd. 1(g)(1).

[14] According to the Minnesota Department of Revenue, all taconite companies have chosen to use the values set by the department.

[15] *Laws of Minnesota* 1921, chapter 223, sec. 1.

[16] *Minnesota Constitution*, art. X, sec. 3; and *Minnesota Statutes* 2014, 298.01, subds. 3 and 4.

[17] *Minnesota Constitution*, art. X, sec. 3.

[18] *Minnesota Statutes* 2014, 298.17(b) and (c).

Exhibit 1.4: Statutory Distribution of Occupation Taxes, 2014

Recipient	Allocation	Amount[a]
General Fund	50%	$ 7,294,164
Mining Environmental and Regulatory Account[b]	Amount equal to what would be generated by a $0.025 tax imposed on taxable tons produced in the preceding calendar year	-
Iron Range Resources and Rehabilitation Board (IRRRB) for environmental development and economic development loans and grants to local governments and businesses in counties in Region 3[c]	Amount equal to what would be generated by a $0.015 tax imposed on taxable tons produced in the preceding calendar year	594,116
IRRRB to transfer to the Iron Range School Consolidation and Cooperatively Operated School Account[b]	Amount equal to what would be generated by a $0.06 tax imposed on taxable tons produced in the preceding calendar year	-
Elementary and Secondary Schools	40%	6,310,624
University of Minnesota	10%	1,577,656
Total	100%	$15,776,560

[a] The specific amounts of occupation tax revenue allocated to the General Fund, Elementary and Secondary Schools, and the University of Minnesota are not tracked. Amounts for these three funds were calculated by the Office of the Legislative Auditor. The amount distributed to Region 3 counties, however, is the actual distribution, as reported by IRRRB.

[b] The Mining Environmental and Regulatory Account and the Cooperatively Operated School Account had not yet started to receive occupation taxes in 2014.

[c] Region 3 is a geographic area created as a development region in "Minnesota Governor's Executive Order 60," issued in 1970. Only Carlton and Koochiching counties qualify for the occupation tax funds.

SOURCES: Office of the Legislative Auditor, analysis of Minnesota Department of Revenue, *Mining Tax Guide* (Saint Paul, 2014), 28; Minnesota Management and Budget data; and *Minnesota Statutes* 2014, 298.17 (a)-(b).

occupation tax. In 2014 alone, the tax generated $15.8 million. The occupation tax generated $4 billion from 1956 to 2014 in 2014 inflation-adjusted dollars.[19]

Sales and Use Tax

Sales tax applies to retail sales of taxable services and tangible personal property, while use tax applies to taxable items and services if sales tax was not paid at the time of purchase. The current rate for sales and use taxes is 6.875 percent of gross receipts from retail sales; when the taxes were enacted in 1967, the rate was 3 percent. Mining companies pay sales and use taxes, but state law creates differences from other taxpayers, such as exclusions specific to mining. These differences are described later in this chapter.

The majority of revenue collected from the sales and use tax is deposited in the state's General Fund. A portion is allocated among the Outdoor Heritage Fund, Clean Water Fund, Parks and Trails Fund, and the Arts and Cultural Heritage Fund.[20] In 2014, taconite companies paid $10.9 million in net use tax. In

[19] To adjust for inflation in this report, we converted nominal dollars to equivalent 2014 dollars using a price index for gross domestic product for state and local government consumption, expenditures, and gross investment from the U.S. Bureau of Economic Analysis.

[20] Of the 6.875 percent sales and use tax rate, revenue generated from the 6.5 percent rate goes to the General Fund, and revenue generated from the additional 0.375 percent rate is allocated among the four other funds.

inflation-adjusted dollars, taconite mining companies paid $693.7 million in net use tax from 1975 to 2014.[21] Over this period, mining companies' net use tax payments fluctuated but decreased by 69 percent in 2014 dollars.

Ad Valorem Taxes

Companies that mine taconite and iron ore pay ad valorem taxes for certain types of property. Taxes apply to five property types: auxiliary mining lands, taconite railroads, unmined taconite and iron sulphides, unmined natural iron ore, and severed mineral interests. For four of these property types, local governments set the tax rates.[22] The exception is the tax on severed mineral interests, for which the rate is set in statute. Counties have roles, such as collecting and distributing revenue, in administering the ad valorem taxes. The Department of Revenue handles the processing and payment of a portion of the severed mineral interests tax. Each tax is described briefly below.[23] Exhibit 1.5 shows a summary of features for each ad valorem tax.

Exhibit 1.5: Summary Features of Ad Valorem Mineral Taxes, Northeastern Minnesota Counties, 2014

Property	Definition	Tax Base	State General Property Tax[a]	Recipients of Tax Revenue
Auxiliary Mining Lands	Property not actively used for mining	Net tax capacity of auxiliary mining lands	√	Local taxing jurisdictions, state General Fund
Taconite Railroads	Property that is integral to the railroad service	Equalized fair market value of operating property	√	Local taxing jurisdictions, state General Fund
Unmined Taconite and Iron Sulphides	Unmined taconite and iron sulphides	Taconite or iron sulphides in a 40-acre tract of land from which less than 1,000 tons of iron ore concentrate is produced		Local taxing jurisdictions
Unmined Natural Iron Ore	Unmined iron ore	Tax capacity of unmined iron ore[b]	√	Local taxing jurisdictions, state General Fund
Severed Mineral Interests	Mineral interest owned separately from the surface real estate	Acres, or portions of an acre, of severed mineral interests		Local taxing jurisdictions, Indian Business Loan Account

[a] In 2014, the state general property tax rate for property classified as industrial was 52.16 percent.

[b] The tax capacity of unmined iron ore is the product of the class rate and the market value. The market value is found using a complex method that finds the present value of future profits from the unmined iron ore reserves.

SOURCES: Office of the Legislative Auditor, analysis of data provided by Aitkin, Cook, Crow Wing, Itasca, Koochiching, Lake, and St. Louis counties, and the Minnesota Department of Revenue; and *Minnesota Statutes* 2014, chapters 270, 273, 275, and 298.

[21] Unlike production and occupation taxes, which are paid in the year following the year in which taconite is produced, use taxes are paid in the same year taconite is produced.

[22] The state general property tax rate also applies to three of these property types.

[23] In the sections that follow, revenue generated by each ad valorem tax is not adjusted for inflation.

Auxiliary Mining Lands

Auxiliary mining lands are defined as those that owners do not actively use for mining and are not otherwise exempt from property taxes. They include buffer zones around tailings basins and land adjacent to mine facilities. Such lands are subject to local property tax rates and the state general property tax. Aitkin, Itasca, and St. Louis counties collect the tax. The tax base is the net tax capacity of the auxiliary mining lands.[24] From 2010 to 2014, the total net tax capacity for auxiliary mining lands in Aitkin and Itasca counties rose from $55,151 to $76,978.[25]

In 2014, the local tax rates ranged within the counties, as shown in Exhibit 1.6. In Aitkin County, the rates ranged from 67 percent in McGregor to 126 percent in Tamarack in 2014, and in Itasca County, the rates ranged from 97 percent in Arbo Township to 215 percent in Taconite. Revenue generated from the local tax rates is distributed to local taxing jurisdictions according to the amounts each levied, while revenue generated from the state general property tax rate is distributed to the state's General Fund.

Taconite Railroads

Since 1989, taconite railroads have been assessed and taxed on an ad valorem basis.[26] Local property tax rates and the state general property tax are levied on the equalized fair market value of railroad operating property.[27] Operating property is that used to perform railroad services, including franchises, rights-of-way, bridges, trestles, shops, docks, wharves, buildings, and structures. Since 2003, Northshore Mining has been the only operating railroad subject to the tax. Lake and St. Louis counties collect the tax. From 2010 to 2014, the total net tax capacity for taconite railroads rose from $6,881 to $20,898.

The local tax rates levied varied by taxing jurisdiction, as shown for 2014 in Exhibit 1.6. In 2014, the rates ranged in Lake County from 74 percent in Beaver Bay Township to 179 percent in Silver Bay, while in St. Louis County the rates ranged from 97 percent in Bassett Township to 200 percent in Babbitt. Revenue generated from the local tax rates is distributed to local taxing jurisdictions according to the amounts each levied, while revenue generated from the state general property tax rate is distributed to the state's General Fund.

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[24] Net tax capacity is a property's market value multiplied by the classification rate for that type of property.

[25] St. Louis County was unable to identify the tax rates, total net tax capacity, and total revenue generated from auxiliary mining lands. Data reported in this section are for only Aitkin and Itasca counties.

[26] For the purposes of taxation, "taconite railroad" includes any company that owns or operates a railway primarily used to move taconite concentrates from production plants to a port or point of consumption beyond the state, or any company that produces taconite concentrates and moves the concentrates during processing to a plant within the state on a railroad that is not a common carrier. See *Minnesota Statutes* 2014, 270.80, subd. 2.

[27] The equalized fair market value of railroad operating property is determined by applying an estimated current year median sales ratio for commercial and industrial property in a county to that county's portion of the railroad operating property's total value.

Exhibit 1.6: Ad Valorem Mineral Tax Rates and Revenue Collected, Northeastern Minnesota Counties, 2014

	Auxiliary Mining Land		Taconite Railroad		Unmined Taconite and Iron Sulphides		Unmined Natural Iron Ore		Severed Mineral Interests[a]	
County	Rate Range (%)	Amount ($)	Rate Range (%)	Amount ($)	Rate Range (%)	Amount ($)	Rate Range (%)	Amount ($)	Rate ($)	Amount ($)
Aitkin	67 to 126	23,658	-	-	-	-	-	-	0.40	22,070
Cook	-	-	-	-	-	-	-	-	0.40	24,030
Crow Wing	-	-	-	-	-	-	58 to 197	2,800	0.40	9,445
Itasca	97 to 215	7,186	-	-	67 to 215	32,468	67 to 215	14,100	0.40	76,220
Koochiching	-	-	-	-	-	-	-	-	0.40	150
Lake	-	-	74 to 179	26,796	-	-	-	-	0.40	56,840
St. Louis	-	-	97 to 200	7,286	90 to 342	247,126	91 to 342	93,900	0.40	307,135

[a] The severed mineral interests tax was levied against an acre or portion of an acre in 38 counties in Minnesota in 2014, and generated a total of $545,870 statewide. The tax generated $495,890 in the seven northeast Minnesota counties shown in this exhibit.

SOURCES: Office of the Legislative Auditor, analysis of data provided by Aitkin, Cook, Crow Wing, Itasca, Koochiching, Lake, and St. Louis counties, and the Minnesota Department of Revenue; and *Minnesota Statutes* 2014, 273.165, subd. 1.

Unmined Taconite and Iron Sulphides

Local property taxes are levied on taconite or iron sulphides contained in a 40-acre tract of land from which less than 1,000 tons of iron ore concentrate is produced annually. The amount of tax levied may not exceed $15 per acre. The state general property tax does not apply to unmined taconite and iron sulphides. Itasca and St. Louis counties currently collect the tax. From tax-payable year 2010 to 2014, the total net tax capacity rose from $176,458 to $201,706.

The tax rates varied in 2014, ranging in Itasca County from 67 percent in Lone Pine Township to 215 percent in the city of Taconite, and in St. Louis County from 90 percent in Balkan Township to 342 percent in Kinney. Revenue generated from the tax is distributed to local taxing jurisdictions according to the amounts each levied.

Unmined Natural Iron Ore

Local property tax rates and the state general property tax are levied on unmined natural iron ore. The tax rates are applied to the tax capacity of unmined iron ore, which is the product of the class rate and the market value. The market value is determined using a complex method that finds the present value of future profits from the unmined iron ore reserves. St. Louis, Itasca, and Crow Wing counties collect the tax. From 2010 to 2014, the total net tax capacity rose from $43,662 to $46,606.

Local rates levied on unmined natural iron ore varied. In 2014, the rates ranged from a low of 58 percent for a municipality in Crow Wing County to 342 percent for the city of Kinney in St. Louis County. Revenue generated from the local tax rates is distributed to local taxing jurisdictions according to the amounts each

levied, while revenue generated from the state general property tax rate is distributed to the state's General Fund.

Severed Mineral Interests

Severed mineral interests are defined as "an interest in any minerals, including but not limited to gas, coal, oil, or other similar interest in real estate, which is owned separately and apart from the fee title to the surface of such real property."[28] The tax applies to any mineral interest that is separate from the land surface; it applies to nonferrous minerals as well as taconite. Unlike other ad valorem taxes, statutes establish a rate of $0.40 per acre or portion of an acre of mineral interest, with a minimum annual payment of $3.20.[29]

In 2014, 38 counties collected a total of $545,870 from the tax. Seven northeast Minnesota counties levied the tax that year and collected $495,890, which was 91 percent of the total.[30] The seven counties levied the tax against 1.46 million acres in 2014, a 1.2 percent decrease from 1.48 million acres in 2010. Revenue from the tax is distributed to local governments, which receive 80 percent, and the Indian Business Loan Account, which receives 20 percent.[31]

Taxes that Do Not Generate Revenues

Three taxes that apply to iron ore and taconite exist in statutes but do not generate revenue. The taxes would be levied if applicable producers began operating. Minnesota has never had a taxpayer for two of the following three taxes, and the third tax has not generated revenue in nearly four decades. Exhibit 1.7 shows summary features of the three nonrevenue-generating taxes.

Agglomerating Facilities Production Tax

The tax applies to "agglomerating" facilities, which are plants other than taconite or semitaconite facilities, that produce sellable iron ore aggregates for shipment and use in a blast furnace.[32] The rate is $0.05 per gross ton of agglomerates plus $0.001 per gross ton for each 1 percent of iron content exceeding 55 percent.

If revenues were generated by this tax, state law would distribute most of them to local taxing jurisdictions. The municipality in which the facility is located would receive 22 percent, the school district 50 percent, the county 22 percent, and the state General Fund would receive the remaining 6 percent.

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[28] *Minnesota Statutes* 2014, 273.165, subd. 1.

[29] *Ibid.*

[30] The counties are: Aitkin, Cook, Crow Wing, Itasca, Koochiching, Lake, and St. Louis.

[31] The Indian Business Loan Account is an account in the state treasury that provides business loans from the Department of Employment and Economic Development to Native Americans.

[32] The process of agglomerating iron ore and other iron-bearing material (other than taconite or semitaconite) is at temperatures of at least 900 degrees Fahrenheit.

Exhibit 1.7: Summary Features of Iron Ore and Taconite Taxes that Generate No Revenue, 2014

Feature	Agglomerating Facilities Production Tax[a]	Semitaconite Tax[b]	Tailings Tax[c]
Tax Rate	$0.05 per gross ton agglomerates plus $0.001 per gross ton for each percent of iron content exceeding 55 percent	Varies depending on the type of semitaconite concentrate	$0.10 per 2,000 pounds of tailings
Tax Base	Gross tons of sellable agglomerates	Gross tons of sellable concentrate	Pounds of tailings not deposited on land
Revenue Recipients	Municipality, school district, and county in which facility is located	Municipality, school district, and county from which semitaconite is mined	State General Fund

NOTE: These taxes are in law but do not generate revenue because the materials are not produced.

[a] Agglomerating facilities are plants other than taconite or semitaconite facilities that produce sellable iron ore aggregates for shipment and use in a blast furnace.

[b] Semitaconite deposits are altered iron formations, taconite, or composites of iron-bearing and other minerals that exist in a mass and must undergo processing to produce taxable concentrates. It is not sellable as iron ore in its natural state.

[c] Tailings are the solid and liquid waste materials that result from processing taconite.

SOURCES: Office of the Legislative Auditor, analysis of Minnesota Department of Revenue data; and *Minnesota Statutes* 2014, 298.24; 298.34; 298.35; 298.391; and 298.393.

Semitaconite Tax

Semitaconite deposits are altered iron formations, taconite, or composites of iron-bearing and other minerals that exist in a mass. The deposit must undergo processing to produce concentrates. The tax rate would vary depending on the type of semitaconite concentrate and where it would be processed; it would be levied on gross tons of sellable concentrate.[33] If the tax generated revenues, 22 percent would be distributed to the municipality in which the mining or processing occurs, 50 percent to the school district, 22 percent to the county, and 6 percent to the state's General Fund.

Tailings Tax

Tailings are the solid and liquid waste materials that result from processing taconite. Statutes establish a tax of $0.10 per 2,000 pounds of tailings only for tailings not deposited on land in accordance with state-issued permits.[34] This tax

[33] According to statutes, the tax rate for semitaconite agglomerated in Minnesota would be $0.05 per gross ton of sellable concentrate plus $0.001 for every 1 percent of iron content in excess of 55 percent. For all other concentrates, the rate would be $0.10 per gross ton of sellable concentrate plus $0.001 for every 0.5 percent of iron content in excess of 55 percent.

[34] *Minnesota Statutes* 2014, 298.24, subd. 2.

was paid in two years in the late 1970s.[35] If this tax generated revenue again, it would go to the state's General Fund.

Total Taconite Taxes

Of the 12 taxes levied on taconite and iron ore, 9 currently generate revenue. Most of the 12 taxes generate a small amount of the total revenue, while a few taxes generate the majority.

Among Minnesota's taxes on taconite, the production tax generates the largest share of revenues by far.

The production tax generated $109.9 million in 2014 while the occupation tax generated $15.8 million. Exhibit 1.8 shows the amount of revenue generated by each taconite tax from 2010 to 2014. Over this period, the production tax comprised an average of 74 percent of the total revenue generated from taxes on taconite and iron ore.

Exhibit 1.8: Taconite Taxes Paid, 2010-2014

Taconite Tax Type	2010 (x $1,000)	2011 (x $1,000)	2012 (x $1,000)	2013 (x $1,000)	2014 (x $1,000)	Percentage of Total in 2014[a]
Production Tax[b]	$81,166	$ 79,138	$ 79,972	$102,633	$109,928	79.78%
Occupation Tax	340	12,617	22,055	21,817	15,777	11.45
Use Tax	17,102	24,674	2,580	24,637	10,947	7.94
Auxiliary Mining Lands[c]	14	15	18	21	31	0.02
Taconite Railroad	10	10	11	14	34	0.02
Unmined Taconite	238	240	229	297	280	0.20
Unmined Natural Iron Ore	86	92	104	110	111	0.08
Severed Mineral Interests[d]	506	505	559	521	496	0.36
Income Tax Withholding on Royalties	138	373	286	232	191	0.14
Total	$99,660	$117,664	$105,814	$150,282	$137,795	100.00%

NOTE: Revenue reported in this exhibit has not been adjusted for inflation.

[a] Rows do not sum to 100 percent due to rounding.

[b] Starting in 2011, the production tax includes revenue generated from taxation of "other iron-bearing material," which is taxed on current year production; taconite is taxed on a three-year average of production.

[c] The total includes revenue collected by only Aitkin and Itasca counties; St. Louis County was not able to identify total revenue collected from auxiliary mining lands.

[d] From 2010 to 2014, between 38 and 40 counties in Minnesota collected the severed mineral interests tax. The majority of the tax was generated in seven northeastern Minnesota counties: Aitkin, Cook, Crow Wing, Itasca, Koochiching, Lake, and St. Louis. The exhibit presents the total generated in those seven counties, not the statewide total.

SOURCES: Office of the Legislative Auditor, analysis of data provided by Aitkin, Cook, Crow Wing, Itasca, Koochiching, Lake, and St. Louis counties, and the Minnesota Department of Revenue.

[35] No information was available on whether the tax was collected in earlier years.

Mineral taxes on taconite and iron ore are a small share of all taxes imposed by the state. Taconite taxes paid in 2014 represent less than 1 percent of the total Minnesota raised from taxes on individual income, corporate income, sales, statewide property, and other smaller statewide taxes.[36]

Aggregates

Aggregates are nonmetallic natural minerals, including sand, silica sand, gravel, crushed rock, limestone, and granite, and taconite tailings and architectural or dimension stone removed from a taconite mine. Some taxes apply solely to aggregates while others that apply to taconite also pertain to aggregates.

Minnesota imposes five taxes that apply to mined aggregate materials.

Aggregate Material Production Tax

Statutes authorize counties and certain townships to levy a production tax on aggregates excavated or imported in Minnesota.[37] In 2013, 32 counties and 2 townships imposed the tax, which generated $6.1 million.[38] The tax rate of $0.215 per cubic yard or $0.15 per ton of aggregate applies to every producer or importer of aggregates in counties or townships where the tax is levied.[39]

The county or town that levies the tax collects the tax revenue. Revenue is primarily allocated to funds within that county or town, including the General Fund and the county road and bridge fund. When the tax generates revenue from certain aggregate materials originating in taconite mines or former mines, revenue is distributed instead to a fund administered by the Iron Range Resources and Rehabilitation Board.[40]

[36] The other taxes are: estate and gift; liquor, wine, and beer; cigarette and tobacco; mortgage registry; deed transfer; insurance gross earnings and fire marshal; controlled substance; other gross earnings; lawful gambling; medical assistance surcharge; motor vehicle registration; and state- and local-collected taconite taxes.

[37] *Minnesota Statutes* 2014, 298.75, subds. 2(a) and (b), 9, and 11.

[38] The production tax on mining aggregate is a local tax administered by the counties or townships that impose it. We calculated the amount of taxes that should have been collected based on the amount of aggregate material produced (reported by counties to the Department of Revenue). In ten counties, the calculated amount of taxes that should have been collected did not match the amount of taxes that counties reported.

[39] If a county borders two states and is not contiguous to a county that imposes the tax, it may impose a rate of $0.10 per cubic yard or $0.07 per ton. In 2013, only Rock County imposed this lower rate.

[40] Revenue distributed to IRRRB from the aggregate material production tax is allocated to the Taconite Environmental Protection Fund. The fund's purpose is to: (1) reclaim, restore, and enhance parts of northeast Minnesota adversely affected by the environmentally damaging impacts of mining and (2) to promote economic development in northeast Minnesota.

Other Taxes

Aggregate mining companies are subject to Minnesota's general sales tax, which is 6.875 percent of gross receipts from retail sales, but exemptions and refunds apply. Materials consumed in industrial production, which includes mining and quarrying, are exempt. The exempt materials include chemicals, fuels, gas, and electricity. Another exemption is the purchase of aggregate material by certain concrete producers to make ready-mix concrete. In addition, most sales to local governments are not taxable. Companies can have expenses refunded for capital equipment that is used in mining. As is true for taconite companies, the majority of revenues collected from the sales and use tax paid by aggregate mining companies are deposited in the state's General Fund; a portion is allocated to the Outdoor Heritage Fund, Clean Water Fund, Parks and Trails Fund, and the Arts and Cultural Heritage Fund.

Aggregate mining companies also pay income taxes based on their company structure and property taxes. The severed mineral interests tax applies to all mineral interests owned separately from the property surface, and thus can apply to aggregates.

Nonferrous Minerals

Nonferrous metallic minerals include all metals except iron ore and taconite. These minerals, such as copper, nickel, platinum, and gold, are taxed somewhat differently than taconite and aggregates.

No nonferrous minerals have been mined in Minnesota, but if they were, current state law would impose six taxes on such mining.

While nonferrous minerals have not been mined in Minnesota, companies are exploring for such minerals. For example, Polymet Mining, Inc., has proposed a copper-nickel-platinum mine in northeastern Minnesota that is under review. If nonferrous minerals were mined, Minnesota would tax the net proceeds of the mining business. Such mining companies would also pay the occupation tax and sales and use taxes. As is true for taconite, nonferrous minerals are subject to the income tax withholding on royalties and ad valorem taxes on auxiliary mining lands and severed mineral interests. Unlike mining for taconite or aggregates, Minnesota does not impose a production tax on nonferrous metals.[41]

Net Proceeds Tax

A tax rate of 2 percent would be levied on the net proceeds from mining if nonferrous mining begins. Net proceeds equals gross proceeds from mining, less certain deductions used to determine taxable income. The deductions include expenses necessary in converting raw ores to marketable quality, such as costs

[41] It is important to note that nonferrous mining companies would also be subject to royalty payments for mining operations on state land, which would be paid to the Department of Natural Resources and distributed based on the classification of land.

associated with refinement. Deductions do not include costs for transportation, stockpiling, marketing, or marine insurance that are incurred after producing ores (unless the expenses are part of gross income). The tax does not apply to iron ore, taconite, aggregates, sands, or soil.

Were mining to commence on nonferrous minerals, revenue from the net proceeds tax would be distributed depending on the location of the mining relative to the Taconite Assistance Area.[42] Revenue from the net proceeds tax on minerals mined within the area would be distributed to local taxing jurisdictions primarily where the minerals are mined or processed and to the IRRRB, as shown in Exhibit 1.9. Minerals mined outside the area would be deposited in the state's General Fund.

Exhibit 1.9: Distribution of Net Proceeds Tax if Nonferrous Mining Commenced, 2014

	Amount
Minerals Extracted within Taconite Assistance Area[a]	
City or town within which mining or processing occur	5%
Taconite municipal aid account	10
School district within which mining or processing occur	10
Group of school districts in which minerals are mined or in which there is a qualifying municipality[b]	20
County within which mining or processing occur	20
St. Louis County, acting as the counties' fiscal agent	20
Iron Range Resources and Rehabilitation Board	5
Douglas J. Johnson Economic Protection Trust Fund	3
Taconite Environmental Protection Fund	7
Minerals Extracted Outside Taconite Assistance Area	
State General Fund	100

NOTES: The net proceeds tax does not apply to production of iron ore or taconite concentrates, sand, gravel, various types of stone, and soil, and therefore does not generate tax revenues when such materials are mined. Although the tax applies to nonferrous metallic minerals, as of April 2015, nonferrous metallic minerals have not been mined in Minnesota. Statutes specify that if nonferrous mineral mining and processing take place in different taxing jurisdictions, 50 percent of the proceeds must be distributed to jurisdictions where mining occurs and 50 percent to jurisdictions where processing occurs.

[a] The Taconite Assistance Area is a geographic region in northeastern Minnesota. The area is used to determine eligibility for recipients of certain mineral tax revenues, such as some production tax revenues.

[b] A municipality qualifies based on: (1) the assessed valuation of unmined iron ore in the municipality in 1941 or (2) whether taconite was mined or concentrated, or there was an electric generating plant in the municipality, in 1977 or when the property was assessed.

SOURCES: Office of the Legislative Auditor, analysis of *Minnesota Statutes* 2014, 273.1341 (b); 298.015, subd. 1; 298.018; and 298.28.

[42] The Taconite Assistance Area is a geographic region in northeastern Minnesota. The area is used to determine recipients of certain mineral tax revenues, such as some production tax revenues. Chapter 2 describes the region and includes a map.

Other Taxes

Mining of nonferrous minerals is subject to five taxes described throughout this chapter, in the same manner as taconite and iron ore:

- Occupation tax
- Sales and use tax
- Income tax withholding on royalties
- Ad valorem tax on auxiliary mining land
- Ad valorem tax on severed mineral interests[43]

ROYALTIES

Mining companies pay royalties to the state when mining on state-owned lands and make lease payments when exploring for minerals on these lands. Royalties are not taxes, but they constitute a significant amount of revenue that mining companies pay to the state.[44] Royalties are paid to explore or mine any type of mineral; they are not restricted to taconite.

Minnesota requires mining companies to pay royalties for exploring or mining on state-owned lands.

Mining companies pay royalties to the Department of Natural Resources for specific statewide functions. The department manages state-owned minerals for the benefit of schools, the University of Minnesota, and local governments. From fiscal years 1890 to 2013, the state collected $572.1 million in royalties; $557.8 million came from iron ore and taconite mining and exploration, and $11.9 million came from nonferrous metallic mineral exploration royalties. In fiscal year 2013 alone, such royalty payments to the state totaled $49.1 million.

Since 2007, 20 percent of the royalties collected each year have gone to the Department of Natural Resources to cover administrative expenses for managing state mineral resources. The remaining 80 percent are distributed to several funds, depending upon the classification of land being mined or explored. Exhibit 1.10 shows how the royalty revenue was distributed from iron ore and taconite leases on different classifications of land from 1890 to 2013.

[43] Due to the net proceeds tax, nonferrous mining companies are exempt from general property taxes except on auxiliary mining lands; this is similar to taconite companies, except that taconite mining companies are exempt from most property taxes due to payment of the production tax.

[44] In this section, the term "royalties" includes rents and royalties paid for state mineral leases. Regarding income taxes withheld on royalties, statutes define "royalty" to mean: "the amount in money or value of property received by any person having any right, title, or interest in any tract of land in this state for permission to explore, mine, take out, and remove ore from the land." See *Minnesota Statutes* 2014, 290.923, subd.1.

Exhibit 1.10: Distribution of Iron Ore and Taconite Royalty Revenue, by Land Class, Fiscal Year 1890-2013

Fund/Account	Trust Land	Tax Forfeited Land	Consolidated Conservation Areas Land[a]	General Gift Lands and Minerals[b]	Natural Resource Fund Land[c]	Total Revenue
School Trust Fund	$319,603,782	-	-	-	-	$319,603,782
University Trust Fund	138,036,593	-	-	-	-	138,036,593
Counties	-	$39,961,604	$11,855	-	-	39,973,459
State General Fund	3,746,502	7,030,600	-	$49,619	-	10,826,721
Mineral Lease Account	-	546,319	-	-	-	546,319
Mineral Management Account[d]	46,471,804	2,392,646	-	-	-	48,864,450
Consolidated Conservation Account	-	-	11,855	-	-	11,855
Natural Resource Fund	-	-	-	-	$8,765	8,765
Total	$507,858,681	$49,931,169	$23,710	$49,619	$8,765	$557,871,944

NOTE: Revenue reported is not adjusted for inflation.

[a] Consolidated Conservation Areas lands have been acquired by the state through tax forfeitures and legislative action, and are held by the state for taxing districts. These lands generated revenue from iron ore and taconite leases from only 1950-1956.

[b] General Gift Lands and Minerals are granted to the state through gifts and have no specific fund designated to receive revenue generated from the land. These lands generated revenue from iron ore and taconite leases from only 1953-1958.

[c] The revenue distributed to the Natural Resource Fund came from Department of Natural Resources-acquired land that contained one stockpile of low-grade iron material for which a stockpile lease was issued. The land is located in the Iron Range Off-Road Highway Vehicle Recreation Area; revenue from any state mineral lease on this land must be deposited in the Natural Resources Fund. The land generated revenue from one iron ore and taconite lease in 2008 and 2010.

[d] The Mineral Management Account is used by the Department of Natural Resources for administrative costs associated with managing the state's mineral resources.

SOURCES: Minnesota Department of Natural Resources, Division of Lands and Minerals, Transactions Section, *Revenue Received from State Mineral Leases, FY 1890-2013* (April 2014); and *Minnesota Statutes* 2014, 93.22, subd. 1(b).

At one time Minnesota taxed royalties, but it has not had a royalty tax in place since 1989. Prior to being repealed, the tax was levied on all royalties paid for permission to explore, mine, and remove ore from land in Minnesota. When it was repealed, the royalty tax rate was 5.75 percent for taconite, semitaconite, and iron ore. From 1914 to 1990, the royalty tax generated a cumulative $64.7 million, which was deposited into the state's General Fund.

Income Tax Withheld on Mining and Exploration Royalties

In this section, we discuss income tax withholdings on royalties. The withholding affects companies that explore for and mine taconite and nonferrous minerals.

Minnesota requires royalty payers to withhold income tax from certain royalty payments.

Since 1990, persons who pay royalties to land owners other than the state have been required to withhold income taxes on certain royalty payments. The rate decreased from 7 percent in 1990 to its current rate of 6.25 percent in 2001. In 2014, companies withheld $191,216 in income taxes on royalties, which went to the state's General Fund.

Withholding is required only under specific circumstances. Royalty payers are not required to withhold income tax from royalties paid to the state of Minnesota because the state is exempt from paying taxes. Income tax withholding is not required from those that do not incur liability for income tax, such as S-Corporations, C-Corporations, and Partnerships.[45] Income tax withholding is required on mineral royalties paid to individuals, single member limited liability companies taxed as disregarded entities, and certain trusts.[46]

GENERAL BUSINESS TAXES ON THE MINING INDUSTRY

In some important respects, the general state-imposed taxes that taconite producers pay differ from taxes paid by other industries. This section discusses differences in the structure and distribution of taconite mining-specific taxes compared with general state taxes.

Beyond mineral taxes, mining companies pay the same types of taxes as other businesses but under different restrictions.

The taconite production tax and the occupation tax are specific to mining companies; no other Minnesota industries currently pay these taxes. Statewide taxes that apply to all industries include the (1) general sales and use tax, (2) corporate franchise tax, and (3) state general property tax. Taconite companies pay these statewide taxes, but in limited ways. The limitations vary by tax and are explained below.[47]

General Sales and Use Tax

Like any business, taconite companies pay the state's 6.875 percent sales and use tax on purchases of tangible personal property and certain services, such as telephone service. The state exempts many specific goods and services from the

[45] S-Corporations and Partnerships are pass-through entities in which the members' incomes are taxed individually, and C-Corporations are subject to the franchise tax.

[46] A "disregarded entity" is an entity that is not considered separate from its owner for federal income tax purposes. Simple trusts, which distribute all royalty income to beneficiaries, are exempt from the royalty withholding unless they choose to have the tax withheld by the royalty payer. If, on the other hand, the trust chooses tax-exempt status, it in essence becomes a royalty payer and is responsible for withholding tax from royalties paid to the trust's beneficiaries.

[47] Lack of certain data by individual taxpayers prevented the comparison of actual tax amounts paid by mining companies with taxes paid by other industries.

sales tax, including items that are specific to the mining industry.[48] Capital equipment that is used for mining in the state and is essential to that mining is exempt. Building materials, equipment, and supplies used for the construction of certain mineral production facilities, such as to manufacture fluxed taconite pellets, are also exempt.[49]

Corporate Franchise Tax

Minnesota taconite mining companies pay the occupation tax in lieu of the 9.8 percent tax on corporate taxable net income, as explained earlier. The occupation tax differs from the corporate franchise tax in several ways. The occupation tax is based on mine value, which is determined by calculating the value of taconite products sold, while the corporate franchise tax is based on taxable net income. "Unitary" provisions that apply to the corporate franchise tax, which calculate the tax of related companies based on the combined income of each company in the group, do not apply to the occupation tax. This means that the occupation tax applies only to the mining activity of the company and not to other, nonmining business the company may conduct. The occupation tax does not permit the mining income or loss of one legal entity to be offset by income or losses from a related but separate legal entity.

Another difference is that all taconite product sales are considered sales within the state, so 100 percent of a mine's taxable income (mine value) is assigned to Minnesota and subject to the occupation tax. By contrast, other industries pay the corporate franchise tax based on only their income attributable to sales in Minnesota. Mining companies subject to the occupation tax are allowed to use percentage depletion in calculating their taxable income, which is a deduction that allows the mine to account for reduction of the taconite reserves.

Mining companies are subject to the corporate franchise tax when engaging in business not subject to the occupation tax. In this circumstance, the tax is computed on the net income of those activities not subject to the occupation tax.

State General Property Tax

For taconite mining companies, most mining lands and buildings are exempt from the state general property tax. However, mining companies are subject to the state general property tax on three types of property: auxiliary mining lands, taconite railroads, and unmined natural iron ore.

[48] Taconite companies do not have to pay sales tax on mill liners, grinding rods, and grinding balls, which are used in the production of taconite.

[49] Fluxed taconite pellets refer to those containing limestone or other additives to improve the productivity of the pellets in blast furnaces.

Mineral Tax Distribution

Taconite mining taxes are primarily distributed to northeastern Minnesota. Some taconite taxes and general business taxes paid by mining companies have different distribution patterns.

Most state taconite taxes paid by mining companies are distributed to Iron Range local governments and the Iron Range Resources and Rehabilitation Board. However, taconite mining companies also pay some taxes for which revenues are distributed statewide.

The production tax paid by mining companies is distributed to local taxing jurisdictions in northeast Minnesota and IRRRB, as explained further in Chapter 2. By contrast, the occupation tax is distributed primarily on a statewide basis, to the General Fund, elementary and secondary schools, and the University of Minnesota. Revenue from income tax withholding on mining royalties and from the sales and use tax paid by mining companies is also primarily distributed on a statewide basis. Business tax receipts from the state sales and use tax, corporate franchise tax, and state general property tax are typically distributed to the state's General Fund. As explained above, mining companies also pay these three taxes, but under specific circumstances.

ADMINISTRATION OF MINERAL TAXES

The Department of Revenue and counties each play a role in administering mineral taxes. In this section, we focus primarily on taconite taxes. Should nonferrous mining begin, the department would have similar roles in the administration of nonferrous taxes.

The Minnesota Department of Revenue is primarily responsible for administering taxes on minerals.

For the taconite production tax, the Minnesota Department of Revenue, which includes an office located in Eveleth, has several key roles and responsibilities. Department personnel track the amount of taconite produced by all mining companies. The department is responsible for calculating how much tax each mining company owes and notifying the companies of amounts due, which are then paid directly to counties and IRRRB. The department also notifies recipients of the amount of production tax revenue they will receive.

In fiscal year 2014, the department had an estimated budget of $347,956 for direct compliance staffing costs related to mineral taxes, which covered 3.75 full-time-equivalent staff and some supervisory staff.[50] From fiscal year 2010 to 2014, the budget for direct compliance activities increased 12 percent and direct compliance staffing increased 36 percent.

[50] Indirect administrative costs such as processing tax returns, systems support, and management are not included.

Regarding the occupation tax, the department determines the process used to calculate mine values, and notifies mining companies of the occupation tax rate. Unlike the production tax, the companies are responsible for calculating the amount of tax owed by using the M30 occupation tax return.

The department has many other roles in mineral tax administration. The department collects use taxes that companies remit directly to the department. It also handles the processing and payment of revenues generated from the severed mineral interests tax for the Indian Business Loan Account. The department sets the value of railroads, including taconite railroads, and assesses the value of natural iron ore reserves for ad valorem tax purposes.

Counties administer some mineral taxes. Counties primarily administer the ad valorem taxes on taconite and iron mining. Local jurisdictions levy rates against auxiliary mining lands, unmined taconite, unmined iron ore, and taconite railroads, from which counties collect the revenues and distribute them to the levying jurisdictions. Similarly, counties and townships that levy the aggregate material production tax collect the tax and distribute its revenues.

Chapter 2: Production Tax

Among mining taxes imposed on taconite producers, Minnesota's production tax generates the most revenue. Its structure is set at the state level, but its revenues pay for local government services. This chapter describes the production tax structure, revenues, and revenue distribution. It contains an addendum on accounts and funds that receive production tax revenues.

STRUCTURE OF PRODUCTION TAX

Key elements of how Minnesota has structured its production tax are the tax rate, the base against which the rate is applied, and the sources that pay the tax. We first analyze the tax rate, followed by the tax base and taxes generated.

Tax Rate

The production tax rate is statutorily set and was most recently changed in 2013. The rate consists of a base rate and an annual adjustment, described below.

The Legislature sets the production tax rate in statute, but the actual rate is adjusted annually using a federal economic indicator.

The current statutory production tax rate is $2.56 per gross ton of sellable iron ore concentrate or pellets produced, while the actual rate is $2.597 per ton. The difference is an annual adjustment to the statutory rate based on the implicit price deflator for gross domestic product.[1] Published by the U.S. Bureau of Economic Analysis, the implicit price deflator is an index that measures inflation in the economy. Typically, the production tax rate equals the previous year's rate plus an additional percentage that reflects the prior year's change in the implicit price deflator.[2] However, in years when the Legislature changes the statutory rate, the rate is used without adjusting for inflation.[3]

[1] The gross domestic product measures the growth in the economy using a "market basket" of goods and services that changes over time based on actual production or purchases. An implicit price deflator is a ratio of nominal gross domestic product to real gross domestic product, which adjusts growth in the economy for changes in prices and output of goods and services over time.

[2] The prior year's change in the implicit price deflator equals the increase from the fourth quarter of the second preceding year to the fourth quarter of the preceding year. An additional tax equal to $0.03 per gross ton of sellable iron ore concentrate is applied for each 1 percent of iron content that exceeds 72 percent. In 2014, this applied only to Mesabi Nugget.

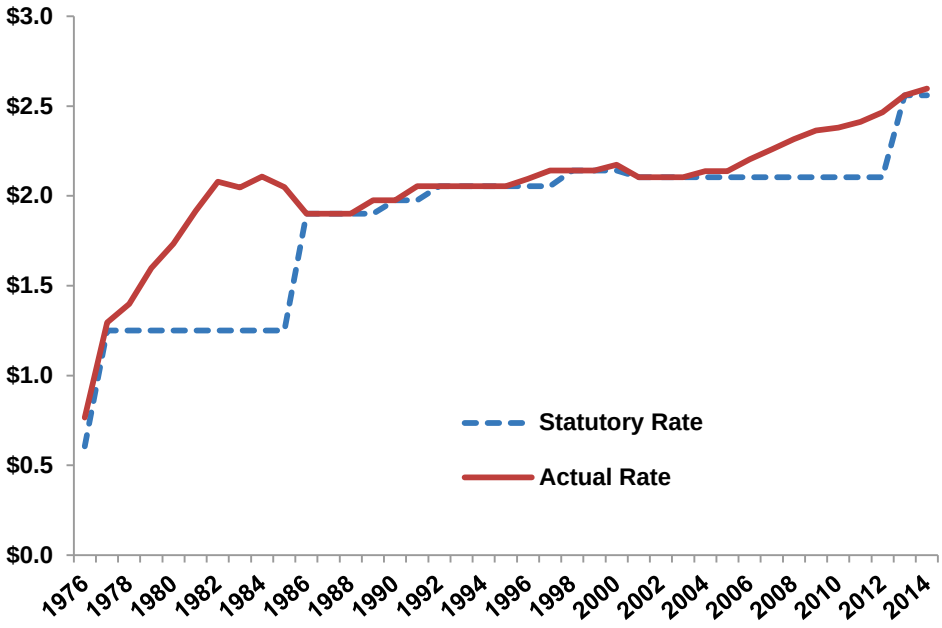
[3] Mine operations that began construction prior to 2008 do not pay the production tax on their first two years of commercial production of direct reduced ore, which is ore with an iron content of at least 75 percent. In the third, fourth, and fifth years, 25 percent, 50 percent, and 75 percent of the tax rate applies, respectively. The full rate applies in all subsequent years. See *Minnesota Statutes* 2014, 298.24, subd. 1(g)(1). Since 2008, this has applied to only Mesabi Nugget.

The production tax rate has increased fairly steadily over time.

The statutory rate increased from $0.05 per ton in production year 1941 to $2.56 per ton in 2014. Over that period, the actual rate increased from $0.055 per ton to $2.597 per ton, due to inflation-based adjustments.

For most years, the actual rate has exceeded the statutory rate, as Exhibit 2.1 shows. The exhibit demonstrates key increases in the statutory tax rate, such as 1977 when the statutory rate more than doubled to $1.25 per ton from $0.605 per ton in 1976. However, the actual tax rate paid by taxpayers increased 69 percent for that period, from $0.765 per ton in 1976 to $1.295 per ton in 1977. From 1977 to 1985, the statutory rate remained $1.25 per ton but the actual rate increased to $2.048 per ton, a 58 percent increase. Since 1986, the statutory production tax rate has changed several times, increasing in 1990, 1992, and 1998, decreasing in 2001, and then increasing again in 2013. The actual rate has increased fairly steadily since 1986. In Appendix A, Exhibit A.1 shows the change in the statutory and actual tax rates over time.

Exhibit 2.1: Changes in Statutory and Actual Production Tax Rates, 1976-2014



NOTE: Each year equates to the year the taconite was produced.

SOURCE: Office of the Legislative Auditor, analysis of Minnesota Department of Revenue, *Mining Tax Guide* (Saint Paul, 2014), 24.

Tax Base

In this section, we discuss total taconite production over time and the base against which the production tax is levied. We also explain the difference between annual tons of production and the taxable tons of production; the production tax is levied on taxable tons.

Taconite production has increased over time, but with significant variation in the total tons produced annually. Mining companies produced 26.4 million tons of taconite in 1977 and 38.5 million tons in 2013, an increase of 46 percent. Exhibit 2.2 shows fluctuations in production over this period and shows the largest amount of taconite production occurred in 1979 when companies produced 55.3 million tons.

In 2014, five companies paid the production tax based on taconite production from nine mining operations. The state of Minnesota also paid the production tax, as discussed later in this chapter. From 2011 to 2013, U.S. Steel-Minntac consistently produced the most taconite annually, while Mining Resources produced the least. Exhibit 2.3 shows each current mining operation's total production from 2011 to 2013.

Because the tax base is a function of the weight of taconite produced, accuracy in measuring the taconite is important. In Minnesota, the Weights and Measures Division of the Department of Commerce is responsible for ensuring the accuracy of heavy-duty scales, including those used in taconite operations.

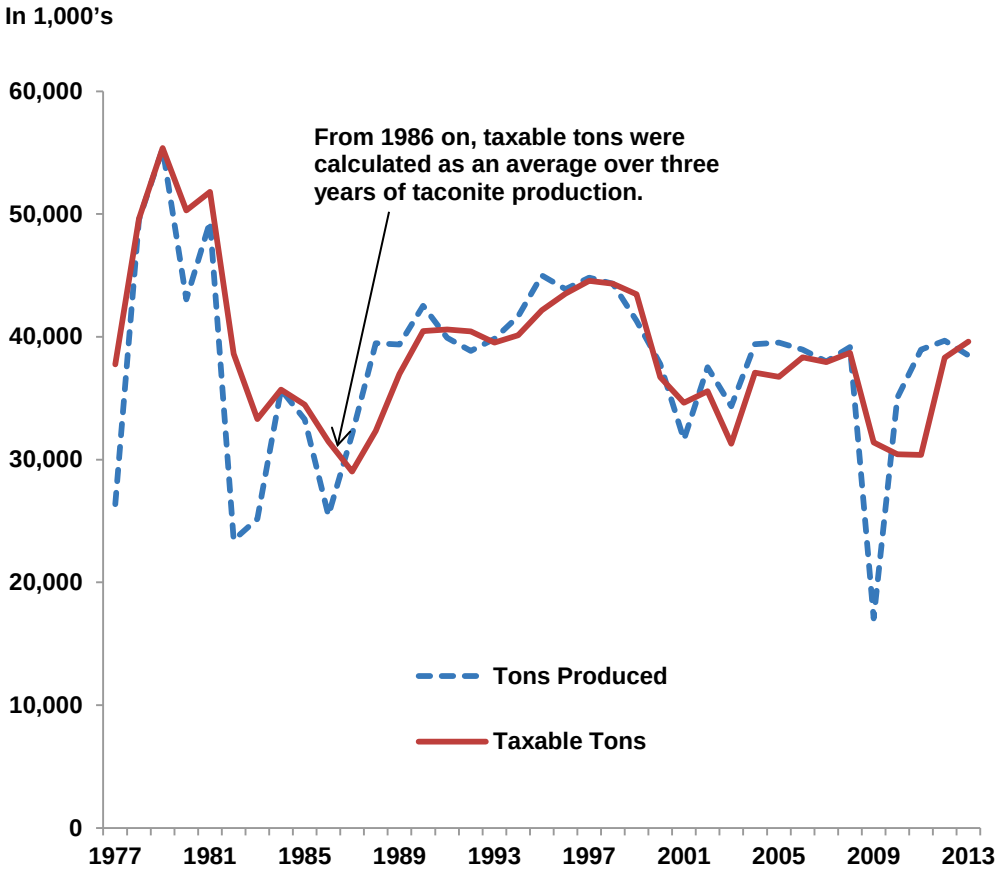
By law, the annual taxable tonnage is an average of three years of taconite production.

In 2013, the tax base was 39.6 million taxable tons of taconite concentrate, which is the three-year average of production for taconite mining companies over 2011, 2012, and 2013. The tax base is calculated by averaging production in the current year plus the prior two years. Such averaging reduces the severity of spikes or troughs in production that could otherwise lead to dramatic changes in annual revenue. Because of the averaging, companies pay higher production taxes in a year when taconite production is low than they would if calculations were based on a single year. Conversely, in a high-production year, that year's amount of taconite averaged with the two prior years of lower production result in lower taxes than if the base were the single year of high production.

Since 2011, the production tax has also been levied on "other iron-bearing material," which is calculated on current year production instead of a three-year average. In 2014, two mining operations, Magnetation and Mining Resources, paid the production tax on current year production of other iron-bearing material.

The production tax has been levied on taxable tons since 1977. The taxable tons have almost always varied from the amount of taconite actually produced

Exhibit 2.2: Tons of Taconite Produced and Taxable Tons, 1977-2013



NOTES: 1977 was the first time the production tax rate was applied against taxable tons, which at the time was the higher of either the current year's production or the average of production for the current year and the prior two years. The taxable tons in 1984 included only the taconite produced that year. In 1985, taxable tons were calculated as the average of production in 1984 and 1985. Since 1986, the three-year average of production has been used consistently on taconite. Since 2011, the production tax has also been levied on "other iron-bearing material," which is taxed on only current year production.

SOURCE: Office of the Legislative Auditor, analysis of Minnesota Department of Revenue, *Mining Tax Guide* (Saint Paul, 2011 and 2014).

annually.[4] One of the greatest variations between the actual tons produced in a year and the taxable tons on which the tax was levied occurred in production year 2009. That year, companies mined 17.1 million tons of taconite but they were taxed on 31.4 million taxable tons, due to the three-year average of production. Had the production tax been levied on the 17.1 million tons of taconite produced, companies would have paid a total of $40.4 million; instead, they paid

[4] The exception was in 1984 when the taxable tons were the same as the number of tons produced.

Exhibit 2.3: Tons of Taconite Produced, 2011-2013

Owner	Mining Operation	Tons Produced 2011	Tons Produced 2012	Tons Produced 2013
U.S. Steel	U.S. Steel – Minntac	13,047,915	13,063,450	13,448,911
ArcelorMittal, Cliffs Natural Resources, U.S. Steel	Hibbing Taconite	7,604,595	7,753,828	7,312,252
Cliffs Natural Resources	United Taconite	5,095,221	5,220,491	5,081,692
Cliffs Natural Resources	Northshore	5,591,721	5,140,985	3,776,603
U.S. Steel	U.S. Steel – Keewatin Taconite	4,969,039	5,144,477	4,956,740
ArcelorMittal	ArcelorMittal Minorca	2,625,659	2,658,023	2,645,243
Steel Dynamics	Mesabi Nugget	153,270	174,964	210,573
Magnetation	Magnetation LLC	30,022	524,505	958,627
Steel Dynamics, Magnetation	Mining Resources	0	0	90,587
Total		39,117,442	39,680,723	38,481,228

SOURCE: Office of the Legislative Auditor, analysis of Minnesota Department of Revenue data.

$74.3 million. Taconite production increased in the following two years, but the low production in 2009 kept the taxable tons below actual tonnage produced in 2010 and 2011. Had the production tax been levied on actual production in 2010 and 2011, companies would have paid a total of $83.4 million and $94 million, respectively; instead they paid $72.4 million in 2010 and $73.3 million in 2011.

The use of taxable tons has a smoothing effect when compared with the highs and lows of tons produced annually, as Exhibit 2.2 showed. The exhibit also demonstrates that even with the smoothing, the tax base has varied significantly from some years to the next. In Appendix A, Exhibit A.2 shows the change in the annual tons and taxable tons over time.

Calculating production taxes using a three-year average of production has advantages and disadvantages.

We interviewed representatives of three mining companies as part of this evaluation: ArcelorMittal Minorca, Cliffs Natural Resources, and U.S. Steel. We also interviewed representatives of a select set of 13 counties, municipalities, and school districts on the Iron Range.[5] Exhibit 2.4 lists the local jurisdictions. The mining companies and the local jurisdictions described both negative and positive aspects of calculating the taconite production tax on a three-year average of production.

Mining companies indicated a preference for paying the production tax based on amounts of taconite actually produced each year. Representatives of the companies we interviewed said levying the production tax on a three-year average is detrimental when production is low or shut down, which is when companies most need to save money. In one company, representatives said

[5] While the number we interviewed is too small to allow us to generalize for the entire Iron Range, we heard many valuable insights from these local officials. We selected the jurisdictions to achieve a mix of locations and tax-base size.

Exhibit 2.4: Local Jurisdictions Interviewed, 2014

Jurisdiction Type	Name
County	Itasca
	Lake
	St. Louis
Municipality	Biwabik
	Buhl
	Cohasset
	Ely
	Hibbing
	Keewatin
	Nashwauk Township
School District	Hibbing-701
	Mesabi East-2711
	Nashwauk/Keewatin-319

SOURCE: Office of the Legislative Auditor.

taxing taconite production discourages companies from increasing production because increased production would increase taxes owed. They said the production tax does not take into account the financial situation of the companies paying the tax and whether or not the company is actually making money.

Most local governments we interviewed said the cyclic nature of mining creates negative impacts on local revenues, but taxing the three-year average of production tonnage lessens the impact of the downturns. Some city officials also said that their budgetary needs do not decline in strong economic times because growth in the mining industry can bring added population and increasing needs for city services. Thus, a year of low taconite production followed by growth, such as 2009 through 2011, can create problems because the low-production year affects funding amounts for the following two years. Some local officials said they cannot set budgets that rely on production tax revenues because revenues vary greatly from one year to the next.

Taxes Generated

In this section, we analyze the amount of revenue the production tax has generated over time. We also describe who pays the production tax and how this has changed.

Production tax revenues fluctuate based on how much taconite is mined and produced.

Production taxes totaled $109.9 million in 2014, based on 39.6 million taxable tons of taconite in 2013, as shown in Exhibit 2.5. The production tax base and production tax revenue have varied greatly over time. When adjusted for inflation, the tax generated $134.8 million in 1977, based on 40.6 million taxable

Exhibit 2.5: Taconite Production Tax Paid, 1977-2014

Year	Tax Paid by Companies (in 2014 dollars; x 1,000)	State Aid[a] (in 2014 dollars; x 1,000)	Total Tax Paid (in 2014 dollars; x 1,000)	Taxable Tons (x 1,000)
1977	$ 134,776	-	$ 134,776	40,575
1978	200,542	-	200,542	37,759
1979	261,579	-	261,579	49,614
1980	300,958	-	300,958	55,373
1981	269,697	-	269,697	50,296
1982	288,689	-	288,689	51,799
1983	224,176	-	224,176	38,624
1984	180,236	-	180,236	33,302
1985	165,898	-	165,898	35,689
1986	162,688	-	162,688	34,477
1987	116,194	-	116,194	31,468
1988	118,281	-	118,281	29,039
1989	126,529	-	126,529	32,326
1990	151,484	-	151,484	36,968
1991	160,139	-	160,139	40,461
1992	161,358	-	161,358	40,606
1993	156,618	-	156,618	40,431
1994	149,137	-	149,137	39,541
1995	147,556	-	147,556	40,126
1996	151,663	-	151,663	42,176
1997	156,732	-	156,732	43,517
1998	160,753	-	160,753	44,563
1999	153,906	-	153,906	44,338
2000	144,926	-	144,926	43,468
2001	120,068	-	120,068	36,711
2002	91,861	$ 19,123	110,984	34,638
2003	91,785	11,335	103,120	35,575
2004	88,887	10,292	99,179	31,302
2005	101,744	10,474	112,218	37,091
2006	95,991	10,154	106,145	36,755
2007	98,074	10,040	108,114	38,335
2008	94,647	9,439	104,086	37,929
2009	99,328	9,435	108,763	38,701
2010	80,114	7,456	87,570	31,411
2011	75,790	7,006	82,796	30,438
2012	75,237	6,862	82,099	30,384
2013	95,447	8,539	103,986	38,310
2014	101,214	8,714	109,928	39,608
Total	$6,051,581	$128,869	$6,180,451	1,473,724

NOTES: Revenue in this exhibit has been adjusted for inflation in terms of 2014 dollars. The production tax is paid in the year following the year the taconite was produced. In 1977 through 1983, the production tax applied to taxable tons, which was the higher of a three-year average or actual tons produced. The taxable tons in 1984 were the actual tons produced, while in 1985 the taxable tons were an average of production in 1984 and 1985. A three-year average of production has been used since 1986 on taconite. Since 2011, the production tax has also been levied on "other iron-bearing material," which is taxed on only current year production.

[a] The state of Minnesota supplements the mineral taxes paid by mining companies; the state allocates from the General Fund an amount equal to $0.22 per ton to be distributed in the same manner as production tax revenue. The state aid amount was enacted in 2001.

SOURCES: Office of the Legislative Auditor analysis of Minnesota Department of Revenue data; *Minnesota Statutes* 2014, 298.285; Minnesota Department of Revenue, *Mining Tax Guide* (Saint Paul, 2011 and 2014); and U.S. Bureau of Economic Analysis, *Table 1.1.4 Price Indexes for Gross Domestic Product*, revised February 27, 2015.

tons in 1976. From 1977 to 2014, the greatest number of taxable tons was 55.4 million, which were produced in 1979 and taxed in 1980. Between 1980 and 2014, the total amount of production tax revenue (in 2014 dollars) decreased 63 percent while the taxable tons decreased 28 percent.

The state of Minnesota annually supplements the mineral taxes paid by mining companies.

The 2001 Legislature approved appropriations from the state General Fund to be used in the same manner as production tax revenue.[6] Since 2003, the state aid for the production tax has been $0.22 per taxable ton.[7] From 2002-2014, the state aid amount for the production tax totaled $128.9 million in inflation-adjusted dollars, which is 9.8 percent of the total revenue generated by the tax since the state aid was enacted. In 2014, state aid of $8.7 million comprised 8 percent of total production tax revenue.

Since 2009, 11 taxpayers have paid the production tax, shown in Exhibit 2.6. In 2014, nine mining operations and the state of Minnesota paid production taxes.

Exhibit 2.6: Production Tax Paid by Taxpayer, 2009-2014

Taxpayer	2009 (x 1,000)	2010 (x 1,000)	2011 (x 1,000)	2012 (x 1,000)	2013 (x 1,000)	2014 (x 1,000)	Percentage Change (2009-2014)[a]	Percentage Change in Inflation (2009-2014)[b]
U.S. Steel – Minntac	$30,912	$26,340	$26,102	$26,019	$ 31,501	$ 33,758	9.2%	10.8%
Hibbing Taconite	18,103	13,410	12,256	12,056	17,301	19,346	6.9	10.8
United Taconite	11,173	11,066	10,942	11,177	12,608	13,139	17.6	10.8
Northshore	11,769	10,524	10,298	10,671	12,598	12,381	5.2	10.8
U.S. Steel – Keewatin Taconite	11,671	7,848	7,634	7,982	12,323	12,860	10.2	10.8
ArcelorMittal Minorca	6,002	5,068	5,189	5,302	6,481	6,766	12.7	10.8
Magnetation LLC	-	-	-	72	1,293	2,454	3,289.0	2.7
Mesabi Nugget	-	-	-	-	100	278	178.0	1.3
Mining Resources	-	-	-	-	-	232	NA	NA
Magnetation Inc.	-	-	21	8	-	-	-60.8	1.9
State of Minnesota	8,514	6,910	6,696	6,685	8,428	8,714	2.3	10.8
Total	$98,145	$81,166	$79,138	$79,972	$102,633	$109,928	12.0%	10.8%

[a] For companies that did not pay the tax in 2009 or 2014, the percentage change in production tax payments is calculated based on their first and last year of production.

[b] The change in inflation was calculated using the state and local government consumption expenditures and gross investment index for gross domestic product. For companies that did not pay the tax in 2009 or 2014, the percentage change in inflation is calculated based on their first and last year of production.

SOURCES: Office of the Legislative Auditor, analysis of Minnesota Department of Revenue data; and U.S. Bureau of Economic Analysis, *Table 1.1.4 Price Indexes for Gross Domestic Product*, revised February 27, 2015.

[6] *Laws of Minnesota* 2001, First Special Session, chapter 5, art. 6, sec. 39.

[7] The first year the General Fund paid the aid was 2002, when the amount was the equivalent of $0.33 per taxable ton.

From 2009 to 2014, the total production taxes paid rose 12 percent, compared with an increase in inflation of 10.8 percent. Exhibit 2.6 also shows the percentage change in production taxes paid and the percentage change in inflation from 2009 to 2014. Of the current taxpayers over this period, the increase in production tax payments was lower than the increase in inflation for four mining operations and the state of Minnesota, while the increase in payments by the remaining five mining operations exceeded the increase in inflation.

Differences with Property Tax

Although some people have voiced interest in comparing production taxes with property taxes, the two tax types are fundamentally different. Yields from production taxes are driven by the tonnage of taconite produced, which varies with worldwide demands for steel. Production taxes are high when taconite production is high, regardless of local government spending. Amounts of property taxes, on the other hand, are driven by property values and local government spending levels. Further, because the value of the full mineral deposit is unknown, the tax rate needed to generate an amount equivalent to a property tax cannot be estimated.

DISTRIBUTION OF PRODUCTION TAX REVENUE

In this section, we examine the distribution of production taxes. First, we explain the two geographic regions where production taxes are allocated. Then we describe the major entities that receive the tax revenue within those regions. Finally, we discuss the changes in production tax allocations over time.

Areas Eligible for Production Tax Revenue

Production taxes are distributed to recipients located in northeastern Minnesota. Some distributions of production taxes depend on a recipient's location in the Taconite Assistance Area, while others depend on being within a similar but smaller area called the Taconite Tax Relief Area. The Taconite Assistance Area includes all or parts of seven counties: Aitkin, Cook, Crow Wing, Itasca, Koochiching, Lake, and St. Louis. The Taconite Tax Relief Area shares all or parts of five counties with the Taconite Assistance Area; it does not include Aitkin and Crow Wing counties.

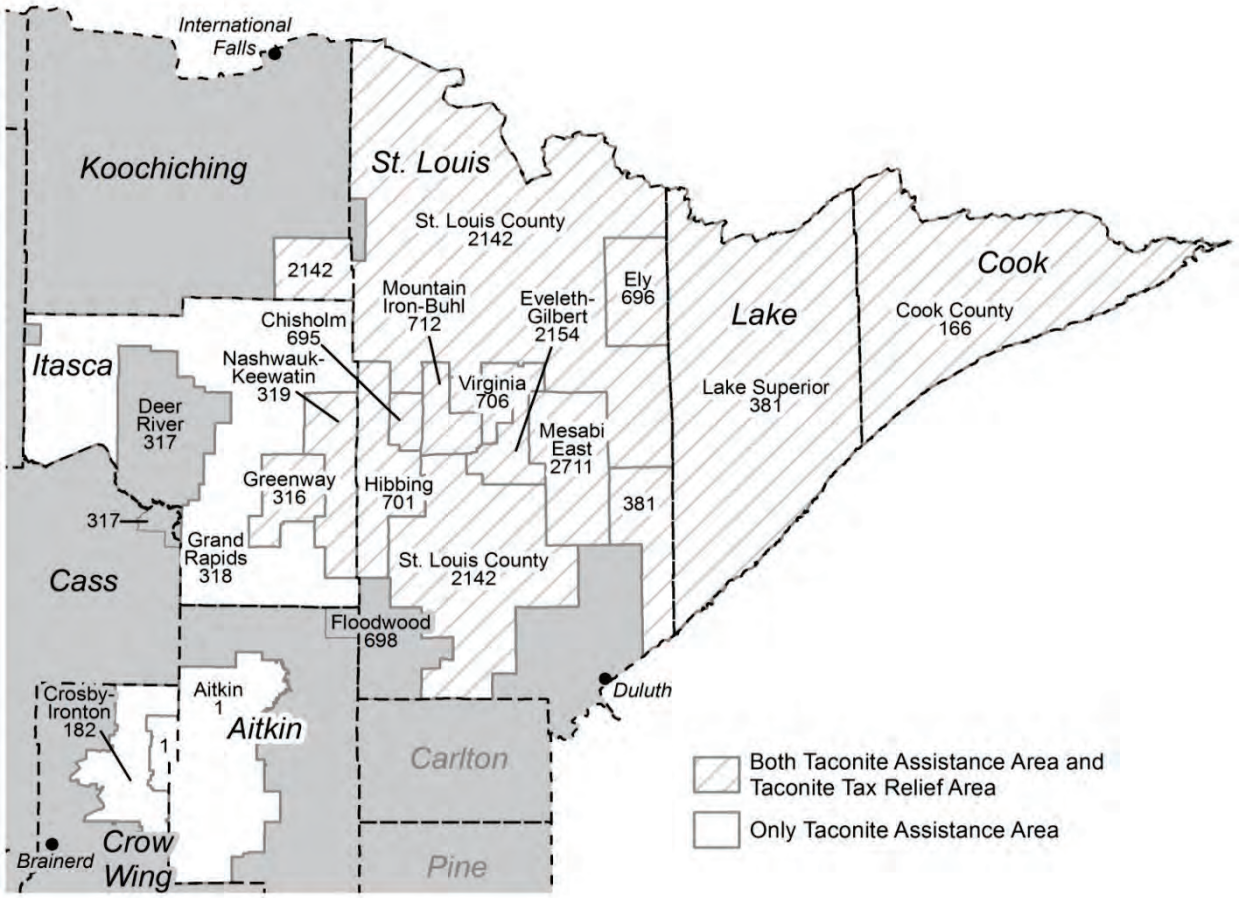
Statutes define the areas in terms of school district boundaries.[8] The Taconite Assistance Area comprises 15 school districts that contain municipalities meeting one of two criteria.[9] The districts are: Aitkin-1, Chisholm-695, Cook County-166, Crosby/Ironton-182, Ely-696, Eveleth/Gilbert-2154, Greenway-316, Grand

[8] *Minnesota Statutes* 2014, 273.134(b), defines the Taconite Tax Relief Area; and *Minnesota Statutes* 2014, 273.1341, defines the Taconite Assistance Area.

[9] One criterion is the percentage of assessed valuation of unmined iron ore in the municipality in 1941. The second is whether, in 1977 or when the property was assessed, taconite was mined or concentrated or an electric generating plant that qualified as a taconite facility was in the municipality.

Rapids-318, Hibbing-701, Lake Superior-381, Nashwauk/Keewatin-319, Mesabi East-2711, Mountain Iron/Buhl-712, St. Louis County-2142, and Virginia-706. By contrast, the Taconite Tax Relief Area comprises 12 school districts also based on two criteria.[10] The school districts are the same as the Taconite Assistance Area, excluding Aitkin-1, Crosby/Ironton-182, and Grand Rapids-318. Exhibit 2.7 displays the two areas.

Exhibit 2.7: Taconite Assistance Area and Taconite Tax Relief Area, 2014



NOTES: Statutes define both areas by describing eligible school districts. The Taconite Assistance Area consists of 15 school districts that contain certain municipalities, based on meeting one of two criteria. One is the percentage of assessed valuation of unmined iron ore in the municipality in 1941. The second is whether taconite was mined or concentrated there, or an electric generating plant that qualified as a taconite facility was in the municipality, as of 1977 or when the property was assessed. The Taconite Tax Relief Area comprises 12 school districts also based on two criteria. One is the percentage of assessed valuation of unmined iron ore in the school district in 1941 and the district's proximity to a taconite mine or plant. The second criterion is whether taconite was mined or concentrated there, or an electric generating plant that qualified as a taconite facility was in the district, as of 1977 or when the property was assessed.

SOURCES: Office of the Legislative Auditor, analysis of *Minnesota Statutes* 2014, 273.134(b) and 273.1341; and Minnesota Department of Revenue data.

[10] One is the percentage of assessed valuation of unmined iron ore in the school district in 1941 and the district's proximity to a taconite mine or plant. The second is whether, in 1977 or the date a property was assessed, taconite was mined or concentrated there or an electric generating plant that qualified as a taconite facility was in the district.

Allocations

Production taxes are allocated into accounts, from which the revenue is distributed to benefit a variety of local jurisdictions and agencies in northeastern Minnesota. In this section, we explain the portions of production taxes allocated to different accounts and how these allocations have changed over time.

Most production tax revenues are allocated to local taxing jurisdictions, the Iron Range Resources and Rehabilitation Board, and to a Taconite Property Tax Relief account.

In 2014, production taxes were allocated to accounts designated for local governments, school districts, the Iron Range Resources and Rehabilitation Board (IRRRB), property tax relief, and a few other recipients, shown in Exhibit 2.8. That year, 46 percent of production taxes went directly to counties, cities, townships, and school districts. IRRRB received 41 percent, some for its own use but most for funds and accounts the agency administers.[11] The Taconite Property Tax Relief account, which pays for taconite homestead credits, received more than 12.5 percent of the total production taxes distributed.

Exhibit 2.8: Production Tax Allocations, 2014

Entity	Amount	Percentage
Cities and Townships	$ 14,911,750	13.6%
Counties[a]	14,502,580	13.2
School Districts	21,426,698	19.5
Iron Range Resources and Rehabilitation Board	45,081,882	41.0
Taconite Property Tax Relief Account	13,783,501	12.5
Range Association of Municipalities and Schools	142,382	0.1
Hockey Hall of Fame	79,216	0.1
Total	$109,928,009	100.0%

[a] Cook, Itasca, Lake, and St. Louis counties receive the production tax revenue shown here for county use. This amount is separate from production tax revenue that counties simply transfer to cities, townships, school districts, and other recipients or funds.

SOURCE: Office of the Legislative Auditor, analysis of Minnesota Department of Revenue data.

State law allocates production tax revenues to 27 separate accounts, primarily distributed to local taxing jurisdictions or the Iron Range Resources and Rehabilitation Board.

Of the 27 accounts eligible to receive production taxes in 2014, seven are for municipalities, three for counties, seven for school districts, nine for IRRRB, one for property tax relief, and two for specific entities.[12] Details on each of the 27 accounts are at the end of this chapter. We also explain for each how revenue

[11] Most tax revenues distributed to IRRRB are used for economic development and community development on the Iron Range; a small percentage is used for IRRRB administrative costs.

[12] Revenue from one account, called Taconite Railroad, is distributed to multiple recipients: municipalities, schools districts, and counties.

is distributed from the account to its final recipients. In the Appendix, Exhibit A.3 provides the amount of production tax revenue allocated to each account in inflation-adjusted dollars, for ten-year increments from 1975 to 2014.

Allocations Over Time

Allocations of production taxes have changed over time. Our analysis of changes to production tax allocations starts in 1975, the earliest year for which data are available.

From 1975 to 2014, the number of accounts receiving production taxes tripled, while the total amount of revenue allocated increased 89 percent.

Between 1975 and 2014, the number of eligible accounts receiving production tax revenue increased from 8 to 27.[13] Some accounts, such as the Taconite Property Tax Relief account and the County Road and Bridge fund, have received production taxes every year since at least 1975.[14] Others have been added over the years. Some were in place for only a year; for instance, statutes allowed a one-time allocation of production taxes for a "biomass energy project loan," which received revenue only in 2008.

Although the size of the revenue distribution also grew from 1975 to 2014, the increase is less than the increase in the number of recipients. When adjusted for inflation, the production tax allocations increased from $58.2 million in 1975 to $109.9 million in 2014. This represents an 89 percent increase, compared with a 238 percent increase in the number of accounts eligible to receive the taxes.

Production tax revenues declined over the last 40 years for most accounts that have been long-term recipients of the tax.

Of eight accounts in 1975, seven received production tax distributions in 2014, and all but one saw their share of the total decline when adjusted for inflation. Among those eight, the only account that no longer receives production taxes is the state of Minnesota, which for a period received revenue for the General Fund and later for the Department of Revenue. Exhibit 2.9 shows the percentage each current and long-term account represents of total production taxes in select years.

Of the long-term accounts still receiving revenue in 2014, the County fund is the only one that received a larger share of revenues in 2014 than in 1975. The fund received 6.9 percent of the total taxes in 1975 and 8.3 percent of the total in 2014. Some long-term accounts received a significantly smaller portion of production taxes over this period; for example, the Taconite Property Tax Relief account's portion fell from 39.1 percent in 1975 to 12.5 percent in 2014. Other accounts had smaller decreases, such as the County Road and Bridge fund. The

[13] Two of the eligible accounts in statute did not actually receive revenue in 2014. They are the Taconite Levy Shortfall Payment account and the School Consolidation and Cooperatively Operated School Account.

[14] Production tax distribution data were not available for the taxes paid in 1979.

Exhibit 2.9: Current and Long-Term Accounts' Percentage of Total Production Tax Allocation, Select Years

Account	1975	1985	1995	2005	2014
City and Township Account	6.8%	1.8%	1.6%	2.3%	1.9%
County Fund	6.9	16.2	11.9	11.5	8.3
County Road and Bridge Fund	4.8	4.2	3.1	3.0	4.2
Douglas J. Johnson Economic Protection Trust Fund[a]	-	2.9	4.8	3.6	4.6
Hockey Hall of Fame	-	-	-	-	0.1
Iron Range Higher Education Account	-	-	-	-	1.8
IRRRB Account[b]	4.8	-	-	-	-
IRRRB Educational Revenue Bonds	-	-	-	-	3.8
IRRRB Fixed Account[b]	-	1.9	1.5	1.4	1.1
IRRRB Indexed Account[b]	-	3.0	3.3	3.5	3.5
Levy Replacement to Municipalities, from School Districts[c]	-	-	-	-	2.1
Mining Effects Account	-	-	-	2.0	1.6
Producer Grant and Loan Fund	-	-	-	3.6	2.9
Range Association of Municipalities and Schools	-	0.1	0.1	0.1	0.1
School Bond Payments	-	-	3.2	5.3	2.4
School Building Maintenance Fund	-	-	-	-	1.4
School Consolidation and Cooperatively Operated School Account[d]	-	-	-	-	-
School District Fund	-	17.0	11.5	6.6	9.7
School District-Regular Account	16.4	4.5	3.0	1.7	1.5
Special City/Township Fund[e]	-	-	-	-	0.1
State[f]	1.8	0.5	0.1	-	-
Taconite Economic Development Fund	-	-	8.4	12.8	11.5
Taconite Environmental Protection Fund	-	13.5	14.1	11.4	11.8
Taconite Levy Shortfall Payment	-	-	-	-	0.0
Taconite Municipal Aid Account[e]	19.4	9.1	8.2	7.4	6.0
Taconite Property Tax Relief Account	39.1	13.8	14.9	15.5	12.5
Taconite Railroad Account	-	4.9	3.9	2.8	2.3
Taconite Referendum Fund	-	6.1	6.0	5.1	5.6
Township Fund	-	-	-	-	1.2

NOTES: Revenue used to calculate accounts' portions of total production taxes was adjusted for inflation in 2014 dollars. Shaded rows are those that received revenue in 1975.

[a] Prior to 2002, this fund was called the Northeast Minnesota Economic Protection Trust Fund.

[b] The IRRRB account that received revenue in 1975 has been replaced with two other accounts: IRRRB Indexed and IRRRB Fixed.

[c] If the combined total of production taxes from the School District Fund, School District-Regular account, and Taconite Railroad account exceeds a school district's levy limit, the excess is transferred to cities and townships within the school district.

[d] The School Consolidation and Cooperatively Operated School Account is eligible to start receiving production taxes in 2015.

[e] Prior to 2009, the Special City/Township amount was included in the Taconite Municipal Aid account.

[f] The state General Fund formerly received a distribution of production taxes; in later years, the "state" distribution was for the Department of Revenue.

SOURCES: Office of the Legislative Auditor, analysis of Minnesota Department of Revenue data; *Minnesota Statutes* 2014, 298.29, subd. 7a(1)(i); and U.S. Bureau of Economic Analysis, *Table 1.1.4 Price Indexes for Gross Domestic Product*, revised February 27, 2015.

IRRRB account and the School District-Regular account appear to have had significant decreases in revenue. However, the entities that receive revenue from those two accounts continue to receive production taxes from new accounts; IRRRB receives revenue from the IRRRB Indexed and IRRRB Fixed accounts, and school districts from various accounts, including the School District Fund.

STATUTORY GUARANTEES AND INFLATION

Provisions in law guarantee that certain accounts receiving production tax revenues will receive at least minimum amounts of funding. Other provisions tie inflation to the amount of certain distributions, which has resulted in automatic annual increases for some accounts. We explain these provisions below.

Statutes do not specify why only some accounts receiving production tax revenue have statutorily guaranteed amounts.

It is unclear why such guarantees are in place for just these 10 of the 27 accounts: Taconite Municipal Aid Account, City and Township account, Mining Effects account, County fund, County Road and Bridge fund, School District fund, Taconite Referendum fund, School District-Regular account, IRRRB Indexed account, and Range Association of Municipalities and Schools. The statutory guarantee also extends to three specific distributions of production taxes from certain accounts.[15] The ten accounts are guaranteed production tax revenue based on amounts they received from taconite production in 1983 or 1999. The Department of Revenue calculates the amount of production taxes from each mining operation that would be allocated to each of the ten accounts and compares this formula amount to the guaranteed amounts for the ten accounts. The accounts receive whichever amount is higher from each mining operation.

Due to the fact that the production tax guarantees are based on amounts received in 1983 and 1999, the guarantee takes into account amounts of taxes paid by Butler and LTV Steel mining companies in those years. Butler and LTV have not operated since 1985 and 2001, respectively; however, when the Department of Revenue calculates production tax distributions, it attributes amounts to these companies. The money to cover production taxes guaranteed from Butler and LTV, and to pay for any guaranteed amounts that exceed the formula distributions by law, comes half each from the Taconite Environmental Protection Fund and the Douglas J. Johnson Economic Protection Trust Fund. If those two funds receive insufficient amounts to cover the guarantees in a given year, the corpus of these two funds would pay the guaranteed amounts.

Statutes do not specify why production tax allocations to only 4 of the 27 accounts are indexed to increase with inflation.

Statutes tie allocation amounts to the implicit price deflator for four accounts: the Township fund, IRRRB Indexed account, Douglas J. Johnson Economic Protection Trust Fund, and resuming in 2018, the Taconite Property Tax Relief

[15] Statutes allocate $0.01 per ton of the County fund and $0.001875 per ton of the Property Tax Relief account for counties containing an electric power plant that provides the primary source of power for a mining operation in another county. Statutes also allocate $0.004541 per ton of the Property Tax Relief account to school districts with an electric power plant that provides the primary source of power for a mining operation in another school district. These electric power plant aids are covered in the statutory guarantee.

account.[16] This means if inflation increases over the year, the amount of the allocation will increase accordingly. For example, for taxes paid in 2014, the Township fund's statutory allocation was $0.03 per ton, but due to indexing it received $0.033 per ton. Similarly, the IRRRB Indexed account's statutory allocation was $0.065 per ton in 2014, but it actually received $0.096 per ton due to indexing and receiving guaranteed revenue. The increase occurs regardless of whether recipients use the funding for functions that inflation may not affect, such as debt service or one-time projects.

For the Township fund, Douglas J. Johnson Economic Protection Trust Fund, and IRRRB Indexed account, allocation amounts are indexed through 2014, but not from 2015-2017.[17] Indexing is set to resume again in 2018 and after. Until 2013, the allocation into the Taconite Property Tax Relief account was indexed to increase with the implicit price deflator (or the steel mill products index in earlier years).[18] Current statutes increase the fund's allocation with the implicit price deflator once again starting in 2018.

The four accounts receive a significant benefit due to inflationary increases. First, the overall production tax is larger because its rate is indexed to increase with inflation; if it were instead calculated using the rate in statute, it would generate a smaller total. Second, amounts going into the four indexed accounts are larger than they would be otherwise because they also rise with inflation.

RECOMMENDATION

The Legislature should review whether the limited number of accounts receiving production taxes through either guaranteed allocations or allocations tied to inflation are accomplishing intended purposes.

Guaranteed allocations provide some accounts (and, in turn, certain local taxing jurisdictions or organizations) with a base of revenue based on taconite production in 1983 or 1999, when two mining companies that are no longer operating produced taconite. The ten guaranteed accounts receive the higher of the guaranteed amount or the current calculated amount from each mining operation. Because two mining operations, Butler and LTV, no longer exist but produced taconite in 1983 or 1999, the guaranteed allocation for each account from these companies will always be higher than the current calculated amount, which will always be $0. As a result, each guaranteed account receives (1) the guaranteed amounts from Butler and LTV and (2) either the guaranteed amount or the calculated amount from the currently operating mines.

The guaranteed allocations provide a particular advantage to jurisdictions in areas that had mining facilities in 1983 and 1999 but no longer do. These jurisdictions would not receive revenue from the guaranteed accounts that distribute revenue

[16] *Minnesota Statutes* 2014, 298.28, subds. 3(d), 7, and 10(a).

[17] *Ibid.*

[18] The U.S. Department of Labor publishes monthly the steel mill products index, which tracks the selling price of all steel products in the United States.

based on mine or plant location were the guarantee not in law. Additionally, because the IRRRB Indexed account and the Range Association of Municipalities and Schools have guaranteed allocations, they also receive funds equal to what they received in 1983 and 1999 from Butler and LTV.

A review of the guarantees is important to address two points that are unclear. One is whether distributions for the ten guaranteed accounts should continue today to be based on amounts received in 1983 and 1999 when two now-closed mines operated. If the intent is to aid jurisdictions that no longer have mining operations, it would be reasonable for the guarantees to continue as now configured. A second unclear point is whether the guarantee should continue to apply to the accounts (IRRRB-Indexed account and Range Association of Municipalities and Schools) which do not provide direct aid to municipalities, counties, and school districts.

Further, it is unclear to us why the production tax allocation increases with inflation for four accounts but not others. A review of indexed allocations—to the IRRRB Indexed account, Douglas J. Johnson Economic Protection Trust Fund, Township fund, and Taconite Property Tax Relief account—should examine whether the advantages of indexing should be limited to these four accounts. Two of the accounts are administered by IRRRB and do not offer direct aid to taxing jurisdictions or reduce local property taxes as do the Township fund and the Taconite Property Tax Relief account.

If the Legislature affirms that only a few accounts should be tied to inflation, it could consider focusing the advantage on accounts that are distributed directly to local taxing jurisdictions or taxpayers. Because the production tax is levied in lieu of property taxes, it is reasonable to concentrate the automatic increases on allocations that directly reduce local property tax burdens.

A consideration to modifying either the guaranteed accounts or the accounts indexed to rise with inflation is that altering them would change the pattern of how production taxes are distributed. This would be a disadvantage to those who currently benefit from the guarantees and indexed allocations. In addition, changes to the specific accounts that currently receive guarantees or indexed allocations would not improve the unpredictable nature of production tax revenues. Such unpredictability is especially keen following years when taconite production levels drop.

RECOMMENDATION

The Legislature should take steps to make annual allocations of production taxes more predictable for local taxing jurisdictions.

One option for the Legislature to make production taxes a more predictable source of funding for local taxing jurisdictions would be to (1) establish a new base year for allocations into most or some of the 27 accounts and (2) use funds from certain taconite tax accounts to guarantee those allocations. Doing so may

also allow calculating the production tax on annual taconite production levels instead of using a three-year average, as discussed more below.[19]

The recommendation is intended as a counterbalance to the unpredictability of production tax revenue for local taxing jurisdictions. Other options to improve predictability exist, such as maintaining production tax aid from year to year within a certain percentage of a set amount. However, the concept of a guaranteed allocation determined by an amount received in a base year is similar to the current guaranteed allocations now in law.

Our recommendation differs from the current guarantees in three possible ways. First, more accounts could receive a guaranteed allocation, not just the ten that currently have guarantees. Alternatively, only specific accounts that meet predetermined criteria (such as those that directly benefit jurisdictions with taxing authority) could receive a guaranteed allocation. Second, the guarantees would not be based on taconite production in 1983 or 1999, as is now the case. Nor would they be tied to mining facilities that no longer exist. Instead they would be based on allocations in a predetermined, more current year.[20] Third, sources for funding the guarantees could differ from current practice.

Allocations of production taxes from the new base year would be guaranteed to the accounts from that point forward. In years with high levels of taconite production, the production tax generated would be sufficient to pay the guarantees; from each mining operation, the accounts would receive the higher of either the guaranteed amount or the amount calculated by formulas in statute. As an alternative, the Legislature could decide that some share of the amount in excess of the guarantee should be set aside for guaranteeing allocations in future years with low taconite production. For example, for years when production tax revenue exceeds what is needed for the guaranteed allocations, the Legislature could reserve 1 percent of the excess to pay future guarantees. This is one way to pay for the guarantees in years that have low taconite production. Alternate sources of revenue for the guarantees are discussed below.

Current guarantees are funded by the Taconite Environmental Protection Fund and the Douglas J. Johnson Economic Protection Trust Fund.[21] When the annual allocations to these two funds are not enough to cover the current guarantees, statutes require drawing revenue for this purpose from the corpus of the funds. We recommend continued reliance on these accounts, as well as on the corpus of the funds (when necessary), to fund the new set of guaranteed allocations. With more guaranteed allocations than now in law, the two funds would likely have to pay higher amounts for the guarantees than they currently do.

An alternate resource to help pay the guaranteed allocations is the Taconite Property Tax Relief account. The statutory purpose of this account is to reduce

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[19] As described earlier, the production tax is levied on a three-year average of taconite production and on only current year production of other iron-bearing material.

[20] If the new base year included currently guaranteed accounts that receive allocations based on 1983 or 1999 production, these amounts would become part of the new guaranteed amount.

[21] *Minnesota Statutes* 2014, 298.225, subd. 2.

property taxes for homestead property, which makes it appropriate for use in paying guaranteed allocations. If used as proposed here, the account's purpose in law would likely need to be expanded to allow tax relief for all classifications of property, instead of only homesteads. The account would continue to pay for taconite homestead credits, as it now does. However, funds remaining after paying the homestead credits would be available to pay the guarantees. This could be done by designating the Taconite Property Tax Relief account as a source of funding for guaranteed allocations, just as the Taconite Environmental Protection Fund and the Douglas J. Johnson Economic Protection Trust Fund are today.[22]

Using the Taconite Property Tax Relief account to help pay guaranteed allocations requires additional considerations. The balance in the account was $1.3 million at the end of 2014. Using this account may require reserving fund balances over a series of years to accumulate a sufficient amount of revenue.

Our recommendation would allow more accounts to receive guaranteed allocations than the ten that currently have guarantees.[23] Alternatively, an option to control the costs of paying for the guaranteed allocations is to narrow the types of accounts that would receive the guarantees, thereby requiring less money to fund the guaranteed amounts. For instance, the guarantee could be made solely to ten accounts distributed directly to counties, municipalities, and school districts.[24] Under this option, accounts managed by IRRRB and others, such as the Range Association of Municipalities and Schools, would still receive allocations but not be eligible for the guaranteed amounts. Focusing the guarantees on accounts distributed directly to local jurisdictions is reasonable because the production tax was established in lieu of local property taxes. Guaranteed allocations would enhance property tax relief by lowering the share local jurisdictions need to raise from property taxes.

Because the guaranteed allocations would be at fixed amounts, it may be necessary to periodically review and adjust them. For instance, every five or so years, the guaranteed allocations could be reviewed in light of changes in taconite production and local economic conditions. The base year of allocations could then be set to a new year, if warranted.

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[22] *Minnesota Statutes* 2014, 298.225, subd. 2, makes the current designation.

[23] In this option, accounts that would not be guaranteed could include those we recommend using as sources to pay for the new guarantees: The Taconite Environmental Protection Fund, the Douglas J. Johnson Economic Protection Trust Fund, and the Taconite Property Tax Relief account. The Taconite Economic Development Fund would not be guaranteed because statutes establish that in years of low production, most of the fund's possible revenue is not allocated to it. Accounts that receive revenue for bond payments would not be guaranteed because their allocations depend on annual repayment schedules separate from the production tax formulas. The Special City/Township account would not be guaranteed because its allocation is determined through a formula that cannot exceed a ceiling for recipients; a guarantee could lock the allocation in at its ceiling. Finally, the accounts that depend on school districts' taconite revenue falling short of or exceeding their levies, such as the Taconite Levy Shortfall Payment, would not be guaranteed.

[24] The ten accounts would be: Taconite Municipal Aid Account, City and Township account, Mining Effects account, Township fund, County fund, County Road and Bridge fund, School District fund, Taconite Referendum fund, School Building Maintenance fund, and School District-Regular account.

A primary benefit of guaranteeing allocations of production taxes is greater predictability of revenues for local taxing jurisdictions that rely on the taxes. The allocations would be made based on formulas now in law, but the guarantees would give local taxing jurisdictions assurances that they will receive at least the amount they received in the base year. This makes the production tax more reliable. A second benefit is augmenting the use of production tax revenue in lieu of property taxation. Depending on how the restructuring is designed, more of the production tax revenue could end up with the jurisdictions that levy property taxes. Third, the new guaranteed allocations would reduce property tax burdens for all property owners. The tax relief would accrue to every classification of property within a local taxing jurisdiction.

Under the recommendation, the calculation of the production tax may no longer have to rely on a tax base defined by a three-year average of taconite production. The guaranteed allocations would reduce the volatility in production tax revenues. Depending on how the guarantees were structured, they could substitute for the smoothing effect that the three-year averaging now provides. This offers an additional benefit in that taxpayers would pay tax on solely the most recent year of taconite production. On the other hand, in years of low taconite production, more revenue would likely be needed to pay the guaranteed allocations than if the three-year average of taconite production were retained.

We recognize that the funds used to pay the guaranteed allocations would diminish over time unless they were replenished. A portion of production tax generated in years with higher taconite production could be reserved to replenish amounts needed to pay the guarantees. As it is, allocations to the Douglas J. Johnson Economic Protection Trust Fund and the Taconite Property Tax Relief account have already been tied to increases in the implicit price deflator.[25] Retaining the statutory provisions that index these funds to inflation would help maintain their ability to pay the guaranteed allocations.

If the mining industry were to encounter year-after-year of reduced taconite production, the funds would eventually be depleted and unable to pay for the guaranteed allocations. In that scenario, the guaranteed allocations may have to be reduced. Otherwise, sources of funding other than taconite mining would have to be identified. Should the industry languish over a long period, seeking alternate funding sources for local services would become necessary regardless of whether the new guarantees are implemented.

[25] As discussed earlier, the Douglas J. Johnson Economic Protection Trust Fund allocation is indexed through 2014, and indexing will resume in 2018. The allocation to the Taconite Property Tax Relief account was indexed through 2013 and will resume in 2018.

Addendum

In this addendum, we provide detail on the 27 accounts that were eligible to receive production tax allocations in 2014.[26] These accounts are referred to throughout Chapter 2. The section below describes features of each account.

RECIPIENTS OF PRODUCTION TAX REVENUE

For each of the 27 accounts, we briefly define the account and then list its statutory allocation, the dollar amount it received in 2014, when it began receiving allocations, the account's portion of total production tax revenue, and how its allocation has changed. We note whether the account's allocation has a statutorily guaranteed amount or whether it is indexed to increase with inflation. Finally, we describe how the allocation is distributed to the account's recipients, the number of recipients, and the average amount distributed to recipients in 2014. The accounts are grouped by the major entities receiving the revenue:

- Municipalities
- Counties
- School districts
- IRRRB
- Other accounts

Municipalities

Municipalities receive production tax revenues through seven accounts. Exhibit 2.10 provides the statutory distribution and amount received in 2014 by each of the seven municipality accounts. Revenue from each account is distributed to different numbers of cities and townships, as described below. In 2014, 181 unique municipalities received production tax revenue from at least one of the seven accounts.

1. Taconite Municipal Aid Account

Definition: Aid to qualifying cities and townships.

Cents per Ton Allocated, 2014: $0.125, less amounts allocated to (1) the Range Association of Municipalities and Schools and (2) the Special City/Township fund (these two accounts are explained below).

[26] One account, the School Consolidation and Cooperatively Operated School Account, was established in 2014 and will receive its first allocation in 2015.

Exhibit 2.10: Production Tax Allocations to Accounts for Municipalities, 2014

Account	Allocation[a]	Amount	Number of Municipalities Receiving
Taconite Municipal Aid Account	$0.125 per ton, less amount to RAMS and Special City/Township Fund[b]	$ 6,633,334	40
Levy Replacement to Municipalities from School Districts	Amount of production taxes school districts receive from certain funds in excess of their levy limit	2,313,588	181
City and Township Account	$0.045 per ton	2,134,737	27
Mining Effects Account	$0.04 per ton	1,794,389	27
Township Fund	$0.03 per ton, increased in the same proportion as the implicit price deflator	1,287,505	69
Special City/Township Fund	An amount based on city or township certified levy and assessed value, not to exceed $75 per capita (city) or $55 per capita (township) based on 1980 population	157,055	2
Taconite Railroad Account, portion to Municipalities	The amount received under *Minnesota Statutes*, 298.26, in 1977	591,142	9
Total		$14,911,750	

[a] The allocation reflects formulas in 2013 statutes, which the Minnesota Department of Revenue used to calculate 2014 allocations.

[b] RAMS is the Range Association of Municipalities and Schools.

SOURCES: Office of the Legislative Auditor, analysis of Minnesota Department of Revenue data; *Minnesota Statutes* 2013, 298.28, subds. 2, 3, and 11; and 126C.48.

Amount Allocated, 2014: $6.6 million, 6 percent of total production taxes.

Began Receiving Allocations: 1975 (earliest data available are from 1975).

Change over Time: The inflation-adjusted allocation to the Taconite Municipal Aid Account has decreased since 1975, from 19 percent of the total production taxes allocated to 6 percent in 2014.

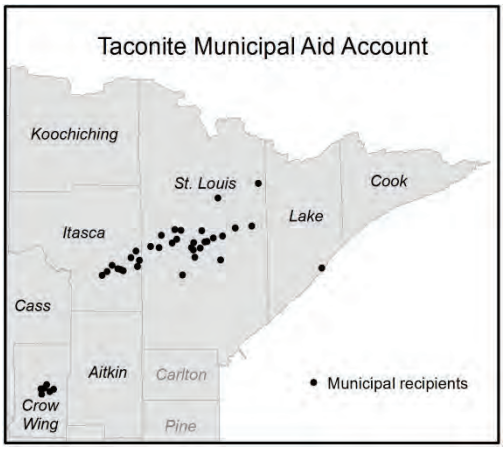
Statutory Guarantee: Yes, based on the amount it received from taconite production in 1983.[27]

Allocation Indexed to Inflation: No.

Distribution: Revenue is distributed from the account to qualifying municipalities based on a distribution index that considers a "fiscal need factor," local tax rates, and the property tax base. The fiscal need factor is defined as the sum of a municipality's local property tax levy, production tax revenues, and local government aid from the state, averaged over the last three years. Communities with high fiscal needs per capita would receive a larger distribution

[27] *Minnesota Statutes* 2014, 298.225, guarantees production taxes to certain accounts based on amounts received in 1983 or 1999. The guaranteed amount is compared with the calculated amount, and the account receives whichever is higher.

of Taconite Municipal Aid than other communities, assuming they have equivalent local tax rates and tax bases. Qualifying municipalities are either (1) located in the Taconite Assistance Area, (2) townships that contain a state park consisting primarily of an underground iron ore mine, or (3) cities located within five miles of the state park.



Number of Recipients, 2014: 40 municipalities received an average $165,833.

2. Levy Replacement to Municipalities, as Transferred by School Districts

Definition: Production tax revenue that school districts receive from certain accounts in excess of their levy limits, which is then distributed to municipalities.[28]

Cents per Ton Allocated, 2014: Not applicable.

Amount Allocated, 2014: $2.3 million, 2.1 percent of total production taxes.

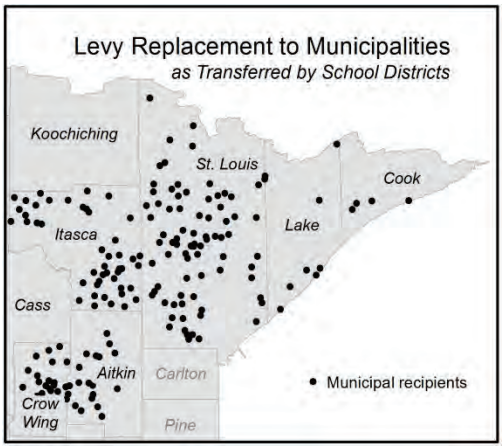
Began Receiving Allocations: Only in 2012, 2013, and 2014.

Change over Time: From 2012 to 2014, the amount transferred to municipalities, when adjusted for inflation, increased 628 percent.

Statutory Guarantee: No.

Allocation Indexed to Inflation: No.

Distribution: The funds are distributed to municipalities in the same proportion that a city's or township's tax base makes up of the school district's total tax base in the year prior to distribution. Cities and townships may not receive this revenue if it exceeds their levies for the year.



Number of Recipients, 2014: 181 municipalities received an average $12,782.

[28] These accounts are: School District Fund, School District-Regular account, and Taconite Railroad, described under the "School District" section in this addendum.

3. City and Township Account

Definition: Aid to cities and townships in which mining or processing occurs.

Cents per Ton Allocated, 2014: $0.045.

Amount Allocated, 2014: $2.1 million, 1.9 percent of total production taxes.

Began Receiving Allocations: 1975 (earliest data available are from 1975).

Change over Time: From 1975 to 1981 in inflation-adjusted dollars, the account's share of total production taxes decreased from 6.8 percent to 1.6 percent. Since then, the account's portion of total production taxes has been fairly constant.

Statutory Guarantee: Yes, based on the amount it received from taconite production in 1999.[29]

Allocation Indexed to Inflation: No.

Distribution: Revenue from the account is distributed to cities and townships in which taconite mining or processing occurs. The distribution follows two steps. First, when mining and processing occur across multiple municipalities, the revenue is split; 50 percent goes to cities and townships where mining occurs and 50 percent to those where processing occurs. Second, if mining or processing occurs in multiple municipalities, the revenue is distributed to municipalities based on the portion of the mining or processing that occurs in each community.

Exhibit 2.11 demonstrates how the City and Township account dollars were allocated to municipalities based on taxes paid by U.S. Steel-Minntac. In 2014, the City and Township account received $593,404 from production taxes generated by U.S. Steel-Minntac. The exhibit shows that mining and processing took place in different municipalities; thus, $296,702 was allocated for municipalities where mining occurred and $296,702 for municipalities where processing occurred. Then, that amount was multiplied by the percentage of mining or processing that occurred in each municipality, providing funds for Great Scott Township, Kinney, and Mountain Iron based on mining activity, and Mountain Iron based on processing activity.

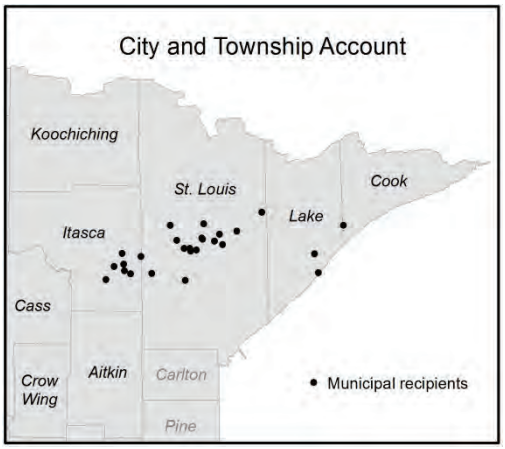
[29] *Minnesota Statutes* 2014, 298.225, subd. 1(b)(1)-(2).

Exhibit 2.11: Example of City and Township Fund Distribution from U.S. Steel-Minntac, 2014

Municipality	Mining or Processing Percentage	Amount
Mining		
Great Scott Township	6.9%	$ 20,472
Kinney	4.2	12,461
Mountain Iron	88.9	263,769
Subtotal	100.0%	$296,702
Processing		
Mountain Iron	100.0%	296,702
Subtotal	100.0%	$296,702
Total allocation to City and Township account from U.S. Steel-Minntac		$593,404

SOURCE: Office of the Legislative Auditor, analysis of Minnesota Department of Revenue data.

Number of Recipients, 2014: 27 municipalities received an average $79,064, although mining and processing occurred in only 22 cities and townships. The five additional municipalities where mining or processing did not take place received revenue due to the statutory funding guarantee based on amounts they received in 1999.[30]



4. Mining Effects Account

Definition: Aid to qualifying cities and townships for infrastructure improvements.

Cents per Ton Allocated, 2014: $0.04.

Amount Allocated, 2014: $1.8 million, 1.6 percent of total production taxes. Production taxes from three operations (Magnetation, Mesabi Nugget, and Mining Resources) were not used to calculate the allocation into the Mining Effects account, because they had no taconite mine pits in production in 2013.

Began Receiving Allocations: 2000.

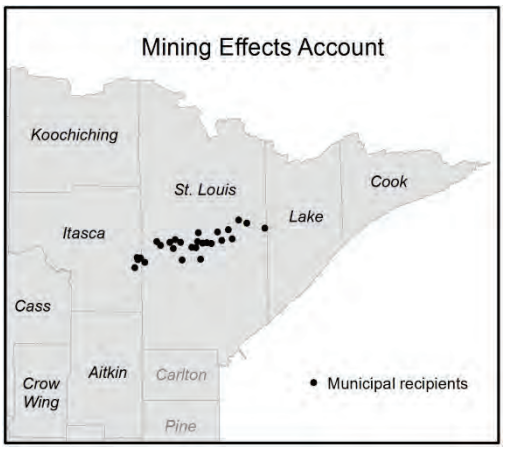
[30] *Minnesota Statutes* 2014, 298.225, subd. 1(b).

Change over Time: Since 2000 when the account received 1.9 percent of total production taxes, its portion of the taxes has remained fairly constant, in inflation-adjusted dollars.

Statutory Guarantee: Yes, based on the amount it received from taconite production in 1999.

Allocation Indexed to Inflation: No.

Distribution: Revenue is distributed to municipalities within three miles of a taconite mine pit that has been actively mined in the past three years. If a city or township is located near more than one qualifying mine, the community may receive aid only from the mine with the greatest production of taxable tonnage. If more than one community qualifies for aid from a particular mine, the revenue is apportioned among the municipalities based on their populations.



Number of Recipients, 2014: 27 municipalities received an average $66,459.

5. Township Fund

Definition: Aid to qualifying townships.

Cents per Ton Allocated, 2014: $0.03.

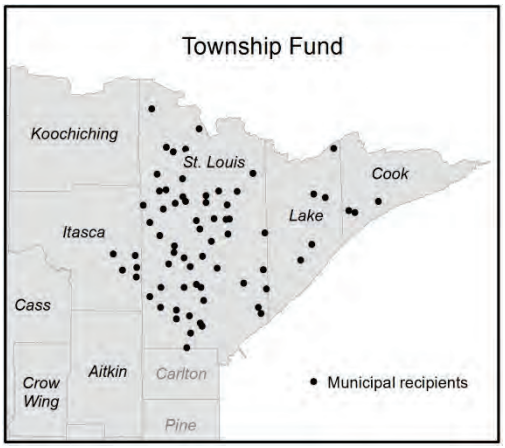
Amount Allocated, 2014: $1.3 million, 1.2 percent of total production taxes.

Began Receiving Allocations: 2009.

Change over Time: Since 2009, the fund's inflation-adjusted portion of total production taxes has remained constant at 1.2 percent.

Statutory Guarantee: No. Although the account is included in the guarantee provision, it did not receive allocations in 1983 or 1999, the years on which the guarantee is based.

Allocation Indexed to Inflation: Yes, from 2010 to 2014; indexing was discontinued for allocations in 2015 through 2017, but is to resume in 2018.



Distribution: Revenue is distributed to townships located entirely in the Taconite Tax Relief Area on a per capita basis, up to a limit of $50,000 annually. In 2014, five townships received the maximum $50,000.

Number of Recipients, 2014: 69 townships received an average $18,659.

6. Special City/Township Fund

Definition: Revenue is allocated to this fund from the Taconite Municipal Aid account for qualifying cities and townships. The amount may not exceed $75 per capita for a city or $55 per capita for a township, based on its 1980 population.

Cents per Ton Allocated, 2014: Not applicable; revenue comes from the Taconite Municipal Aid account.

Amount Allocated, 2014: $157,055, which is 0.1 percent of production taxes.

Began Receiving Allocations: 2010. Prior to 2010, the amount for the Special City/Township fund was part of the Taconite Municipal Aid Account.

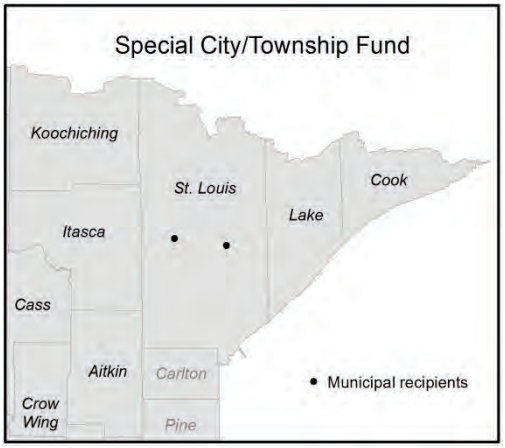
Change over Time: Since 2010, the allocation into the Special City/Township fund in dollars adjusted for inflation has increased 196 percent and has been distributed to only the city of Kinney and White Township.

Statutory Guarantee: No.

Allocation Indexed to Inflation: No.

Distribution: To qualify, cities and townships must be in the Taconite Tax Relief Area and meet certain criteria for iron ore's assessed valuation in the municipality.[31] In 2014, only the city of Kinney and White Township qualified.

Number of Recipients, 2014: Two; Kinney received $33,525 and White Township received $123,530.



[31] *Minnesota Statutes* 2014, 298.28, subd. 3(b), specifies that the assessed valuation of a township or city must be at least 75 percent iron ore, as of 1982 for a township and 1980 for a city.

7. Taconite Railroad Account

Definition: The account collects a fixed amount of revenue that is distributed to municipalities, counties, and school districts based on amounts received by the local taxing jurisdictions under taconite railroad statutes in 1977.

Cents per Ton Allocated, 2014: Not applicable; production taxes are allocated for the account from the remainder of funds after all other allocations have been made and before the remainder is divided between the Taconite Environmental Protection Fund and the Douglas J. Johnson Economic Protection Trust Fund.

Amount Allocated, 2014: $2.5 million, distributed to counties, school districts, and municipalities, which was 2.3 percent of total production taxes.

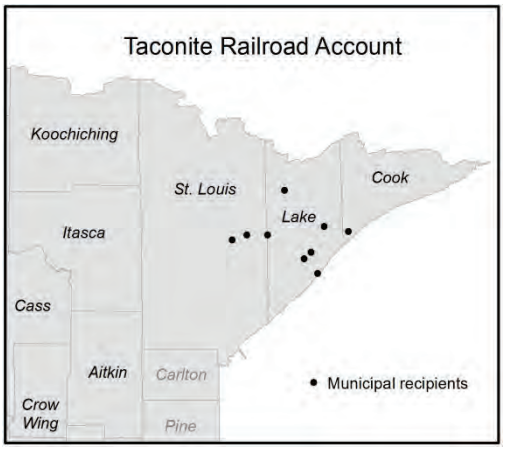
Began Receiving Allocations: 1980, although data are not available for 1979.

Change over Time: When adjusted for inflation, the allocation into the account decreased 76.9 percent from 1980 to 2014.

Statutory Guarantee: No.

Allocation Indexed to Inflation: No.

Distribution: The distribution to recipients is a fixed amount each year based on what the local jurisdictions received under taconite railroad statutes in 1977.



Number of Recipients, 2014: Nine municipalities received an average $65,682, and totaled $591,142. This was 23.8 percent of the Taconite Railroad account revenue; the remainder went to counties and school districts.

Counties

Counties receive production tax revenues from three accounts. Although the Taconite Assistance Area contains all or part of seven counties, only four receive production tax revenue for county functions. However, the four counties do not receive revenue from each of the accounts listed below. Summaries of the statutory allocation into each account are in Exhibit 2.12.

Exhibit 2.12: Production Tax Allocations to Accounts for Counties, 2014

Account	Allocation[a]	Amount	Number of Counties Receiving
County Fund[b]	$0.15525 per ton[c]	$ 9,095,093	4
County Road and Bridge Fund	$0.10525 per ton	4,623,110	3
Taconite Railroad Account, portion to Counties	The amount received under *Minnesota Statutes*, 298.26, in 1977	784,377	3
Total		$14,502,580	

[a] Allocations reflect formulas in 2013 statutes, which the Minnesota Department of Revenue used to calculate 2014 allocations.

[b] $0.01 per ton from the County fund is paid to counties that contain an electric power plant providing the primary source of power to a mining company in another county. The only county to which this applies is Cook.

[c] The 2014 Legislature reduced the allocation to the County fund by $0.05 to $0.10525 per ton.

SOURCES: Office of the Legislative Auditor, analysis of Minnesota Department of Revenue data; *Minnesota Statutes* 2013, 298.28, subds. 5(b)-(d) and 11(b); and *Minnesota Statutes* 2014, 298.28, subd. 5(b).

1. County Fund

Definition: Aid to counties in which mining or processing occurs.

Cents per Ton Allocated, 2014: $0.15525 per ton, decreased to $0.10525 per ton for allocations in 2015.

Amount Allocated, 2014: $9.1 million, 8.3 percent of total production taxes.

Began Receiving Allocations: 1975 (earliest data available are from 1975).

Change over Time: From 1975 to 1984, the County fund's portion of production taxes increased from 6.9 percent to 17.5 percent, in dollars adjusted for inflation. Since 1984, however, the fund's portion has decreased to 8.3 percent of total allocations.

Statutory Guarantee: Yes, at least 75 percent of the amount it received from taconite production in 1983.[32]

Allocation Indexed to Inflation: No.

Distribution: Revenue is distributed to counties in which mining or processing occurs, using the same two-part distribution described previously for the City and Township account. The funds are allocated 50 percent each to counties where

[32] *Minnesota Statutes* 2014, 298.225, subd. 1(a)(2)(ii).

mining occurs and processing occurs, then distributed based on the portion of mining or processing occurring in each county. According to statutes, if an electric power plant located in one county provides the primary source of power for a mining company located in another county, $0.01 per ton of the amount distributed to the County fund is paid to the county in which the plant is located.[33]

Number of Recipients, 2014: Four; three counties received revenue from the fund due to mining or processing occurring within their boundaries: Itasca County received $897,284; Lake County $627,892; and St. Louis County $7.5 million. Cook County received $114,701 based on the electric power plant provision.

2. County Road and Bridge Fund

Definition: Aid to counties in which mining or processing occurs.

Cents per Ton Allocated, 2014: $0.10525.

Amount Allocated, 2014: $4.6 million, 4.2 percent of total production taxes.

Began Receiving Allocations: 1975 (earliest data available are from 1975).

Change over Time: The fund's inflation-adjusted portion of production taxes has fluctuated slightly over time, decreasing from 4.8 percent in 1975 to 4.2 percent in 2014.

Statutory Guarantee: Yes, at least 75 percent of the amount it received from taconite production in 1983.[34]

Allocation Indexed to Inflation: No.

Distribution: Revenue in the fund is distributed to counties in which mining or processing occurs, using the same two-part distribution described previously under the City and Township account. The funds are allocated 50 percent each to counties where mining occurs and where processing occurs, then distributed based on the portion of mining or processing occurring in each county.

Number of Recipients, 2014: Three; Itasca County received $455,467; Lake County $246,744; and St. Louis County $3.9 million.

3. Taconite Railroad Account

Definition: The account collects a fixed amount of revenue that is distributed to municipalities, counties, and school districts based on amounts received by the local taxing jurisdictions under taconite railroad statutes in 1977.

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[33] *Minnesota Statutes* 2014, 298.28, subd. 5(c).

[34] *Minnesota Statutes* 2014, 298.225, subd. 1(a)(2)(ii).

Cents per Ton Allocated, 2014: Not applicable; production taxes are allocated for Taconite Railroad from the remainder of funds after all other allocations have been made and before the remainder is divided between the Taconite Environmental Protection Fund and the Douglas J. Johnson Economic Protection Trust Fund.

Amount Allocated, 2014: $2.5 million, distributed to counties, school districts, and municipalities, which was 2.3 percent of total production taxes.

Began Receiving Allocations: 1980, although data are not available for 1979.

Change over Time: When adjusted for inflation, the allocation into the account has decreased 76.9 percent from 1980 to 2014.

Statutory Guarantee: No.

Allocation Indexed to Inflation: No.

Distribution: The distribution to recipients is a fixed amount each year based on what the local jurisdictions received under taconite railroad statutes in 1977.

Number of Recipients, 2014: Three counties received $784,377, which was 31.6 percent of the $2.5 million in the Taconite Railroad account. The counties were Cook ($187,190), Lake ($243,034), and St. Louis ($354,153).

School Districts

Production tax revenue is allocated into seven accounts for school districts. One account did not receive production taxes in 2014, as detailed below. Revenue from these accounts was distributed to 15 school districts, although each district did not receive revenue from each account. Production tax revenue does not reduce the general state education aid to school districts. Exhibit 2.13 summarizes statutory allocations for each account and amounts received in 2014.

1. School District Fund

Definition: Aid to qualifying school districts.

Cents per Ton Allocated, 2014: $0.2472.

Amount Allocated, 2014: $10.7 million, 9.7 percent of total production taxes.

Began Receiving Allocations: 1980, although data are not available for 1979.

Exhibit 2.13: Production Tax Allocations to Accounts for School Districts, 2014

Account	Allocation[a]	Amount	Number of Districts Receiving
School District Fund	$0.2472 per ton	$10,676,982	15
Taconite Referendum Fund	$0.213 per ton and amount based on the district's net tax capacity, weighted average daily membership, and revenue allowance in various years	6,178,596	15
School Bond Payments	Amount specified in *Minnesota Law*	2,631,867	9
School Building Maintenance Fund	$0.04 per ton	1,535,158	10
School District-Regular Account	$0.0343 per ton	1,610,748	10
Taconite Railroad Account, portion to School Districts	62 percent of the amount received under *Minnesota Statutes,* 298.26, in 1977	1,106,935	4
Taconite Levy Shortfall Payment	An amount that covers the difference between the amount of production taxes received and a district's levy	0	0
Levy Replacement from School Districts to Municipalities	Amount of production taxes school districts receive from certain funds in excess of their levy limit	(2,313,588)	NA
Total		$21,426,698	

[a] The allocation reflects formulas in 2013 statutes, which the Minnesota Department of Revenue used to calculate 2014 allocations.

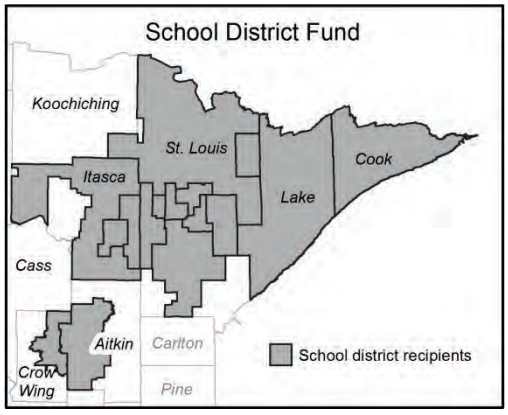
SOURCES: Office of the Legislative Auditor, analysis of Minnesota Department of Revenue data; *Laws of Minnesota* 2008, chapter 154, art. 8, sec. 8; and *Minnesota Statutes* 2013, 126C.48, subd. 8(5); and 298.28, subds. 4 and 10.

Change over Time: The fund's portion of production taxes has fluctuated over time, decreasing from 18.6 percent in 1984 to 6.3 percent in 2008 in dollars adjusted for inflation; but its proportion increased to 9.7 percent in 2014.

Statutory Guarantee: Yes, at least 31.2 percent of the production tax it received in 1983.[35]

Allocation Indexed to Inflation: No.

Distribution: Revenue is distributed to school districts located in the Taconite Tax Relief Area or with a qualifying municipality.[36] The distribution is based on an index that considers pupil units and average adjusted net tax capacity per pupil unit. Districts with a larger tax capacity per pupil unit generally



[35] *Minnesota Statutes* 2014, 298.225, subd. 1(a)(2)(i).

[36] Based on *Minnesota Statutes* 2014, 273.134 (a), a qualifying municipality either had (1) unmined iron ore comprise at least 40 percent of assessed valuation in 1941 or (2) taconite processing or mining, or an electric generating plant that qualified as a taconite facility, as of 1977 or when the property was assessed.

receive a smaller proportion of revenue from the fund.[37] For certain districts, the distribution of the fund also includes a grandfathered amount of revenue equal to a portion of occupation tax dollars they received in 1975. Six school districts in St. Louis County, two in Itasca County, and one in Lake County received grandfathered amounts.

Number of Recipients, 2014: 15 school districts received an average of $711,799.

2. Taconite Referendum Fund

Definition: Aid to school districts that have a levy increase authorized by a referendum for taxes paid in 2001.

Cents per Ton Allocated, 2014: The allocation has two parts: (1) $0.213 per ton and (2) an amount based on the district's net tax capacity, weighted average daily membership, and revenue allowance in various years. The allocation is described in greater detail in Chapter 3.

Amount Allocated, 2014: $6.2 million, 5.6 percent of total production taxes.

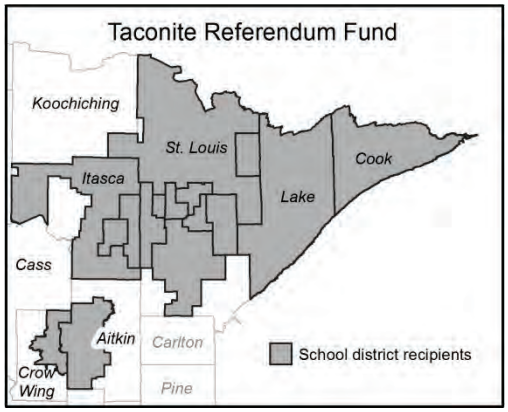
Began Receiving Allocations: 1982.

Change over Time: In dollars adjusted for inflation, the fund's portion of total production taxes has fluctuated, from 5.7 percent in 1984 to 8.3 percent in 1987 and 3.8 percent in 2010 through 2012.

Statutory Guarantee: Yes, based on the production tax it received in 1983.[38]

Allocation Indexed to Inflation: No.

Distribution: The funds are distributed to districts located in the Taconite Tax Relief Area or with a qualifying municipality.[39] The distribution uses a two-part formula, with each part containing multiple components. The first part is calculated using the pupil units and district's tax base. The second part is calculated using the district's referendum revenue allowance in fiscal year 2013, its weighted average



[37] Minnesota Department of Revenue, *Mining Tax Guide* (Saint Paul, 2014), 8.

[38] *Minnesota Statutes* 2014, 298.225, subd. 1(a).

[39] Based on *Minnesota Statutes* 2014, 273.134 (a), a qualifying municipality either had (1) unmined iron ore comprise at least 40 percent of assessed valuation in 1941 or (2) taconite processing or mining, or an electric generating plant that qualified as a taconite facility, as of 1977 or when the property was assessed.

daily membership in fiscal year 2012, and tax base in 2011. Statutes specify that districts must reserve a portion of the revenue received from the account, which they may use for early childhood programs.[40]

Number of Recipients, 2014: 15 school districts received an average of $411,906.

3. School Bond Payments

Definition: For any given year, Minnesota law specifies amounts of production tax revenue allocated to pay for certain school district bonds.

Cents per Ton Allocated, 2014: Not applicable; allocations of production taxes for school bond payments come from the remainder of funding after all other allocations have been made.

Amount Allocated, 2014: $2.6 million, 2.4 percent of total production taxes.

Began Receiving Allocations: 1989.

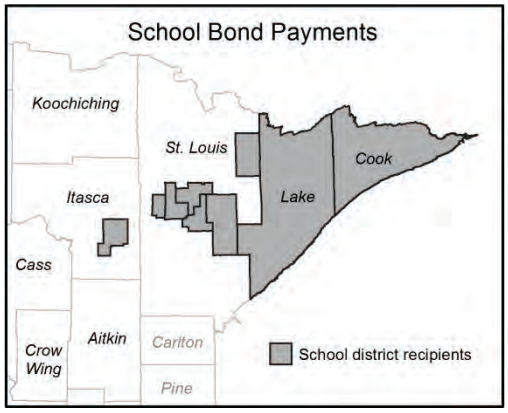
Change over Time: When adjusted for inflation, the portion of total production taxes allocated for school bonds has fluctuated over time, ranging from 1.3 percent in 1989 to 6.5 percent in 2003 and 2004.

Statutory Guarantee: No.

Allocation Indexed to Inflation: No.

Distribution: Each bond sale has its own schedule of repayments; the bonds for the school districts that receive production taxes are set to make their final payments between 2016 and 2023.

Number of Recipients, 2014: Nine; payments ranged from $63,760 in the Ely School District to $500,000 in the Mesabi East School District.



4. School Building Maintenance Fund

Definition: Aid to statutorily specified school districts for building maintenance and repairs.

[40] *Minnesota Statutes* 2014, 298.28, subd. 4(d)(2)(B), says that districts must reserve either $25 per pupil unit or the lesser of the amount received in the two-part formula used to calculate districts' revenue distribution from the Taconite Referendum fund.

Cents per Ton Allocated, 2014: $0.04.

Amount Allocated, 2014: $1.5 million, 1.4 percent of total production taxes.

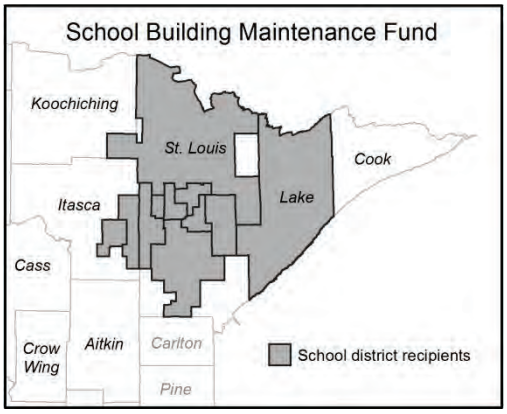
Began Receiving Allocations: 2009.

Change over Time: Since 2009, the fund's portion of total production taxes has been diminished slightly from 1.6 percent to 1.4 percent.

Statutory Guarantee: No. Although the account is included in the guarantee provision, it did not receive allocations in 1983 or 1999, the years on which the guarantee is based.

Allocation Indexed to Inflation: No.

Distribution: Revenue is attributed from particular mining companies to particular school districts. For example, according to statutes, proceeds from Hibbing Taconite are distributed to the Chisholm and Hibbing school districts.[41] If more than one district receives revenue from one company, the revenue is apportioned based on the number of pupil units. Production taxes from three mining operations, Magnetation, Mesabi Nugget, and Mining Resources, are not used to calculate the distribution into fund. This is because none of these three mining operations is listed in the section of statute that determines which companies' proceeds go to particular school districts.



Number of Recipients, 2014: Ten districts received an average $153,516.

5. School District-Regular Account

Definition: Aid to school districts in which mining or processing occurs.

Cents per Ton Allocated, 2014: $0.0343.

Amount Allocated, 2014: $1.6 million, 1.5 percent of total production taxes.

Began Receiving Allocations: 1975 (earliest data available are from 1975).

Change over Time: The account's portion of total production taxes has decreased over time but fluctuated significantly; in 1975 it received 16.4 percent of total production taxes, while in 1976 its portion increased to 34.4 percent. By 1980 its portion dropped to 3.8 percent. However, the School District-Regular account was the only recipient of production taxes designated directly for schools

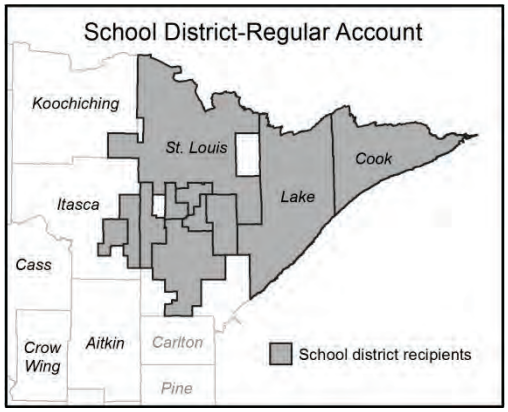
[41] *Minnesota Statutes* 2014, 298.28, subd. 4(b)(ii)(2).

until 1980. By contrast, in 2014 seven accounts received revenue for schools, and the combined accounts received 19.5 percent of total production taxes.

Statutory Guarantee: Yes, at least 31.2 percent of the production tax it received in 1983.[42]

Allocation Indexed to Inflation: No.

Distribution: Revenue is distributed to districts using the same two-part distribution described previously for the City and Township account. Funds are allocated 50 percent each to districts where mining and processing occurs, then distributed based on the portion of mining or processing occurring in each district.



Number of Recipients, 2014: Ten districts received an average $161,075.[43]

6. Taconite Railroad Account

Definition: The account collects a fixed amount of revenue that is distributed to municipalities, counties, and school districts based on amounts received by the local taxing jurisdictions under taconite railroad statutes in 1977.

Cents per Ton Allocated, 2014: Not applicable; production taxes are allocated for Taconite Railroad from the remainder of funds after all other allocations have been made and before the remainder is divided between the Taconite Environmental Protection Fund and the Douglas J. Johnson Economic Protection Trust Fund.

Amount Allocated, 2014: $2.5 million, distributed to counties, school districts, and municipalities, which was 2.3 percent of total production taxes.

Began Receiving Allocations: 1980, although data are not available for 1979.

Change over Time: In dollars adjusted for inflation, the allocation into the account has decreased 76.9 percent from 1980 to 2014.

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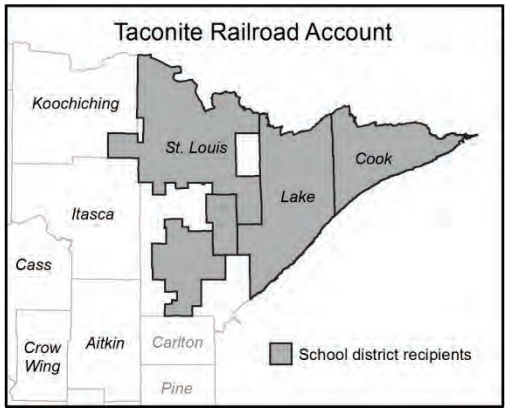
[42] *Minnesota Statutes* 2014, 298.225, subd. 1(a)(2)(i).

[43] Mining and processing occurred in only nine school districts in 2014. Cook County School District received revenue although no mining or processing occurred in the district. The district received revenue because of a provision in *Minnesota Statutes* 2014, 298.28, subd. 6(c), that provides $0.004541 per ton to school districts that contain an electric power plant providing the primary source of power for a mining company in another district. This electric power plant aid is statutorily guaranteed at 31.2 percent of the amount it received from taconite production in 1983.

Statutory Guarantee: No.

Allocation Indexed to Inflation: No.

Distribution: The distribution to recipients is a fixed amount each year based on what the local jurisdictions received under taconite railroad statutes in 1977. School districts receive 62 percent of the amount received in 1977.



Number of Recipients, 2014: Four school districts received $1.1 million, which was 44.6 percent of the $2.5 million in the Taconite Railroad account. The districts were Cook County, Lake Superior, St. Louis County, and Mesabi East, and they received an average of $276,734.

7. Taconite Levy Shortfall Payment

Definition: School districts that receive production tax revenues that are less than the amount of their levy reductions under *Minnesota Statutes* 2014, 126C.48, subd. 8, receive a distribution of production taxes to cover the difference.

Cents per Ton Allocated, 2014: None.

Amount Allocated, 2014: In 2010 and 2011, the payments totaled $541,218 and $844,529, respectively, in 2014 inflation-adjusted dollars; they represented 0.6 percent of total production taxes in 2010 and 1 percent in 2011.

Began Receiving Allocations: This account received production taxes in only 2010 and 2011. However, the provision remains in statute, allowing districts to receive funds should they encounter taconite levy shortfalls in the future.

Change over Time: From 2010 to 2011, the amount allocated for payments increased 56 percent.

Statutory Guarantee: No.

Allocation Indexed to Inflation: No.

Distribution: The revenue to make these payments is derived from proportionate reductions in the distribution to other school districts that receive revenue from the School District fund. However, when there is not enough revenue in the School District fund to cover the shortfall, the revenue is to come from the Taconite Property Tax Relief account; this occurred in 2010 and 2011.

Number of Recipients, 2014: None in 2014. Using 2014 inflation-adjusted dollars, in 2010, 10 districts received payments averaging $54,122; and in 2011, 13 districts received payments averaging $64,964.

Iron Range Resources and Rehabilitation Board (IRRRB)

Production tax revenue to IRRRB goes into nine accounts. Two accounts are for IRRRB's own use. The agency administers the other seven as grants or loans to local jurisdictions or for economic development projects. One new account will start receiving production taxes in 2015. Summaries of the statutory allocations to the nine accounts, and amounts received in 2014, are in Exhibit 2.14.

Exhibit 2.14: Production Tax Allocations to Accounts for the Iron Range Resources and Rehabilitation Board, 2014

Account	Allocation[a]	Amount
IRRRB Indexed Account	$0.065 per ton, increased annually with the implicit price deflator	$ 3,819,425
IRRRB Fixed Account	The amount received under *Minnesota Statutes*, 298.22, in 1977	1,252,520
Taconite Environmental Protection Fund	Two-thirds of the remaining revenue after production taxes are distributed to all other accounts	12,938,216
Taconite Economic Development Fund	$0.301 per ton; plus an amount equal to 50 percent of the production tax for concentrate sold as pellet chips and fines, not to exceed $700,000[b]	12,621,936
Douglas J. Johnson Economic Protection Trust Fund	$0.0335 per ton, increased annually with the implicit price deflator; plus one-third of the remaining revenue after production taxes are distributed to all other accounts; plus an amount equal to one-third of the increased tax proceeds attributable to the increase in the implicit price deflator from 2015 to 2017	5,080,122
IRRRB Educational Revenue Bonds	Amount specified in *Minnesota Law*	4,147,804
Producer Grant and Loan Fund	$0.05 per ton; plus fixed amount equal to the increased tax proceeds from the implicit price deflator from 2004 to 2005	3,241,471
Iron Range Higher Education Account	$0.05 per ton	1,980,388
School Consolidation and Cooperatively Operated School Account[c]	$0.10 per ton; plus an amount equal to two-thirds of the increased tax proceeds attributable to the increase in the implicit price deflator from 2015 to 2017	0
Total		$45,081,882

[a] Allocations reflect formulas in 2013 statutes, which the Minnesota Department of Revenue used to calculate 2014 allocations.

[b] The 2014 Legislature reduced future allocations to the Taconite Economic Development Fund by $0.05 to $0.251 per ton.

[c] The 2014 Legislature created this account, with the provision that allocations begin in 2015.

SOURCES: Office of the Legislative Auditor, analysis of Minnesota Department of Revenue data; *Minnesota Statutes* 2013, 298.28, subds. 7, 7a, 9a, 9b, 9d, 10, and 11; and *Minnesota Statutes* 2014, 298.28, subds. 7a and 9a.

1. and 2. IRRRB (two accounts: Indexed and Fixed)

Definition: The IRRRB received two allocations of production taxes for its organizational and programmatic needs, an indexed amount and a fixed amount.

Cents per Ton Allocated, 2014: Indexed allocation: $0.065 per ton, increased at the same rate as the implicit price deflator. Fixed allocation: amount equal to what the agency received in 1977 under laws at the time.

Amount Allocated, 2014: The indexed account received $3.8 million, and the fixed account received $1.3 million, a total of 4.6 percent of the production taxes.

Began Receiving Allocations: Both accounts began receiving production taxes in 1980, although data are not available for 1979. A separate account for IRRRB received production taxes starting in at least 1975 and ending with the last known allocation in 1978.

Change over Time: The sum of the two allocations in inflation-adjusted dollars comprised a low of 2.7 percent of total allocations in 1980 and a high of 6 percent in 1987, averaging 4.8 percent of total production taxes annually from 1980 to 2014.

Statutory Guarantee: The $0.065 per ton indexed allocation is statutorily guaranteed an amount of production taxes, based on the amount it received from taconite production in 1983.

Allocation Indexed to Inflation: The $0.065 per ton allocation is indexed through 2014, but the indexing is discontinued until resuming in 2018.

Distribution: Statutes do not create specific purposes for the revenue allocated for IRRRB; the indexed and the fixed distributions are generally to be used to benefit the Taconite Assistance Area and for purposes specified in law for IRRRB. In its fiscal year 2015 budget, IRRRB used its taconite production tax distributions as part of its funding for various program, facilities, and operation and development needs. Uses include expenses for Giants Ridge (a resort owned by IRRRB), information systems, and legal counsel.

Number of Recipients, 2014: One, IRRRB.

3. Taconite Environmental Protection Fund

Definition: The fund's purpose is to (1) reclaim, restore, and enhance parts of the Taconite Assistance Area adversely affected by the environmentally damaging impacts of mining and (2) promote economic development in northeast Minnesota. Statutes specify that the fund is to be used for investigating environmental issues, reclaiming and restoring mine lands, supporting local

economic development and public works projects, and monitoring health issues of mining employees.[44]

Cents per Ton Allocated, 2014: The fund received two-thirds of the funds remaining after production tax allocations were made to all other accounts.

Amount Allocated, 2014: $12.9 million, 11.8 percent of total production taxes.

Began Receiving Allocations: 1978.

Change over Time: Since 1978, the fund's portion of the production taxes has fluctuated, but it has consistently received a significant share of the taxes. Since 1987 and in dollars adjusted for inflation, the fund has received between 8 percent and 21 percent of the total production taxes distributed each year.

Statutory Guarantee: No.

Allocation Indexed to Inflation: No.

Distribution: IRRRB uses revenue from the fund for a variety of community grant programs, business assistance, local business guarantees, public works, and IRRRB operations and development expenses. Some of the funds are awarded on a competitive basis and others are not, but all require the local governments and businesses to complete an application. Projects that have received revenue from the fund include a $3.6 million direct loan in 2010 to the Mountain Iron Economic Development Authority for a solar panel manufacturing facility. Another example is $300,000 in 2013 to the town of Lutsen for Superior National Golf Course landscaping and irrigation. As of June 2014, the fund had a balance of $11.2 million.

Number of Recipients, 2014: 41 business development and infrastructure projects received revenue in fiscal year 2014.

4. Taconite Economic Development Fund

Definition: Aid to mining companies for qualified projects, such as reinvesting in taconite plants, as approved by IRRRB. Companies must provide a 100 percent match to receive revenue.

Cents per Ton Allocated, 2014: $0.301, decreased to $0.251 per ton for allocations in 2015. The fund also received an amount equal to 50 percent of the tax on concentrate sold as pellet chips and fines, which is not to exceed $700,000 annually.

Amount Allocated, 2014: $12.6 million, 11.5 percent of total production taxes.

Began Receiving Allocations: 1993.

[44] *Minnesota Statutes* 2014, 298.223, subd. 1 (1)-(6).

Change over Time: Since 1993, the fund has received between 5 and 13 percent of total production taxes in dollars adjusted for inflation; the one exception was in 2010 when it received only 0.3 percent. In that year, taconite production fell to 17 million tons. Statutes specify that distributions of the $0.251 per ton amount are not made to the fund when total industry production falls below 30 million tons.[45]

Statutory Guarantee: No.

Allocation Indexed to Inflation: No.

Distribution: Revenue is distributed to mining companies for qualified projects as approved by IRRRB. Projects companies propose must be reviewed by a joint committee of each company's salaried employees and nonsalaried employees. If the board does not approve a proposed expenditure, the funds must be deposited into the Taconite Environmental Protection Fund. For taxes paid in 2011, the board did not approve $4.5 million of proposed mining company projects; it instead transferred those funds to the Taconite Environmental Protection Fund for public works projects. In Chapter 3, we discuss in detail issues related to this fund.

Number of Recipients, 2014: All nine mining operations received revenue, ranging from $88,460 (Mining Resources) to $4 million (U.S. Steel-Minntac).

5. Douglas J. Johnson Economic Protection Trust Fund

Definition: The fund's purpose is to promote economic rehabilitation and diversification in areas where there have been economic dislocation and unemployment due to a single industry's decline.[46] Statutes give funding priority to projects that create and maintain permanent, skilled employment; encourage economic diversification and promote the development of mining, alternative energy, forestry, small businesses, and tourism; and are technologically and economically feasible.[47]

Cents per Ton Allocated, 2014: $0.0335 per ton, increased annually at the same rate as the implicit price deflator. The fund also received one-third of the revenue remaining after production tax allocations were made to all other accounts. From 2015 to 2017 the fund is to receive an additional amount equal to one-third of the increased tax proceeds attributable to the increase in the implicit price deflator on the production tax rate.

Amount Allocated, 2014: $5.1 million, 4.6 percent of total production taxes.

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[45] *Minnesota Statutes* 2014, 298.28, subd. 9a (a), specifies that no distribution of the $0.251 per ton amount is made to the Taconite Economic Development Fund in years when total production falls below 30 million tons. However, the statute does not limit into the fund the allocation that is equal to 50 percent of the tax on concentrate sold as pellet chips and fines, which was still distributed to the fund in 2010.

[46] *Minnesota Statutes* 2014, 298.292, subd. 1.

[47] *Minnesota Statutes* 2014, 298.292, subd. 1(1)-(3).

Began Receiving Allocations: 1978.

Change over Time: Since 1978, the fund's portion of total production taxes (in dollars adjusted for inflation) has varied greatly. For example, in 1981 the fund received 10.7 percent of the total production taxes, while in 1984 the fund paid out more revenue than was allocated to it, accounting for a negative 3.1 percent of the production taxes. On average, the fund's allocation was 4.5 percent of total production taxes annually.

Statutory Guarantee: No.

Allocation Indexed to Inflation: The $0.0335 per ton allocation was increased annually from 2000 to 2014, and the indexing will resume in 2018.

Distribution: The fund is administered as two separate accounts, the Trust Fund and the Operating Fund. IRRRB has used the Trust Fund for major, one-time economic development projects in the region. These have included a $5 million loan to the Chisholm/Hibbing Airport in 2013 and a $20 million loan in 2014 to Segetis, a renewable biochemical company. By contrast, IRRRB uses the Operating Fund annually to pay for smaller projects that aid business development, economic development, and workforce development. As of June 2014, the fund had a balance of $66.7 million.

In December 2014, IRRRB voted to pursue the establishment of a nonprofit Range Trust Project to manage up to $100 million of the corpus of the Trust Fund. The purpose of this nonprofit would be to foster economic development, create jobs, and enhance economic and employment development efforts of government and private entities in the Taconite Assistance Area. As of April 2015, the Range Trust Project had not been officially formed.

Number of Recipients, 2014: Seven business development projects received revenue from the Operating Fund, and one business and one airport received revenue from the Trust Fund in fiscal year 2014.

6. IRRRB Educational Revenue Bonds

Definition: The 2005 and 2013 Legislatures allocated certain amounts of production tax revenue for IRRRB to issue specific revenue bonds to school districts.[48] The 2005 bonds were for health, safety, and maintenance improvements, while the 2013 bonds were primarily for building projects, including energy efficiency, technology, infrastructure, health, safety, and maintenance improvements.

Cents per Ton Allocated, 2014: Not applicable; revenue for the 2005 bond payments comes equally from the Taconite Environmental Protection Fund and the Douglas J. Johnson Economic Protection Trust Fund. Revenue for the 2013 bond payments comes from the remainder of production taxes after all other

[48] *Laws of Minnesota* 2005, chapter 152, art. 1, sec. 39, subds. 1 and 2; and *Laws of Minnesota* 2013, chapter 143, art. 11, sec. 11, subds. 1 and 2.

allocations are made but prior to the division of the remainder between the Taconite Environmental Protection Fund and the Douglas J. Johnson Economic Protection Trust Fund, in an amount up to $0.10 per ton. Any amount exceeding the maximum $0.10 per ton comes from the Douglas J. Johnson Economic Protection Trust Fund.

Amount Allocated, 2014: $4.1 million, 3.8 percent of production taxes.

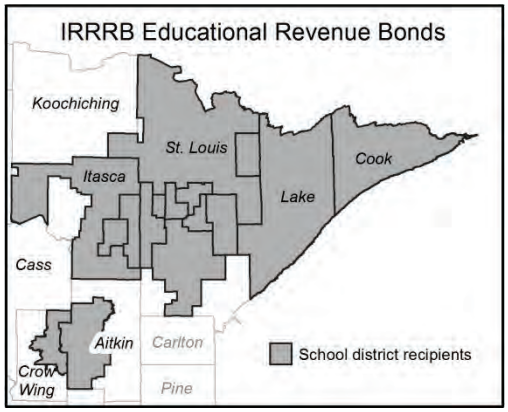
Began Receiving Allocations: 2007.

Change over Time: Since 2007, the portion of inflation-adjusted production taxes for the payments has increased from 1.5 percent to 3.8 percent in 2014.

Statutory Guarantee: No.

Allocation Indexed to Inflation: No.

Distribution: In 2005, the Legislature authorized IRRRB to issue revenue bonds totaling $15 million for grants to school districts in the Taconite Assistance Area or the Taconite Tax Relief Area. The 2013 Legislature authorized IRRRB to issue revenue bonds totaling $38 million for grants to school districts in the Taconite Assistance Area or the Taconite Tax Relief Area.



Number of Recipients, 2014: IRRRB received $4.1 million to pay for revenue bonds issued to make grants to school districts; in 2014, 15 school districts received an average of $2.5 million.

7. Producer Grant and Loan Fund[49]

Definition: As of 2009, revenue in the fund has been statutorily designated for purposes as specified for the Taconite Environmental Protection Fund and as approved by IRRRB. Prior to that, the fund's revenue was used for specific municipal and county public works and infrastructure projects.

Cents per Ton Allocated, 2014: $0.05, and a fixed amount equal to the increased tax proceeds from the implicit price deflator from 2004 to 2005, which was $1,261,083.

Amount Allocated, 2014: $3.2 million, 2.9 percent of total production taxes.

[49] The current "Producer Grant and Loan fund" should not be confused with the "Producer Grant" account, which received production taxes from 1998 to 2003 for one-time project grants to taconite companies (producers).

Began Receiving Allocations: 2005.

Change over Time: From 2005 to 2012, the portion of inflation-adjusted, total production taxes for the fund was fairly constant, ranging from 3.4 percent to 3.6 percent. The fund's allocation decreased to 3.1 percent in 2013 and 2.9 percent in 2014.

Statutory Guarantee: No.

Allocation Indexed to Inflation: No.

Distribution: Revenue is used for the same purposes as specified in law for the Taconite Environmental Protection Fund.

Number of Recipients, 2014: As described above, revenue from the Producer Grant and Loan Fund is used for purposes under the Taconite Environmental Protection Fund, which funded 41 business development and infrastructure projects in fiscal year 2014.

8. Iron Range Higher Education Account

Definition: Aid for higher education programs.

Cents per Ton Allocated, 2014: $0.05.

Amount Allocated, 2014: $2 million, 1.8 percent of production taxes.

Began Receiving Allocations: 2008.

Change over Time: In inflation-adjusted dollars, since 2008, the account's portion of total production taxes has remained fairly constant, averaging 1.9 percent annually.

Statutory Guarantee: No.

Allocation Indexed to Inflation: No.

Distribution: Revenue is used for higher education programs provided by postsecondary institutions in the Taconite Assistance Area, as approved by IRRRB.

Number of Recipients, 2014: The Northeast Higher Education District received three distributions of production taxes from the account for three separate programs, totaling $1.85 million.

9. School Consolidation and Cooperatively Operated School Account

Definition: Aid to assist with school bond payments and other qualified school projects within the Taconite Assistance Area.

Cents per Ton Allocated, 2014: Starting in 2015, this account will receive $0.10 per ton. In 2015 through 2017, the fund is also to receive an amount equal to two-thirds of the increased tax proceeds attributable to the increase in the implicit price deflator on the production tax rate.[50]

Amount Allocated, 2014: Not applicable.

Began Receiving Allocations: Will begin receiving allocations in 2015.

Change over Time: Not applicable.

Statutory Guarantee: No.

Allocation Indexed to Inflation: No.

Distribution: Revenue will be distributed to school districts for school bond payments and projects as approved by IRRRB.

Number of Recipients, 2014: Not applicable because the distribution is to begin in 2015.

Other Accounts

Production taxes are allocated to three remaining accounts. Statutory allocations to these accounts, and amounts received in 2014, are summarized in Exhibit 2.15.

Exhibit 2.15: Production Tax Allocations to Other Accounts, 2014

Account	Allocation[a]	Amount
Taconite Property Tax Relief Account	$0.348 per ton	$13,783,501
Range Association of Municipalities and Schools	$0.003 per ton	142,382
Hockey Hall of Fame	$0.002 per ton	79,216

[a] The allocation reflects formulas in 2013 statutes, which the Minnesota Department of Revenue used to calculate 2014 allocations.

SOURCES: Office of the Legislative Auditor, analysis of Minnesota Department of Revenue data; and *Minnesota Statutes* 2013, 298.28, subds. 6, 8, and 9c.

1. Taconite Property Tax Relief Account

Definition: Aid to be used as property tax relief for homesteaded properties.

Cents per Ton Allocated, 2014: $0.348.

[50] In addition, the account will receive revenue from the occupation tax. From the occupation tax allocation to the General Fund, the account is to receive an amount equal to what would be generated by a $0.06 per ton production tax.

Amount Allocated, 2014: $13.8 million, 12.5 percent of total production taxes.

Began Receiving Allocations: 1975 (earliest data available are from 1975).

Change over Time: Since 1975, the account's share of inflation-adjusted production tax revenue has varied, but overall it has diminished. In 1975, the account received 39 percent of total production taxes distributed; this compares with 13.3 percent in 1990 and 15.5 percent in 2005. As of December 2014, the account had a balance of $1.3 million.

Statutory Guarantee: No.

Allocation Indexed to Inflation: Resuming in 2018; until 2013, the allocation into the account was indexed to increase with the implicit price deflator (or another index in earlier years).

Distribution: St. Louis County is the fiscal agent of the Taconite Property Tax Relief account. It distributes to other counties revenue used as property tax relief for homestead property owners in the Taconite Tax Relief Area. We discuss the account in more detail in Chapter 3.

Number of Recipients, 2014: Unknown for 2014. In 2013, homesteaded properties in 139 jurisdictions received revenue.

2. Range Association of Municipalities and Schools (RAMS)

Definition: Aid for the organization to promote the welfare and economic development of Iron Range cities, towns, and schools.

Cents per Ton Allocated, 2014: $0.003.

Amount Allocated, 2014: $142,382, 0.1 percent of total production taxes.

Began Receiving Allocations: 1980, although data are not available for 1979.

Change over Time: The organization's portion of total production taxes (in inflation-adjusted dollars) has remained constant since 1980.

Statutory Guarantee: Yes, based on the amount it received from taconite production in 1983.

Allocation Indexed to Inflation: No.

Distribution: RAMS receives the production tax allocation to support its organizational needs. In its bylaws, one of RAMS' purposes is to serve as the primary representative of collective interests of Iron Range municipalities and schools before the Minnesota Legislature and other associations.

Number of Recipients, 2014: One, RAMS.

3. Hockey Hall of Fame

Definition: Aid to the city of Eveleth for managing and maintaining the Hockey Hall of Fame.

Cents per Ton Allocated, 2014: $0.002.

Amount Allocated, 2014: $79,216, which was 0.1 percent of total production taxes.

Began Receiving Allocations: 2007.

Change over Time: Since 2007, the city has received nearly the same portion of total production taxes in dollars adjusted for inflation. The one exception was in 2012 when it did not receive any distribution for this purpose.

Statutory Guarantee: No.

Allocation Indexed to Inflation: No.

Distribution: The city of Eveleth receives the allocation for the Hockey Hall of Fame.

Number of Recipients, 2014: One, the city of Eveleth.

Chapter 3: Mineral Taxation Issues

Earlier chapters describe Minnesota's mineral taxation structure and the distribution of tax revenues. In this chapter, we examine issues connected to taxes on mining taconite. The issues relate primarily to components of the production tax. Some, however, relate to the entire system of taconite taxes.

Specifically we address here: property tax relief provided by the production tax, legislative allocations of one-time grants from production tax revenue, the Taconite Economic Development Fund, and the regional nature of distributing production tax revenue. We also examine the complexity of mineral taxation.

TACONITE PROPERTY TAX RELIEF

The Taconite Property Tax Relief account aims property tax relief specifically to property owners who live in or near the Taconite Tax Relief Area and own residential homesteads or farm homesteads.[1] The tax relief is in the form of a taconite homestead credit, which reduces the tax bill that homestead owners would otherwise pay. It does not reduce the property tax burden for owners of any other classifications of property.

In 2014, statutes allocated $0.348 per taxable ton of taconite to the account, as Chapter 2 described.[2] Between 2003 and 2013, however, the actual amount going into the account exceeded $0.348 per ton because the allocation rate was statutorily tied to inflation.[3] The Legislature in 2013 and 2014 eliminated the escalator for distributions in 2014 through 2017. The escalator is set to resume in 2018. Exhibit 3.1 lists both the statutory and inflation-adjusted rates, the amount of revenue generated, and how the revenue was spent.

The size of the taconite homestead credit for homestead property owners depends in part on where in northeastern Minnesota they live. State law provides for what is known as (1) "regular" taconite homestead tax credits and (2) "supplementary" credits, as explained next.[4] Exhibit 3.2 displays a map of the 12 school districts in the Taconite Tax Relief Area where homestead property is eligible for regular taconite homestead credits and 5 other school districts where eligible property qualifies for supplementary credits.

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[1] *Minnesota Statutes* 2014, 273.124, subd. 1(a), defines homestead property as residential real estate or agricultural land occupied by its owner who must be a Minnesota resident.

[2] *Minnesota Statutes* 2014, 298.28, subd. 6(a).

[3] *Minnesota Statutes* 2012, 298.28, subd. 10(a), increased distributions with an escalator that reflected increases in the gross domestic product implicit price deflator. Since at least 1979, the account has been indexed to some measure of inflation.

[4] *Minnesota Statutes* 2014, 273.135 and 273.1391.

Exhibit 3.1: Taconite Property Tax Relief Account Tax Rates, Tax Generated, Allocations, and Fund Balances, 2005-2014

Year Tax was Paid	Statutory Rate (per ton)	Rate Adjusted for Inflation (per ton)[a]	Production Tax Revenue Generated (x 1,000)	Taconite Homestead Credit Amounts Distributed (x 1,000)[b]	Amounts for One-Time Grants from Account Surplus (x 1,000)	Amount per Ton for One-Time Grants	End-of-Year Fund Balance (x 1,000)
2005	$0.339	$0.3645	$13,518	$10,937	-	-	$27,145
2006	0.339	0.3733	13,720	11,079	-	-	31,135
2007	0.339	0.3849	14,754	11,235	$10,887	$0.384[c]	24,790
2008	0.339	0.3944	14,959	11,240	4,325	0.114[d]	22,751
2009	0.339	0.4045	9,657	11,128	5,999	0.155[e]	21,536
2010	0.339	0.4129	12,468	11,222	9,033	0.28757[f]	14,534
2011	0.339	0.4157	11,847	11,478	-	-	14,696
2012	0.339	0.4213	12,802	11,497	-	-	15,979
2013	0.339	0.4305	16,493	11,346	14,826	0.387	6,266
2014	0.348	0.3480	13,784	-	7,462	0.1884	1,256

[a] By law, the rate for allocations into the account has been adjusted annually by a measure of inflation called the gross domestic product implicit price deflator. The Legislature discontinued the automatic increase in the amount of allocations into the account in 2014 through 2017, however, the adjustment is to resume in 2018.

[b] The so-called "regular" homestead credits are paid from the Taconite Property Tax Relief account; in contrast, "supplemental" taconite homestead credits are paid out of the state's General Fund. Data here reflect only the regular homestead credit amounts paid from the Taconite Property Tax Relief account.

[c] For distributions in 2007, the 2006 Legislature established a special fund called the Public Works and Local Economic Development Fund to receive $0.384 per ton that would otherwise be allocated to the Taconite Property Tax Relief account. The allocations were instead made for specific one-time grants to cities, counties, and other entities. The original amount allocated was $14.7 million, but $3.8 million of that had been appropriated to an economic-development working group instead of a local government. The money was not spent but the Legislature instead moved the amount the following year to IRRRB for distribution to local jurisdictions.

[d] For distributions in 2008, the 2008 Legislature established a special (unnamed) fund to receive $0.114 per ton that would otherwise be allocated to the Taconite Property Tax Relief account. The allocations were instead made for specific one-time grants to cities, school districts, a township, an economic development authority, and a community hospital.

[e] In 2009, the Legislature allocated to IRRRB for renewable energy initiatives $0.155 per ton that would otherwise have gone to the Taconite Property Tax Relief account.

[f] The original allocation in 2010 was for a total $0.31463 per ton, but Governor Tim Pawlenty vetoed $0.02706 per ton allocated to the Virginia Regional Medical Center for operating room equipment.

SOURCES: Office of the Legislative Auditor, analysis of Minnesota Department of Revenue data; *Laws of Minnesota* 2014, chapter 308, art. 5, sec. 11; *Laws of Minnesota* 2013, chapter 143, art. 11, sec. 10; *Laws of Minnesota* 2010, chapter 389, art. 7, sec. 20; *Laws of Minnesota* 2009, chapter 78, art. 7, sec. 15 and sec. 22; *Laws of Minnesota* 2008, chapter 366, art. 10, sec. 15; and *Laws of Minnesota* 2006, chapter 259, art. 12, sec. 13.

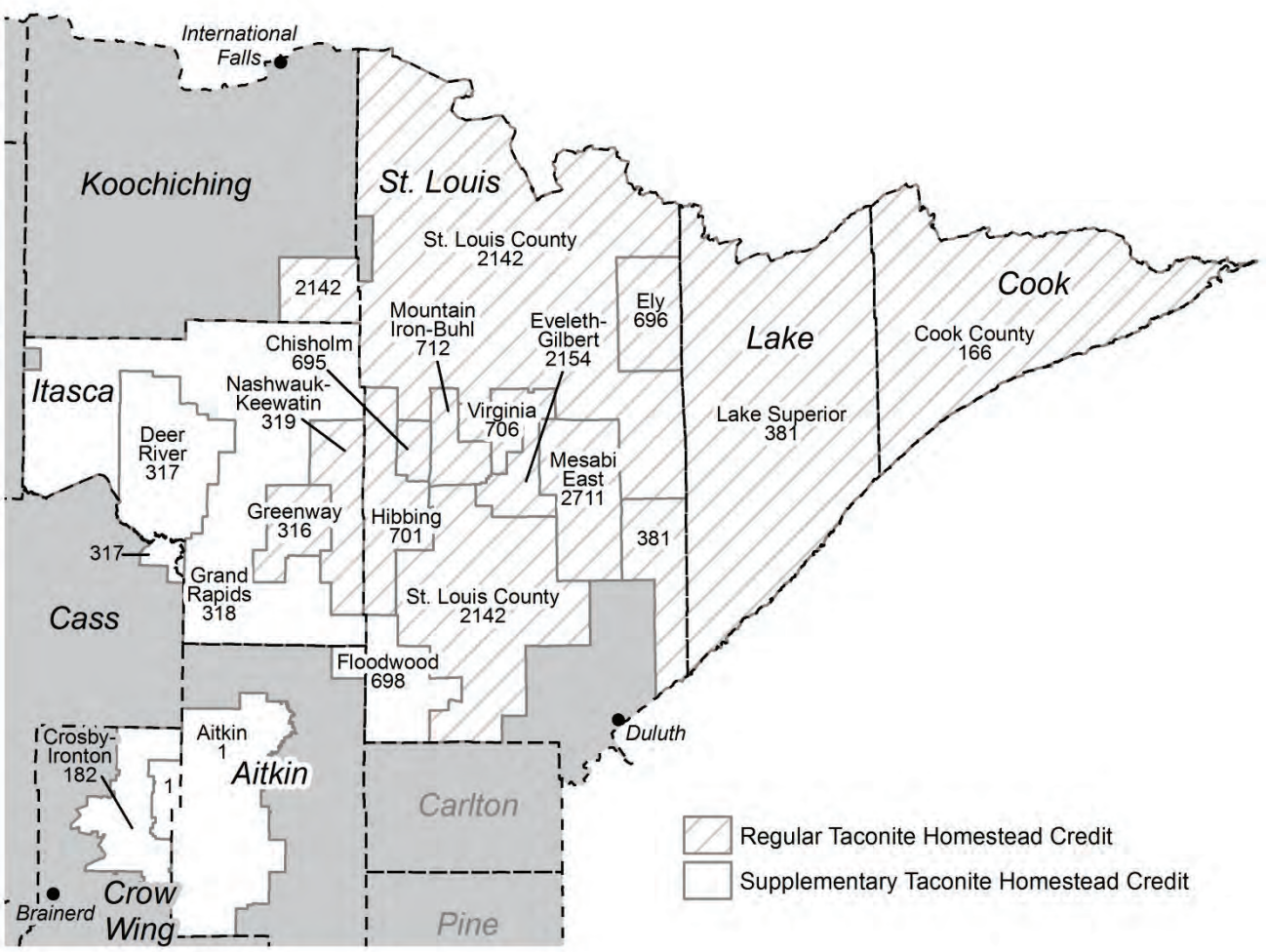
Regular Taconite Homestead Credit

Homesteaders within 1 of 12 school districts defined in law as the Taconite Tax Relief Area are eligible for the regular taconite homestead credit.[5] If such homesteaders live in a "qualifying" city or township, they are eligible for a property tax credit of 66 percent of their tax bill up to a maximum credit of $315.10. By law, a qualifying municipality has to meet one of two conditions.[6]

[5] *Minnesota Statutes* 2014, 273.134 (b).

[6] *Minnesota Statutes* 2014, 273.134 (a)(1) and (2).

Exhibit 3.2: School Districts Where Property is Eligible for the Taconite Homestead Credit, 2014



NOTES: Eligible homesteads for the Regular Taconite Homestead Credit are located inside the Taconite Tax Relief Area in 1 of the 12 school districts depicted here with striping. Regular Taconite Homestead Credits are paid by production tax revenue. Eligible homesteads for the Supplementary Taconite Homestead Credit are located outside the Taconite Tax Relief Area in one of five school districts depicted here in white. Supplementary Taconite Homestead Credits are paid by the state's General Fund.

SOURCES: Office of the Legislative Auditor, analysis of Minnesota Department of Revenue data; and *Minnesota Statutes* 2014, 273.134 (a)-(b); 273.1391, subds. 2 (a)-(c) and 5; and 298.28, subd. 6.

One is the proportion of unmined iron ore in a municipality's property values in 1941, and the second is proximity to a mining facility as of a particular date.[7] If, on the other hand, homesteaders live outside a qualifying city or township but

[7] In detail, the first condition is that the assessed value of a municipality's property consisted of at least 40 percent of unmined iron ore as of May 1941. The second is that the city or town has a taconite concentrating plant, an active taconite mine, or an electric generating plant that qualified as a taconite facility as of January 1, 1977, or when a property was assessed.

still within 1 of the 12 Tax Relief Area school districts, they are eligible for a credit of 57 percent of the tax up to a limit of $289.80. In 2013, property owners in 139 local jurisdictions received regular taconite homestead credits.

As an example of qualifying for the 57 percent credit, the city of Grand Marais is in the Cook County-166 School District, which is part of the Taconite Tax Relief Area. However, homesteaders in Grand Marais qualify for only the 57 percent credit, not the full 66 percent credit. Grand Marais was not a qualifying city for these reasons: unmined iron ore did not make up at least 40 percent of its assessed valuation in 1941; and it did not have as of January 1977 a taconite plant or mine or an electric power plant that qualified as a taconite facility.

For the regular taconite homestead credits in 2013, $6.8 million was paid to property owners qualifying for the 66 percent credit and $4.6 million for the 57 percent credit. Exhibit 3.3 provides details on the type and amounts of homestead credits by county.

Exhibit 3.3: Taconite Homestead Credits, 2013

	Regular Credit[a]				Supplementary Credit[b]			
	66 Percent of a Homesteader's Property Taxes, up to $315.10		57 Percent of a Homesteader's Property Taxes, up to $289.80		66 Percent of a Homesteader's Property Taxes, up to $315.10		57 Percent of a Homesteader's Property Taxes, up to $289.80	
County	# of Jurisdictions	Amount	# of Jurisdictions	Amount	# of Jurisdictions	Amount	# of Jurisdictions	Amount
Aitkin	0	$ 0	0	$ 0	0	$ 0	27	$ 914,766
Cook	1	27,205	13	499,557	0	0	0	0
Crow Wing	0	0	0	0	7	473,454	17	696,469
Itasca	9	765,891	12	459,054	1	273,199	70	2,730,518
Koochiching	1	4,705	0	0	0	0	0	0
Lake	1	226,737	9	916,035	0	0	0	0
St. Louis	23	5,727,214	70	2,719,376	0	0	9	159,575
Total	35	$6,751,752	104	$4,594,022	8	$746,653	123	$4,501,328

NOTES: The Taconite Property Tax Relief account receives production tax revenue to pay for the Regular Taconite Homestead Credits. By contrast, the state's General Fund pays for the Supplementary Taconite Homestead Credits. Eligibility for both the regular and supplementary Taconite Homestead Credits depends on a homesteaded property's location within qualifying school districts.

[a] Eligible homesteads for the Regular Taconite Homestead Credit are located inside the Taconite Tax Relief Area in 1 of 12 school districts: Chisholm, Cook County, Ely, Eveleth-Gilbert, Greenway, Hibbing, Lake Superior, Mesabi East, Mountain Iron-Buhl, Nashwauk-Keewatin, St. Louis County, and Virginia.

[b] Eligible homesteads for the Supplementary Taconite Homestead Credit are located outside the Taconite Tax Relief Area in one of five school districts: Aitkin, Crosby-Ironton, Deer River, Floodwood, and Grand Rapids.

SOURCES: Office of Legislative Auditor, analysis of Minnesota Department of Revenue data; and *Minnesota Statutes* 2014, 273.134 (a)-(b); 273.1341; 273.135, subds. 1-2; and 273.1391, subd. 5.

Supplementary Taconite Homestead Credit

State law provides supplementary taconite homestead credits as property tax relief to additional homestead owners living outside the boundaries of the

Taconite Tax Relief Area.[8] However, the supplementary credit is paid for out of the state's General Fund. Thus, the tax relief does not come from revenue generated by production taxes on mines and plants, as it does for the regular taconite homestead tax credit.

Depending on where they live, eligible property owners receive a tax credit worth either 57 percent of their property tax (up to a $289.80 limit) or 66 percent of their tax (up to a $315.10 limit). Homesteaders living in Deer River School District or the Floodwood School District are eligible for the 57 percent tax credit. Those living in the Aitkin, Crosby-Ironton, or Grand Rapids school districts are eligible for either the 57 percent or the 66 percent credit. Within these latter districts, homestead property is eligible for the 66 percent credit when it is in municipalities that lie outside of the Taconite Tax Relief Area, but meet qualifying conditions.[9] On the other hand, homestead property is eligible for the 57 percent credit if it lies within the Taconite Assistance Area but is in neither a qualifying municipality nor the Taconite Tax Relief Area.[10]

Regarding the supplementary credits, far more is paid out for property meeting criteria for the 57 percent credit than for the 66 percent credit. In 2013, homestead owners in 131 local jurisdictions received supplementary taconite homestead credits. Exhibit 3.3 also shows supplementary homestead credits by county.

Production tax revenue significantly lowers property tax burdens for owners of homesteaded property.

In 2013, $16.6 million in taconite homestead credits lowered the property tax bills of homesteaded property owners in and near the Taconite Tax Relief Area. About $15.9 million of that tax relief went to residential homestead owners; $682,000 went to farm homestead owners. Annual amounts of total taconite homestead credits have changed only slightly over the prior eight years, averaging $16.6 million annually between 2005 and 2013.

Significance of the Taconite Homestead Credit

Homesteaded property makes up large shares of the property tax base for many communities in the area eligible for taconite homestead credits. For taxes paid in 2013, homesteads made up 42 percent of market value for all property in the area. Shares of homesteaded property in the area ranged from an average of 7 percent of market value in Koochiching County to 47 percent in St. Louis County.

[8] *Minnesota Statutes* 2014, 273.1391.

[9] The qualifying conditions are the same as for the 66 percent credit available through the regular homestead credit. See *Minnesota Statutes* 2014, 273.1391, subd. 2(c).

[10] As Chapter 2 described, the Taconite Assistance Area consists of 15 school districts located in 7 northeastern Minnesota counties.

Further, the taconite homestead credit pays for a substantial share of northeastern Minnesota homesteads' property tax burdens. For instance, in Hibbing for taxes paid in 2013, homesteaded property accounted for two-thirds of the city's market value across all property classifications. Those property owners paid a net $4.5 million in property taxes in 2013. The taconite homestead credit reduced those taxes for Hibbing homestead owners by a cumulative $1.6 million, which is 36 percent of the net tax burden. Across the area eligible for taconite homestead credits, homestead property owners paid $62.7 million in net property taxes in 2013. The $16.6 million in homestead credits that year represents 26 percent of their net taxes—that is, 26 percent more that homestead property owners did not have to pay.

Effective Property Tax Rates

Property tax burdens paid by homestead property owners averaged less in the area eligible for taconite homestead credits than statewide in 2013. We analyzed "effective tax rates"—the net tax paid as a percentage of properties' market value.[11] Owners of homestead property in the area receiving taconite homestead credits paid lower average effective property taxes than the average statewide in 2013. Exhibit 3.4 shows that effective tax rates in 2013 for homestead property within the area receiving taconite homestead credits ranged from an average 0.04 percent to 0.86 percent among the seven counties in the area. By contrast,

Exhibit 3.4: Effective Property Tax Rates by Major Property Classifications, Taxes Paid in 2013

		Area Eligible for Taconite Homestead Credits						
Property Classification	Statewide	Aitkin	Cook	Crow Wing	Itasca	Koochiching	Lake	St. Louis
Commercial-Industrial-Utility	3.80%	2.99%	2.72%	3.17%	2.85%	1.97%	3.16%	3.69%
Apartment	1.85	1.46	0.96	2.03	1.53	0.00	1.54	1.89
Nonhomestead[a]	1.17	0.64	0.56	0.84	1.00	0.64	0.82	1.28
Homestead[b]	1.14	0.40	0.51	0.62	0.73	0.04	0.63	0.86
Commercial Seasonal	1.09	0.60	0.77	0.86	0.70	0.00	0.78	0.91
Cabin	0.98	0.73	0.72	0.86	1.04	0.74	0.96	1.29

NOTES: Effective tax rate is a measure of property tax burden. It is the net tax paid as a percentage of market value of the property. Effective property tax rates here for individual counties represent the portion of each county that is within the area eligible for taconite homestead credits.

[a] Nonhomesteads include both residential and farm property that is not homesteaded.

[b] Homesteads include both residential and farm property that is homesteaded.

SOURCE: Office of the Legislative Auditor, analysis of Minnesota Department of Revenue data.

[11] The effective tax rate is a measure of the property tax burden that allows comparisons across different property classes, such as homesteads or commercial property, and different regions of the state.

the statewide rate was 1.14 percent. Proceeds from the taconite homestead tax credits help explain why effective property tax rates are lower in the area eligible for those credits.

Taconite Homestead Tax Credit as a Source of Local Revenue

For a few communities, taconite homestead credits from production tax revenues represent significant shares of their total local property-tax-related revenue sources. The Department of Revenue analyzed revenue sources for Iron Range cities and townships as part of a 2014 study.[12] In 18 cities and towns out of the 189 compared, taconite homestead credit amounts were between 10 and 24 percent of total local property-tax-related revenues in 2013.

The Taconite Property Tax Relief account accumulates balances when incoming revenues exceed the amounts paid out for taconite homestead credits. For instance, the balance at the end of 2013 was $6.3 million and at the end of 2014 was $1.3 million, as Exhibit 3.1 showed. Fund balances occurred in every year since 1989.[13] Between 2000 and 2014, the annual fund balance averaged $20 million. Legislative changes in 2013 and 2014 removed the inflation factor that had previously escalated the amount allocated to the account; current law reinstates the escalator for distributions in 2018.[14]

ONE-TIME GRANTS

In recent years, Iron Range legislators have proposed using balances in the Taconite Property Tax Relief account for one-time allocations, typically (but not uniformly) to Iron Range cities and townships for public works and infrastructure projects. Legislators most often proposed these allocations in the minerals article of the omnibus tax bills. For example, the 2014 Legislature approved a total $0.1884 per taxable ton from the Taconite Property Tax Relief account in distributions to 18 recipients. Among the varied projects to be funded that year included demolition of a public building, a stormwater project, and a recreational trail. Exhibit 3.5 provides information on the one-time grants since 2007. While most of the one-time grant recipients were cities, a few were counties, school districts, economic development agencies, and nonprofit organizations.

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[12] Minnesota Department of Revenue, *Iron Range Fiscal Disparities Study* (St. Paul, January 31, 2014). Revenue sources included local levies, property tax aids (such as local government aid to cities), property tax credits (including the taconite homestead credit), direct distributions from the production tax, grants and loans from the Iron Range Resources and Rehabilitation Board, and levies from the Iron Range fiscal disparities distribution (a program that regionally shares 40 percent of the annual growth in the commercial and industrial tax base).

[13] *Minnesota Statutes* 2014, 298.293, specifies that if the Property Tax Relief account has insufficient funds to pay the homestead property tax credits, the Douglas J. Johnson Economic Protection Trust Fund will pay for that tax relief. The Department of Revenue reports this last occurred in 1989.

[14] *Minnesota Statutes* 2014, 298.28, subd. 10; and *Laws of Minnesota* 2013, chapter 143, art. 11, sec. 8.

Exhibit 3.5: One-Time Legislative Grants from Taconite Property Tax Relief Account, 2007-2014

	Number of Projects Receiving Grants	Amount Allocated (per ton)	Number of Recipients			
			Cities	Towns	Counties	Other
2007	19	$0.384000	13	0	1	5[a]
2008	12	0.114000	7	1	1	3[b]
2009[c]	32	0.362625	25	2	2	1
2010	46	0.287570[d]	28[e]	5	1	3
2013	21	0.387000	14[f]	1	0	3
2014	18	0.188400	13	4	0	1[g]
Total	148	$1.723595	100	13	5	16

[a] Among "other" grant recipients in 2007, a distribution of $0.10 per ton went to the Iron Range Resources and Rehabilitation Board (IRRRB) to be deposited in a Highway 1 Corridor Account on behalf of Babbitt, Cook, Ely, or Tower for economic development projects to be approved by at least seven IRRRB members.

[b] Among "other" grant recipients in 2008, a distribution went to school districts. School boards for the St. Louis County, Ely, Mountain Iron-Buhl, and Virginia school districts received equal shares of $0.01 per ton to study the "potential for and impact of consolidation and streamlining the operations of their school districts." This is the only one-time grant to school districts from 2007-2014.

[c] In 2009, the Legislature allocated to IRRRB (for renewable energy initiatives) $0.155 per ton that would otherwise have gone to the Taconite Property Tax Relief account. The Legislature also allocated one-time grants, not from the Taconite Property Tax Relief account, but instead from the Taconite Environmental Protection Fund. Among grants to cities that year, Cook and Grand Rapids each received allocations for two projects.

[d] The original allocation in 2010 was for a total $0.31463 per ton, but Governor Tim Pawlenty vetoed $0.02706 per ton allocated to the Virginia Regional Medical Center for operating room equipment.

[e] In 2010, Chisholm received grants for three projects; Aitkin, Gilbert, Mountain Iron, and Virginia each for two projects; and Grand Rapids for four projects.

[f] In 2013, Cook, Grand Rapids, and Hibbing each received allocations for two projects.

[g] Legislators allocated $0.065 per ton to IRRRB for "township block grants to be distributed by the board."

SOURCES: Office of the Legislative Auditor, analysis of *Laws of Minnesota* 2014, chapter 308, art. 5, sec. 11; *Laws of Minnesota* 2013, chapter 143, art. 11, sec. 10; *Laws of Minnesota* 2010, chapter 389, art. 7, sec. 20; *Laws of Minnesota* 2009, chapter 78, art. 7, sec. 15 and sec. 22; *Laws of Minnesota* 2008, chapter 366, art. 10, sec. 15 (1)-(12); and *Laws of Minnesota* 2006, chapter 259, art. 12, sec. 13.

Legislative allocations for one-time grants from the Taconite Property Tax Relief account have lacked sufficient safeguards.

We compared the process Iron Range legislators used to allocate one-time grants with criteria and best practices on issuing state grants and contracting, which this office has advocated in the past.[15] We focused on criteria pertaining to announcing, awarding, paying, and monitoring state grants, which Exhibit 3.6 summarizes.

[15] Office of the Legislative Auditor, Program Evaluation Division reports: *Workforce Programs* (St. Paul, February 2010); *State Grants to Nonprofit Organizations* (St. Paul, January 2007); and *Professional/Technical Contracting* (St. Paul, January 2003).

Exhibit 3.6: Criteria for Managing State Grants

Activity	Criteria
Announcing grants	• Publicize grants as broadly as possible. • The notice should identify grant expectations and selection criteria.
Awarding grants	• Award grants through a competitive application process. • Review all applications using standardized scoring sheets and clearly specified selection criteria. • Write a contract, with clearly detailed expectations.
Paying and monitoring grants	• Make payments on a reimbursement basis or for services rendered. • Conduct a formal site visit during the contract period. • Require recipients to submit progress reports at least every six months. • Close out the grant by reviewing the services provided and writing an assessment of the recipient.

NOTE: These criteria are among a number of others that are intended to apply when the state grants awards to nonprofit organizations. Because not all criteria for grants to nonprofits necessarily apply for grants to local governments, we analyzed a select set of the criteria.

SOURCE: Office of the Legislative Auditor, Program Evaluation Division, *State Grants to Nonprofit Organizations* (St. Paul, January 2007), 22-26.

Inadequate Notice

The process legislators followed has shortcomings when compared with criteria for administering state grants. One criterion is publicizing grants broadly and including selection criteria in the notice. No notice was publicized regarding funding available through the surplus in the Taconite Property Tax Relief account from 2007 through 2014.

Several of the local governments we interviewed as part of this evaluation told us they had not been aware of such funding; they learned about it when one of their legislators contacted them and inquired about "shovel-ready" projects. Many of the municipal representatives we interviewed also told us that close relationships with their legislators were key to knowing about and receiving the allocations. Representatives of two counties we interviewed said they did not know whether they could apply for the one-time grants. However, counties had received a small number of one-time grants for projects in 2007, 2008, 2009, and 2010.

As part of this evaluation, we also interviewed six legislators who were current or past members of IRRRB. One explained that local governments would not necessarily know about the surplus funding unless legislators had informed them. Legislators told us they learned about infrastructure projects in need of additional funding when speaking with municipal officials from their legislative districts.

Legislators said they tended to look for projects that had received some funding through IRRRB but lacked sufficient funding to be completed.[16]

No Application Process or Competitive Awards

A second shortcoming is the lack of either a formal application process or a competitive award. Criteria for administering state grants include following a competitive application process. However, recipients of the one-time grants did not apply for the funding—because there is no application process. Lacking such a process prevents potential applicants from competing for a grant. Some legislators pointed out that projects having received IRRRB funding had been vetted through that agency's application process. However, not all recipients of the one-time grants were eligible for IRRRB funding or had applied to IRRRB. Exhibit 3.7 lists examples of one-time grant recipients in 2013 and 2014 with projects that had not gone through IRRRB.

Exhibit 3.7: Sample of One-Time Grants for Projects that Had Not Received Funding from the Iron Range Resources and Rehabilitation Board, 2013-2014

Recipient	Year	Amount (per ton)	Project
Balkan Township	2014	$0.0039	Salt storage building and energy efficient cold-storage buildings
City of Buhl	2013	0.025	Roof on Mesabi Academy
City of Cuyuna	2014	0.0047	Improvements to city properties and facilities, including construction, electrical, water, sewer, and site preparation
City of Grand Rapids	2014	0.005	Reif Center soil and landscape remediation
Crane Lake Water and Sanitary District	2013	0.018	Sanitary sewer extension
Greenway Joint Recreation Board	2013	0.005	Coleraine hockey arena renovations
Morse Township	2014	0.003	Recreational trail
Nashwauk Township	2014	0.005	Nashwauk town hall

NOTE: Some recipients had applied to IRRRB for funding other projects unrelated to the project for which they had received one-time appropriations in the given year.

SOURCES: Office of the Legislative Auditor, analysis of *Minnesota Laws* 2014, chapter 308, art. 5, sec. 11; *Minnesota Laws* 2013, chapter 143, art. 11, sec. 10; and IRRRB data on projects funded through the Taconite Environmental Protection Fund or Douglas J. Johnson Economic Protection Trust Fund.

Another criterion for awarding grants is using clearly specified selection criteria when reviewing applications. However, recipients of the one-time funding were not determined based on specified selection criteria. Legislators described

[16] One also mentioned projects for which municipalities sought funding from the Public Facilities Authority, which provides financing programs for municipal infrastructure improvements, such as wastewater treatment projects.

criteria they used in making their selections, but they were not always consistent. For instance, one legislator looks for a "demonstrated link between the project and local property taxes," among other criteria. Another looks for projects with the "greatest funding needs." More than one legislator we interviewed, but not all, look for "shovel-ready projects" that can be completed quickly.

A third criterion for awarding grants is writing a contract specifying what is expected of the recipient. However, contracts or grant agreements have not been routinely written for the one-time grants. According to the St. Louis County Auditor-Treasurer, who is by law the fiscal agent for the account, the role for his office typically is simply distributing the amounts appropriated by the Legislature. He recalled three grant agreements that the county had written in the past when the one-time grants were to nongovernmental entities, such as a nonprofit organization.

Inadequate Oversight

A third shortcoming is inadequate oversight of the one-time grants. As noted above in Exhibit 3.6, criteria for administering state grants include making payments to the recipient on a reimbursement basis and closing out grants by reviewing the work provided. However, recipients of the one-time grants were not required to submit invoices or receipts before receiving the grant money.

Nor was any person or agency in charge of overseeing whether the projects were completed. Although some legislators we interviewed indicated they called or spoke with grant recipients to follow up, their oversight was informal; other legislators said overseeing the grants was not their role.

Moreover, among the one-time grants appropriated since 2007, in only one year were grant agreements written for all projects. In 2009, the Legislature appropriated money for the grants from the Taconite Environmental Protection Fund (not the Taconite Property Tax Relief account).[17] Because IRRRB manages the Taconite Environmental Protection Fund, staff there distributed the 2009 legislative grants through grant agreements, meaning that recipients received reimbursements only after providing evidence of completed work. IRRRB staff also conducted follow-up work after grantees completed projects. IRRRB staff were not involved in overseeing the one-time grants in other years.

In our interviews with a sample of local governments, we asked about the projects that had been awarded one-time grants. Based on the interviews, we do not believe recipients used the funding inappropriately.[18] However, outside of the Omnibus Tax bills, there was no documentation on the intended use of the funding. The tax bills themselves provided only very brief and often vague

[17] *Laws of Minnesota* 2009, chapter 78, art. 7, sec. 15.

[18] For some of the 2014 funding, projects were still underway or were not planned to start until 2015.

descriptions of projects to be funded, such as "0.65 cents per ton to the city of Aurora for an infrastructure project."[19]

We learned of one project that had been included in the tax bill but was not undertaken. In this instance, the legislator representing that city had instructed city officials to use the one-time grant, not on the project included in law, but on an infrastructure project for a business that was expanding. City officials complied and used the grant to help pay for the infrastructure upgrade instead of the electrical substation project cited in law.

RECOMMENDATION

The Legislature should establish a process to improve the use of production tax for one-time legislative grants to local jurisdictions.

A clearly defined process for managing one-time grants would better conform to criteria and best practices for grants of public dollars, be fairer to local governments needing the resources, and offer consistent oversight where it is currently lacking. Such a process should include: steps for providing widespread notice about availability of funds, applications from interested localities, and criteria for judging applications. It should also include steps for formal and consistent oversight of the funds.

Although there are other options, one possibility is to have IRRRB staff manage the process for administering and overseeing grants. Legislators who are board members of IRRRB would still decide which projects to fund and at what amounts. IRRRB staff, on the other hand, would manage the one-time legislative grants much as they do the agency's current grant and loan programs. Information on the availability of funding for those IRRRB programs is communicated on the agency's website and through outreach efforts, including e-mail, social media, community visits, and a monthly newsletter. Applicants must follow the agency's established application processes; the agency's application materials specify criteria for eligible projects. Staff review applications and compare them against criteria established for each program. Staff set up grant agreements with the recipient. They require recipients to submit receipts for work done, and they provide reimbursements only after receiving such receipts. In addition, after recipients complete projects, IRRRB staff follow up with a site visit or a final report.

Another option is to expand the role now played by St. Louis County, the fiscal agent for the Taconite Property Tax Relief account. While the county could conceivably take on such a role, doing so has drawbacks. Unlike IRRRB, it would have to develop a new process to oversee a substantial number of legislatively approved grants. The county is not currently paid for serving as fiscal agent, but an expanded role could require additional resources for which compensation might reasonably be requested. Further, if the county were to assume this expanded role, it could possibly be in charge of a process through

[19] *Laws of Minnesota* 2014, chapter 308, art. 5, sec. 11.

which it would be competing with others for grant money. This would likely raise questions about conflicts of interest.

Taconite Property Tax Relief Account Surplus

Despite the fund balances that remained each year (displayed in Exhibit 3.1) after paying for Taconite Homestead Credits, legislators have not prescribed ongoing uses for such fund balances. Instead they have tended to spend the surplus on a year-by-year basis. This raises concerns about fiscal accountability, as described next.

Statutes do not specify oversight or purposes for surplus funds in the Taconite Property Tax Relief account.

Lack of Oversight for the Surplus

Nothing in statute establishes oversight of surplus funds remaining in the Taconite Property Tax Relief account after the account has paid for the taconite homestead credits. Despite St. Louis County being fiscal agent of the account, when the account has a balance, the county has no additional authority except to invest the funds according to law. Statutes do not prescribe how surplus funds are to be spent. Nor do they suggest a size of fund balance that should remain in the account.[20] As described earlier, legislators have used such balances for one-time grants to Iron Range communities. Annual amounts for those grants ranged from $4.3 million to $14.8 million since 2007, as Exhibit 3.1 showed.

For other accounts that receive substantial production tax revenues, statutes have authorized IRRRB to oversee use of the revenues including surpluses. For instance, IRRRB has statutory authority to administer the Douglas J. Johnson Economic Protection Trust Fund for specified purposes, including creating jobs and diversifying the economy. IRRRB is also authorized to use funding in the Taconite Environmental Protection Fund for specified projects, including local economic development projects and public works.

Unspecified Purposes for the Surplus

By law, the purpose of the Taconite Property Tax Relief account is to provide property tax relief to homesteads in the Taconite Tax Relief Area.[21] Three additional statutory purposes remain in law for the Taconite Property Tax Relief account. But they are relatively insignificant compared with the Taconite Homestead Credits. They account for little or none of the account's funding and are described next.

[20] One could argue that a fund balance is not important. As noted earlier, *Minnesota Statutes* 2014, 298.293, requires the Douglas J. Johnson Economic Protection Trust Fund to pay for property tax relief if the Property Tax Relief account has insufficient funds to pay the homestead property tax credits. This last occurred in 1989.

[21] *Minnesota Statutes* 2014, 273.135, subd. 1.

First, statutes establish the Taconite Property Tax Relief account as a backup for specific funding to school districts under special circumstances.[22] School districts that receive less for a given year in taconite tax revenues than the amount of their levy reductions from two years prior are eligible for an additional distribution to make up the difference.[23] The School District fund is to pay for these additional distributions, but if it has insufficient funds for this purpose, statutes require paying them out of the Taconite Property Tax Relief account.[24] In only two years has the account been tapped for this purpose. The amounts were relatively small: $807,218 in 2010 and $501,635 in 2009.

Second, the statute establishing the account states that $0.001875 and $0.004541 per taxable ton are to go first to a county and school district, respectively, under specific conditions. When a mining company owns an electric power plant that powers mining operations, but the plant is located in one county and the mining and processing in other counties, $0.001875 per ton would come from the Taconite Property Tax Relief account and be distributed to the county with the power plant.[25] Similarly, if the plant is located in one school district with the mining and processing in a different district, the statute allocates $0.004541 per taxable ton from the Taconite Property Tax Relief account to the school district with the plant.[26] This situation applied in Cook County and Cook County School District when LTV Steel owned a power plant in Taconite Harbor. Since LTV Steel closed in 2001, however, no money from the Taconite Property Tax Relief account has been distributed to the county or school district.[27]

Third, the statute on the Taconite Property Tax Relief account also refers to distributing an amount to a Public Works and Economic Development Fund prior to spending money on the homestead property tax credits. However, this language is now obsolete as it was for distributions in 2007 only.[28]

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[22] *Minnesota Statutes* 2014, 298.28, subd. 4 (c)(ii).

[23] The levy reductions are based on *Minnesota Statutes* 2014, 126C.48, subd. 8, which requires reducing school district levies when they exceed statutory levy limits.

[24] *Minnesota Statutes* 2014, 298.28, subd. 4 (c)(ii).

[25] *Minnesota Statutes* 2014, 298.28, subd. 6 (b).

[26] *Minnesota Statutes* 2014, 298.28, subd. 6 (c).

[27] Instead, a separate statutory provision guarantees payment of the distributions to the county and school district based on 1983 taconite production levels, according to *Minnesota Statutes* 2014, 298.225, subd. 1(a)(1) and (2). Such distributions come—not from the Taconite Property Tax Relief account—but in equal amounts from the Taconite Environmental Protection Fund and the Douglas J. Johnson Economic Protection Trust Fund.

[28] *Minnesota Statutes* 2014, 298.28, subd. 6 (a), says the $0.348 per ton, "less any amount required to be distributed under . . . section 298.2961, subdivision 5," must be allocated for property tax relief. The reference is to a subdivision added in 2006 specifically to allocate one-time grants in 2007 for local government projects. See *Laws of Minnesota* 2006, chapter 259, art. 12, sec. 13.

RECOMMENDATION

The Legislature should specify criteria in law for use of surplus funds in the Taconite Property Tax Relief account.

A change would affect *Minnesota Statutes*, 298.28, subdivision 6, which directs the account to provide property tax relief. The recommended criteria should identify on what types of projects the fund balance could be spent after the account pays for taconite homestead credits. This would make explicit the Legislature's intent for future surplus funds.

Other criteria should specify authority for managing and overseeing use of the fund balance. This would bring responsibility for managing surpluses in the Taconite Property Tax Relief account in line with other major accounts such as the Douglas J. Johnson Economic Protection Trust Fund.

One might question whether an amended law is needed, given the relatively small surplus in the account as of the end of 2014 compared with the previous decade. Even if the surplus dwindles further in the near future, however, the possibility that the surplus will expand is strong, given existing law. As noted earlier, the escalator that until 2014 automatically increased the amount allocated into the Property Tax Relief account will apply again beginning in 2018.

TACONITE ECONOMIC DEVELOPMENT FUND

Established in 1992, the Taconite Economic Development Fund now receives a distribution of $0.251 per ton from the production tax, as Chapter 2 described. Funds are held by IRRRB and distributed to mining companies following IRRRB review and approval. Statutes prohibit distributing the funding to taconite producers in years when production industrywide is less than 30 million tons.[29] Eligible projects must meet one of three purposes: acquiring plant and stationary mining equipment and facilities, providing workforce development, or financing research and development of new mining or production technology.

To receive the funding, mining companies must follow procedures, such as reviewing the projects with their nonsalaried production and maintenance employees before proposing them to IRRRB. They are also required to match the funding with an equal amount of their own revenue. Exhibit 3.8 lists a selection of projects proposed for IRRRB approval in 2013 and 2014.

Current law and IRRRB procedures prohibit mining companies from using the funds for purchasing mobile equipment, including haulage trucks and mining

[29] *Minnesota Statutes* 2014, 298.28, subd. 9a(a). Total taconite production fell below the 30 million ton threshold most recently in 2009, 1986, 1983, and 1982. An additional amount is allocated to the fund; it is equivalent to 50 percent of the tax on pellet chips and fines, up to a maximum of $700,000 annually. However, this additional amount is not subject to the proscription against allocations to the fund when production is less than 30 million tons.

Exhibit 3.8: Select Projects Proposed for Funding from the Taconite Economic Development Fund, 2013-2014

Project Title	Project Details	Amount Requested
Concentrator Finisher Upgrades	Replace outdated magnetic separators (used to separate iron ore from waste materials) with larger separators equipped with stronger magnets for increased extraction of iron ore.	$5,000,000
Fine Screening Upgrade	Replace single-deck vibrating screens with multi-deck screens, producing lower silica content in the concentrate to be agglomerated and higher yields of iron recovery in the flotation process.	1,800,000
Machine Shop Upgrades	Redesign the machine shop to improve safety and efficiency; replace equipment that is outdated, in poor condition, or in need of technological upgrading.	324,559
Vacuum Disc Filter Refurbishments	Replace obsolete disc filters with energy-efficient units that will be compatible with a new air system being installed.	296,160
Tailings Pump Upgrades	Convert six pumps (used to pump fine tailings slurry to a tailings basin) to a larger, higher efficiency size with greater durability of bearings and safer access to a pump seal.	210,684

SOURCE: Office of the Legislative Auditor, review of mining company proposals for funding from the Taconite Economic Development Fund.

shovels.[30] A 2007 law instituted the ban.[31] However, from the fund's beginning in 1992 through 2006, purchases of mobile equipment were allowed. Prior to the ban, statutes had imposed sanctions against removing such equipment from the Taconite Tax Relief Area when purchased with money from the Taconite Economic Development Fund.[32]

Because state law requires companies to review their proposed projects jointly with their nonsalaried production and maintenance employees, we interviewed representatives of United Steelworkers (USW) District 11 and mining companies that produce taconite in Minnesota. The three union locals interviewed were: USW Local 1938 (workers at the MinnTac mine), USW Local 6115 (ArcelorMittal Minorca mine), and Local 6860 (United Taconite mine). The three companies interviewed were: U.S. Steel Corporation, ArcelorMittal, and Cliffs Natural Resources, Inc.

Representatives of mining companies and mining employees said revenue from the Taconite Economic Development Fund allows useful reinvestments, although they suggested changes.

[30] *Minnesota Statutes* 2014, 298.227 (a), allows purchasing "stationary" mining equipment.

[31] *Laws of Minnesota* 2007, chapter 135, art. 5, sec. 1.

[32] *Minnesota Statutes* 2006, 298.227 (a), required companies that removed mobile equipment to repay a portion of the funds used for the purchase. The portion to repay diminished depending on the number of years the equipment had been kept in the Taconite Tax Relief Area before being removed. To date, no company has removed equipment that required repayment.

Investments made with the Taconite Economic Development Fund have been beneficial, according to representatives of steelworkers and mining companies we interviewed, despite misgivings they also expressed. Union officials told us that money from the fund paid for changes that improved the taconite plant, added to plant longevity, and was to the benefit of union members. They believe the funding is important and do not want to see it eliminated. Further, they generally felt they had adequate input into the process of determining projects to be funded. At the same time, one union's representatives stated that the process could be improved. They reported that the company was not consistent in adequately involving them in determining project proposals, and they had little recourse when that happened.

All of the mining company representatives we interviewed said the funding was useful to make plant reinvestments that otherwise might not be made. For instance, one said the funding is used as an incentive to convince the parent company to direct investments toward Minnesota facilities.

On the other hand, representatives of two companies emphasized they would rather see the production tax reduced and let taconite companies keep those dollars to make their own reinvestments in facilities. In addition, companies identified improvements they thought are needed. For instance, all companies we interviewed said the decision to award funds should be more reliable instead of discretionary from one year to the next. We discuss this point in more depth in the next section. As another example, one company's officials stated that discontinuing the distribution to producers when overall production dips below 30 million tons is counterproductive. They said low production years are the times when mining companies are "most starved" for capital and most in need of reinvestment.

Representatives of employees and mining companies thought allowing expenditures on mobile equipment could be advantageous. Some of the employee representatives reported that the restriction against spending the funds on mobile equipment precluded companies from proposing certain projects that could benefit union members. For example, one proposal had been to purchase a "low boy" trailer, which the union believed would allow union workers to do work that otherwise is contracted out. Company representatives criticized the prohibition against mobile equipment as a hindrance because such equipment could be the biggest need at a facility; they feel their plant managers are in the best position to propose appropriate reinvestments. One company representative called the notion of a company removing an ore haulage truck with a 240-ton payload capacity by driving it to another state "absurd."

Current Minnesota law allows the Iron Range Resources and Rehabilitation Board to deposit money from the Taconite Economic Development Fund elsewhere for uses other than mining company proposals, leaving the fund's purpose not fully clear.

When begun in 1992, the Taconite Economic Development Fund received $0.104 per ton, which was held by IRRRB but intended for mining companies' use following IRRRB approval. Eligible uses by producers included (1) acquiring mining equipment and facilities and (2) research and development

on mining and production technology. This changed with 2007 and 2009 legislative amendments. Under the amended language, if IRRRB does not approve companies' proposals, the board must deposit the money instead into the Taconite Environmental Protection Fund for its authorized uses.[33] Statutes establishing the Taconite Economic Development Fund do not make clear, however, that the fund has multiple purposes. They focus instead on use of the funds by iron ore producers.[34]

In 2011, IRRRB voted to use slightly more than half of the money for mining companies' proposals and instead use the remaining half for expenditures from the Taconite Environmental Protection Fund to fund communities' public works projects.[35] This was a legal use of the funding. However, mining companies we interviewed said they now view the fund as an unreliable funding source. They had come to count on the funding as part of their planning for major capital investments, but they said the funding has become uncertain, and some said this makes capital planning difficult. Exhibit 3.9 shows the amounts over time that IRRRB approved for companies' proposals.

Further, mining companies described concerns about the political nature of the approval process for the Taconite Economic Development Fund. They emphasized that when they follow all the steps of the application process as prescribed, they expect the funding will be made available in the amounts projected; they believe they can no longer count on this.

RECOMMENDATION

The Legislature should remove the prohibition against using Taconite Economic Development Fund monies for mobile mining equipment. Further, it should clarify the intended uses of the fund.

We believe the Taconite Economic Development Fund has value in leveraging mining company reinvestments in plant and equipment, which is one of the purposes of the law. But we think there is room for improvement. Removing the prohibition against funding nonstationary mining equipment is a start. Doing so would require changing *Minnesota Statutes*, 298.227 (a), which describes the fund.

[33] *Minnesota Laws* 2009, chapter 78, art. 7, sec. 16; and *Minnesota Laws* 2007, chapter 135, art. 5, sec. 1.

[34] *Minnesota Statutes* 2014, 298.227 (a). Paragraphs (b) and (c) in this section of law specify alternative uses for allocations to the fund, but they were for uses limited to 2008 only.

[35] Specifically, the approved vote was to use $0.154 per ton for mining company projects and $0.147 per ton for expenditures through the Taconite Environmental Protection Fund.

Exhibit 3.9: Amounts Approved by Iron Range Resources and Rehabilitation Board from Taconite Economic Development Fund for Mining Company Projects, 2008-2014

	2008 (x1000)	2009 (x1000)	2010[a] (x1000)	2011[b] (x1000)	2012 (x1000)	2013 (x1000)	2014 (x1000)
ArcelorMittal	$ 575	$ 846	$ 0	$ 457	$ 775	$ 831	$ 818
Hibbing Taconite	1,577	2,353	0	793	1,505	2,113	2,275
Magnetation Inc.	-	-	-	12	5	0	0
Magnetation LLC	-	-	-	-	43	562	709
Mesabi Nugget	-	-	-	-	-	40	54
Mining Resources	-	-	-	-	-	-	88
Northshore Mining	1,158	1,611	83	748	1,453	1,667	1,601
U.S. Steel, Keewatin Taconite	1,231	1,726	57	623	1,142	1,539	1,512
U.S. Steel, Minntac	2,710	4,057	9	1,717	3,295	3,860	3,969
United Taconite	1,252	1,620	105	848	1,629	1,619	1,595
Total	$8,503	$12,213	$254	$5,199	$9,845	$12,231	$12,622

NOTES: Columns may not sum to totals due to rounding. Years noted are when IRRRB approved funds; the amount of production tax revenue was based on taconite production in the prior year.

[a] By law, no distribution of the statutory cents per ton is made into the Taconite Economic Development Fund when industrywide production falls below 30 million tons; this occurred in 2010 based on taconite production of 17 million tons in 2009. However, an amount up to $700,000 is still distributed into the fund from a tax on pellet chips and fines of a certain dimension.

[b] For amounts in 2011, IRRRB distributed $5.2 million for mining company proposals and transferred $4.5 million into the Taconite Environmental Protection Fund; it allocated the transferred money for local government public works and other projects.

SOURCES: Office of the Legislative Auditor, analysis of Iron Range Resources and Rehabilitation Board data; and Minnesota Department of Revenue, *Mining Tax Guide* (St. Paul, 2011 through 2014).

As long as the Legislature continues the state policy of investing production tax revenues into mining facilities, it should allow companies greater discretion in proposing projects that reflect the highest priorities at the time. Both union officials and company management see advantages to purchasing mobile equipment. Requirements for joint review of proposals by employee representatives and management help ensure that projects will be beneficial from both perspectives. If concern persists over the removal of nonstationary equipment, it would be useful to consult with employees and company officials regarding limiting the prohibition to practical items. For example, the prohibition could be limited to expenditures for small equipment that is readily transportable, such as GPS units.

A second improvement would clarify and make more explicit the Legislature's intent to use the Taconite Economic Development Fund for projects other than mining company plant and stationary equipment. The 2007 and 2009 Legislatures took the initial step by requiring funds to be deposited in the Taconite Environmental Protection Fund when IRRRB disapproves mining company proposals. For the sake of clarity, a second step is needed.

How the Taconite Economic Development Fund should be used is a policy choice for the Legislature to make. If the Legislature chooses to continue the

policy of an expanded use of the Taconite Economic Development Fund, it should state this clearly. This would require amending *Minnesota Statutes*, 298.227 (a), to expand the purposes for which the IRRRB may release funds to include the functions paid for by the Taconite Environmental Protection Fund. Doing so would make clear that the Taconite Economic Development Fund is a multipurpose fund, not one reserved for mining companies' projects.

On the other hand, the Legislature may determine that the allocations going into the Taconite Economic Development Fund should be used as incentives for companies' reinvestments, more along the lines of the law's original intent. If so, it should amend the statute by deleting the provision for depositing disapproved funds into the Taconite Environmental Protection Fund.

A 2001 change in law deleted a requirement that employee representatives approve company proposals.

When the Taconite Economic Development Fund was established in 1992, proposals submitted to IRRRB for funding had to first be approved by a joint committee of company management staff and nonsalaried production and maintenance employees. In a 2001 court case, the U.S. District Court ruled in favor of a mining company that challenged this provision of law, saying it gave the union veto power over allocation of tax funds to the companies. Consequently, the 2001 Legislature modified the language to require only a joint committee *review* (not approval) of companies' proposals.

In 2014, the then-commissioner of IRRRB told us that although the law does not require workers' approval of company proposals, he would not present a proposal to the board that did not have approval from the company's employee review committee. In effect, such approval means representatives of nonsalaried employees have signed off on the company's proposed projects. To the extent that is not the case, workers' representatives have an option to make their case to IRRRB. We learned from a union local that union members lobbied IRRRB one year when they believed the company's proposed projects failed to meet the letter of the law.

REGIONAL DISTRIBUTION OF REVENUES

Property tax revenue is generally spent by the same local taxing jurisdiction that set the tax levy. For production taxes, by contrast, the tax rate is set by the state while revenues are distributed to local governments throughout the Taconite Assistance Area and Taconite Tax Relief Area, as described in Chapter 2. In this section, we analyze how the state distributes production tax revenues. We examine how heavily municipalities rely on production tax revenue. We also briefly describe the Iron Range "fiscal disparities" program, which affects local government finances on a regionwide basis.

Mineral taxes come from mining facilities located within St. Louis, Itasca, and Lake counties, but production tax revenues are distributed throughout the Iron Range.

Opinion is divided among local officials we interviewed over whether the current distribution of production tax revenues is appropriate. Those we interviewed tended to fall into three groups. One group felt that because the production tax is imposed on mining companies in lieu of property taxes, more of its revenues should stay primarily with the communities that are home to mining plants or pits. One local official said it should be made more clear how areas without mining facilities receive their amounts of production tax.

The second group believed that the production tax revenues should benefit the Iron Range as a whole, not only where the mining facilities are currently located. Some stressed the need to diversify and improve the economic development of all of northeastern Minnesota. They said that the production tax should be used to help redevelop communities that were home to mining facilities in the past.

The third group expressed little or no opinion on changing the current distribution. Many said the current distribution seems fair. Some said they lacked sufficient knowledge of the system to give informed opinions. Some believed questions about what is an appropriate distribution are best left in the hands of elected legislators.

During our interviews, we also heard differing perspectives on the share of production tax revenue that is distributed to IRRRB. For instance, some believed that the share IRRRB receives is too high; some question how IRRRB distributes its funds, saying funding decisions appear too political instead of being based on communities' actual economic development needs.

Production tax revenues were distributed to 181 cities and townships in 2014, even though plants or mines are located in just 22 of the municipalities, as Exhibit 3.10 shows. All 15 school districts in the Taconite Assistance Area received production tax revenues but just 9 districts had plants or mines. Among counties receiving revenue for county-specific functions, St. Louis, Itasca, and Lake counties had mines or plants, with most of them in St. Louis County. However, Cook County also received a distribution of production tax revenues. Exhibit 3.11 shows the distribution breakdown for school districts and counties.

Local jurisdictions that contain plants and mines receive the bulk of production tax revenues, but this is not true when measured on a per capita basis.

Large proportions of revenues from the production tax go to jurisdictions where mining pits and taconite processing facilities are located. The 22 municipalities where plants or mines are located received 65 percent of the portion of the production tax distributed to cities and townships in 2014. Of the 15 school districts in the Taconite Assistance Area, the 9 with plants or mines received 77 percent of revenues distributed to school districts. Among counties, the three with plants or mines received about 98 percent of the production tax revenues distributed for county functions.

At the same time, when analyzed on a per capita basis, the distribution is not aligned as strongly with the location of taconite plants and mines. Among the

Exhibit 3.10: Production Tax Distributed to Municipalities, 2014

County/City	Municipality: Distribution to Municipality	Municipality: % of Total to Municipalities
With Plant or Mine		
Itasca		
Keewatin	$ 241,349	1.62%
Nashwauk	203,369	1.36
Nashwauk Township	214,491	1.44
Taconite	77,349	0.52
Trout Lake Township	29,943	0.20
Lake		
Beaver Bay	2,733	0.02
Silver Bay	502,494	3.37
St. Louis		
Babbitt	708,408	4.75
Biwabik	127,806	0.86
Biwabik Township	144,333	0.97
Eveleth	670,681	4.50
Fayal Township	198,842	1.33
Gilbert	286,192	1.92
Great Scott Township	111,946	0.75
Hibbing	2,678,307	17.96
Kinney	88,090	0.59
Leonidas	15,598	0.11
McDavitt Township	148,662	1.00
Mountain Iron	1,218,150	8.17
Virginia	1,469,302	9.85
White Township	420,004	2.82
Wuori Township	135,778	0.91
Without Plant or Mine		
Multiple Counties		
159 Municipalities without Plant or Mine	5,174,463	34.70
Subtotal 22 with Plant or Mine	9,737,287	65.30
Subtotal 159 without Plant or Mine	5,174,463	34.70
Total	$14,911,750	100.00%

SOURCE: Office of the Legislative Auditor, analysis of Minnesota Department of Revenue data.

top 20 cities and townships receiving production tax per capita in 2014, 6 (30 percent) did not have a plant or mine. Among counties, St. Louis County contains the most mines and plants, but it received $59 per capita—nearly the same as Cook County (at $58 per capita), which has no plants or mines.

The 2014 Legislature's creation of a new account for schools will reduce funding distributed to other accounts and affect the regional distribution of production tax revenues.

Starting in 2015, the new School Consolidation and Cooperatively Operated School Account will receive $0.10 per taxable ton of production tax revenues. It

Exhibit 3.11: Production Tax Distributed to School Districts and Counties, 2014

County/School District	Plant or Mine[a]	School Districts: Distribution to School District	School Districts: % of Total to School Districts	Counties: Distribution to County[b]	Counties: % of Total to Counties
Aitkin				$ 0	0.0%
1-Aitkin		$ 296,500	1.6%		
Cook				301,891	2.1
166-Cook County		405,828	2.2		
Crow Wing				0	0.0
182-Crosby-Ironton		484,422	2.6		
Itasca	√			1,352,751	9.3
316-Greenway	√	1,376,352	7.3		
318-Grand Rapids		1,427,289	7.6		
319-Nashwauk-Keewatin	√	710,021	3.8		
Lake	√			1,117,670	7.8
381-Lake Superior	√	1,135,165	6.0		
St. Louis	√			11,730,268	80.9
695-Chisholm		1,403,486	7.5		
696-Ely		298,281	1.6		
701-Hibbing	√	3,260,290	17.4		
706-Virginia	√	1,910,188	10.2		
712-Mountain Iron-Buhl	√	1,178,832	6.3		
2142-St. Louis County	√	1,559,396	8.3		
2154-Eveleth-Gilbert	√	1,882,616	10.0		
2711-Mesabi East	√	1,466,165	7.8		
Subtotal with Plant or Mine	√	14,479,025	77.0	14,200,689	97.9
Subtotal without Plant or Mine		4,315,806	23.0	301,891	2.1
Total		$18,794,831	100.0%	$14,502,580	100.0%

[a] A checkmark indicates the jurisdiction had a mine or processing plant located within it in 2013.

[b] Distribution is revenue for county functions only; it does not include production tax revenue a county receives simply to transfer to cities, townships, school districts, or other local taxing jurisdictions.

SOURCE: Office of the Legislative Auditor, analysis of Minnesota Department of Revenue data.

will also receive an amount from the occupation tax. The amount from the *occupation* tax will be equivalent to what would be generated by $0.06 per ton from the *production* tax. The amount equivalent to $0.06 per ton of production tax will be taken from the share of occupation tax revenues that are otherwise distributed to the state's General Fund. Because of the newness of the account, the allocation had not been made as of early 2015.

Around the same time that the Legislature established this account for cooperatively operated schools, it made four changes to allocations for six existing accounts. First, the 2014 Legislature decreased the allocation to the County account by $0.05 per ton. Second, it also reduced by $0.05 per ton the allocation to the Taconite Economic Development Fund.

Third, the 2014 Legislature removed the indexing of distributions to three accounts in 2015, 2016, and 2017: the Douglas J. Johnson Economic Protection Trust Fund, the IRRRB Indexed account, and the Township fund. In each case, the indexing is set to resume in 2018. Fourth, the Legislature removed indexing from distributions to the Taconite Property Tax Relief account in 2014 through 2017 and is set to resume in 2018. Removing indexing is significant because it lowers the amount going into an account so that only the cents per ton set in statute are allocated instead of adjusting the amount for inflation. For instance, the production tax generated revenue of $13.8 million in 2014 for the Taconite Property Tax Relief account, compared with $16.5 million in 2013 when the indexing still applied.

Legislative changes in 2014 will increase the amount of mineral tax revenues managed by the Iron Range Resources and Rehabilitation Board. In 2013, IRRRB received 41 percent of production tax revenues, more than any other set of recipients. Because IRRRB has authority starting in 2015 over the School Consolidation and Cooperatively Operated School Account, it will control nine accounts instead of the eight that had been under its management in 2014. This change, combined with the legislative changes to allocations described earlier, alters the regional distribution of production tax revenue. More revenue will be under IRRRB control.

Some local taxing jurisdictions on the Iron Range rely far more heavily than others on the production tax to pay for local services, but not all of them have mining facilities.

More than one in five Iron Range municipalities relied on production tax revenues for 20 percent or more of their local property-tax-related revenue sources in 2013.[36] Of 183 northeastern Minnesota communities, 15 relied on production tax revenues for *half* or more of their local property-tax-related revenue sources in 2013. Only 7 of those 15, however, had a processing plant or mining pit located there. The revenues include (1) proceeds from the production tax going directly to communities, (2) taconite homestead credits, and (3) IRRRB grants and loans funded through the production tax. Exhibit 3.12 shows communities with the highest reliance on production tax revenue.

Another 26 communities relied on production tax revenues in 2013 for between 20 and 49 percent of local revenue sources. Only 11 of these communities contained mining facilities.

On the other hand, 65 of 183 communities used production tax proceeds for relatively small portions—5 percent or less—of their local property-tax-related revenue sources. All of these are in counties other than St. Louis, which is the county where the bulk of mines and processing plants are located. One (Trout Lake Township in Itasca County) contained a mine.

[36] This analysis is of data from Minnesota Department of Revenue, *Iron Range Fiscal Disparities Study* (St. Paul, January 31, 2014), 41-47.

Exhibit 3.12: Iron Range Municipalities with Production Tax as High Share of Local Property-Tax-Related Revenue Sources, 2013

Municipality	County	Production Tax as Share of Local Revenues	Mine or Plant within Municipality
Eveleth	St. Louis	73.3%	√
Bigfork	Itasca	70.6	
Riverton	Crow Wing	70.0	
Buhl	St. Louis	68.0	
Keewatin	Itasca	65.7	√
Chisholm	St. Louis	64.7	
Two Harbors	Lake	59.0	
Calumet	Itasca	54.0	
Gilbert	St. Louis	54.0	√
Nashwauk	Itasca	51.0	√
Babbitt	St. Louis	50.5	√
Leonidas	St. Louis	50.0	√
Tower	St. Louis	50.0	
Aurora	St. Louis	49.5	
Virginia	St. Louis	49.5	√

NOTE: Included in the production tax share are: (1) proceeds from the production tax going directly to communities, (2) taconite homestead credits paid for with production taxes, and (3) Iron Range Resources and Rehabilitation Board grants and loans funded through the production tax.

SOURCE: Office of the Legislative Auditor, analysis of Minnesota Department of Revenue, *Iron Range Fiscal Disparities Study* (St. Paul, January 31, 2014), 41-47.

The Iron Range Fiscal Disparities Program is another factor that affects the regionwide distribution of local government revenue.

Each year since the mid-1990s, the "fiscal disparities" program has shared across the Taconite Assistance Area 40 percent of the annual growth in commercial, industrial, and utility tax base. This increment of tax base is pooled and has a uniform, areawide tax rate applied to it. Each municipality receives a share of the pooled tax base and applies the same property tax rate to its share as to its own property owners.

As a result, communities with low-value tax bases prior to the redistribution receive somewhat more taxable value than they would otherwise have; those with relatively high-value tax bases receive somewhat less. Sharing tax base in this way does not directly affect mining companies because they are not subject to the property tax on properties with active mining. But the program does affect property taxes paid by other (nonmining) commercial, industrial, and utility property.

The shared pool of tax base has grown significantly in the past decade due to relatively strong growth in commercial, industrial, and utility property values on the Iron Range. About $8 million of tax base was shared as of 2014, a

600 percent increase from 2001. St. Louis County is the largest net recipient of the pooled tax base. Itasca County is the largest net contributor.

Some communities rely relatively heavily on the redistributed tax base as a source of local revenues. In 2013, 18 of 183 communities relied on the revenues from the fiscal disparities pool for at least 10 percent of their local revenues. Ten of those 18 are located in St. Louis County (the largest net recipient of tax base).

In our interviews, local government officials spoke about effects of the fiscal disparities program in combination with the distribution of production tax revenues. Some believe the fiscal disparities program affects their overall funding situation. For example, officials in Cohasset (the largest net contributor to the regional tax base pool in 2014) believe the payments made into the fiscal disparities program by commercial-industrial property are much more significant than what the city receives in production tax revenues.

At the same time, St. Louis County officials described benefits of the fiscal disparities program. They justified the redistributed tax base in light of production tax revenue that is distributed regionally instead of benefiting only local jurisdictions where mining facilities are located. They also point out that growth in their commercial, industrial, and utility property is shared in the regionwide pool.

LACK OF CLARITY AND UNDERSTANDING

Mineral taxation in Minnesota comprises multiple taxes, numerous recipients of tax revenue, and multipart formulas for calculating tax distributions. In speaking with taxpayers and recipients and conducting other research, the nature of Minnesota's mineral taxation system emerged.

The mineral tax system can be complex, difficult to understand, and can lack transparency.

Complexity is not unique to mineral taxation, of course. Many tax types have complex provisions that have built up over time. We discuss here the complexity of mineral taxation to acknowledge the difficulty that users of the system face.

The next section describes local government officials' perspectives on the understandability of mineral taxation, as relayed to us during our site visits and interviews with representatives of 13 local taxing jurisdictions. It also presents evidence of the tax system's complexity as shown in outdated and confusing legal provisions, complicated formulas used to distribute production tax proceeds, and errors we identified in statutes and other documents. Finally, it addresses the importance of accuracy in calculations the Department of Revenue makes for distributing the production tax.

Local Jurisdictions' Perceptions

Most local government officials we interviewed said the production tax was not transparent and spoke of the complexity of the mining tax system. Many of the local officials also said the system was difficult for them to fully understand. Representatives of three jurisdictions specifically said they doubt that the general public understands the system. They added that local officials have the benefit of the Department of Revenue's *Mining Tax Guides* and answers from the department's production tax specialist to their queries. In two jurisdictions, officials said other factors, such as the "fiscal disparities" program (discussed earlier in this chapter) and cuts in local government aid, have large impacts on local government funding and can affect transparency.

The 3 school districts we interviewed are among 14 school districts in the Taconite Assistance Area that contract with the Arrowhead Regional Computing Consortium. Representatives of these districts said they rely on the consortium for its expertise in understanding and explaining mining taxation and its effects on education funding. They told us they do not have the capacity on their own to obtain the necessary data and check calculations related to their share of production tax.

Representatives of many local governments we interviewed told us that the taconite homestead credits are very important as property tax relief. But some said few property owners understand the relief is funded with production tax revenue (that comes through the Taconite Property Tax Relief account). Many local officials told us that there is confusion about the taconite homestead credit. Some said taxpayers do not realize the significance of the property tax relief that production taxes provide.

Outdated Statutory References

Chapter 298 of *Minnesota Statutes* is the chapter on minerals taxes, and it contains numerous outdated references. This reduces the transparency of the law and makes sections of the chapter difficult for users to understand. In this evaluation, we did not search for all outdated legal provisions or tally them. We did, however, encounter many outdated references and present here a few examples.

One example of outdated references is the section of law that provides for the Taconite Environmental Protection Fund. Among other provisions, the section includes production tax amounts the 2009 Legislature decided should be allocated to a select set of local governments that year.[37] The distributions were made in 2009 only, but the language remains in statute.

A second example is of statutory provisions for the Producer Grant and Loan Fund managed by IRRRB. This section of law contains seven subdivisions describing how money in the fund should be distributed and used in various years. All of those sections are obsolete with the exception of one sentence that

[37] *Minnesota Statutes* 2014, 298.223, subd. 1 (6).

remains relevant. That sentence allocates money in the account in 2009 "and subsequent years" for projects funded through the Taconite Environmental Protection Fund.[38] The irrelevant language remains and clutters the statute.

A third example is outdated language related to the Taconite Economic Development Fund. Two paragraphs in this section of law describe requirements in place for distributions of funding from 2008.

Confusing Legal Provisions

Statutes pertaining to mineral taxation are not always straightforward. For instance, part of the distribution of production taxes to counties, municipalities, and school districts relies on Chapter 294 of statutes from 1976.[39] A section of this chapter, which covers the distribution of gross earning taxes on taconite railroad companies, still provides factors for calculating today's allocations—even though the section was repealed in 1987.[40]

Legal provisions spread through multiple chapters of law add to the tax system's complexity and make understanding it difficult. Numerous chapters of law pertain to the topic of mineral taxation. Chapter 298 is the main chapter on mineral taxation; but at least seven other chapters contain significant provisions on mineral taxation.

As one example, the Mineral Taxation chapter in *Minnesota Statutes* contains dozens of references to the "taconite assistance area." It does not, though, define the taconite assistance area. That definition is in a different chapter of law, one on the listing and assessment of taxes.[41] In a second example, the Mineral Taxation chapter establishes the Taconite Property Tax Relief account but does not describe how the tax relief is to be distributed; sections in a separate chapter do that.[42]

Multilayered Formulas

Calculating the annual distribution of production taxes involves many steps and is done by the Minnesota Department of Revenue. Among the 27 accounts receiving production tax, the calculations for distributing amounts to local governments have numerous components. For example, one account with distributions to cities and townships actually comes in part from distributions to school districts. If school districts receive certain production tax distributions that exceed their levy limits, they must reduce their levies by 95 percent of a calculated sum. That sum is the previous year's distributions to a school district

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[38] *Minnesota Statutes* 2014, 298.2961, subd. 4(e).

[39] *Minnesota Statutes* 2014, 298.28, subd. 11(b) and (d); and *Minnesota Statutes* 1976, 294.26.

[40] *Laws of Minnesota*, 1987, chapter 268, art. 9, sec. 43(a).

[41] *Minnesota Statutes* 2014, 273.1341, defines the Taconite Assistance Area.

[42] *Minnesota Statutes* 2014, 298.28, subd. 6, allocates a portion of production taxes to property tax relief. *Minnesota Statutes* 2014, 273.135 and 273.1391, describe homestead property tax relief in its two forms.

plus the amount the school district distributed to cities and towns that same year due to taconite reductions. Taconite reductions refer to reductions the state made in general education aid when the amount a school district received in production tax revenue was greater than the district's levy. Production tax revenue that exceeds levies after the 95 percent reduction is instead transferred the following year to cities and townships within the school district.

A second example is multiple calculations for the Taconite Referendum Fund. Revenues from this fund go to Taconite Tax Relief Area school districts with a levy referendum as of taxes paid in 2001. The calculation is made in two parts. For the first part, eligible school districts receive from the fund $175 for each pupil unit enrolled in the second previous year or the 1983-1984 school year, whichever is greater; this amount is reduced by the product of 1.8 percent times the school district's taxable net tax capacity in 2011. For the second part, the school district receives additional taconite aid equal to 22.5 percent of the amount obtained through a formula, as follows. The Department of Revenue first subtracts 1.8 percent of the school district's 2011 net tax capacity from the district's weighted average daily membership for fiscal year 2012. Then it multiplies the result by the sum of $415 plus the district's referendum revenue allowance for fiscal year 2013.

A third example is of distribution formulas that depend on statutes now repealed. Statutes on distributions to school districts reduce the $0.325 per ton going to districts by an amount computed using a 2008 subdivision—which was repealed in 2009.[43] Current law still refers to the 2008 subdivision and requires the calculation to be based on what would have been computed for the current year as if the 2008 subdivision still existed.

Addressing Complexity

It would be tempting but overly simplistic to recommend that the state reduce the complexity of Minnesota's system of mineral taxation. Structural changes could potentially create major shifts in the pattern of revenue distribution. Such shifts would have to be studied in-depth prior to making the changes, something that is beyond the scope of this evaluation. We present the following merely as examples of possible simplification steps. We are not advocating for or against them because we have not quantified their outcomes.

Consolidating the 27 accounts that receive production tax allocations is one possibility for simplification, but it would have consequences. Each account has an attendant formula governing allocation amounts. Deleting or changing those formulas would alter the balance of the allocation and could undermine the historical intent underlying the distribution.

Another option for reducing complexity is to alter legal requirements on how certain distributions are used. For instance, $0.04 per ton distributed to school districts is currently designated for maintenance of school buildings. The

[43] *Minnesota Statutes* 2014, 298.28, subd. 4 (a). The subdivision refers to *Minnesota Statutes* 2008, 126C.21, subd. 4, repealed in 2009.

Legislature could instead provide the revenue as part of a lump sum that school districts spend on whatever are the districts' highest priorities.

Errors

While conducting our evaluation, we discovered errors in written documents. One was in statute, and others were in Department of Revenue materials.

Statutes

Minnesota Statutes 2014, 298.018, subd. 1 (4), pertains to the distribution of net proceeds taxes to school districts. This section of law provides revenues to school districts if minerals are mined in the school district or if there is a qualifying municipality as defined in 273.134(b). This reference is incorrect because paragraph (b) defines the tax relief area—not qualifying municipalities. Instead, the statute's paragraph (a) defines a municipality.

RECOMMENDATION

The Legislature should ensure that outdated mineral taxation statutes are deleted and erroneous statutes corrected.

Removing extraneous statutory references is not a simple undertaking, but it would be a first step to improve understanding of mineral taxation. Outdated references add to the tax system's lack of transparency. Our recommendation would require a careful and thorough review of the Mineral Taxation chapter of *Minnesota Statutes*. If the Legislature agrees to such a review, the Office of the Revisor of Statutes is the logical place to authorize one.

Where existing errors are identified, they should be corrected. The error we discovered in *Minnesota Statutes* 2014, 298.018, subd. 1 (4), is relatively benign, and fixing it would be an easy technical correction. It is common for the Department of Revenue and other state agencies to support legislation containing technical corrections to statutes.

Department Materials

We also found several errors in some editions of the Department of Revenue's *Mining Tax Guides*. The guides are published annually and are the department's chief way of explaining what it calls the "complicated tax statutes" using nontechnical language, tables, and graphs. On its website, the department maintains PDF versions of the guides back through 2002; earlier versions are available only through libraries. We relied heavily on the department's guides while conducting this evaluation, and in doing so discovered erroneous numbers, which we had the department verify. Some of the errors are described here.

A few typographical errors occurred in the *Mining Tax Guide* for 2013. One of that guide's tables shows production tax distributions over time, but not all of the entries were correctly updated. For instance, the amount for "levy replacement

money to cities/townships" in year 2010 was listed as "(1,742,074)" when it should have been "0." Two other entries, one in 2009 and the second in 2008, also had not been accurately updated in that table. A similar error occurred in the 2008 *Mining Tax Guide* where the entry for a distribution to Balkan Township was listed under the 2003 year, although it should have been under 2002. Likewise, in the 2008 *Mining Tax Guide*, the 2004 amount for the Taconite Economic Development Fund should have been "$11,229,214" but was reported as "$11,684,231."

We identified some errors that were repeated in multiple editions of the *Mining Tax Guides.* As an example, regarding data on occupation taxes paid by mining companies, the 2005 *Mining Tax Guide* reported that U.S. Steel-Keetac paid $1 million in 2004; the correct amount was $147,000. Although the error was corrected in the 2006 through 2011 editions, the 2012 *Mining Tax Guide* reported incorrect amounts in columns for both the 2004 and 2005 years; the 2013 *Mining Tax Guide* repeated the erroneous amount for 2005.

RECOMMENDATION

The Department of Revenue should maintain accurate historical information on mineral taxation that is broadly accessible to users and corrected in real time as errors are found.

Accuracy is important in the Department of Revenue's *Mining Tax Guides,* as they are the primary written materials on mineral taxation outside of *Minnesota Statutes*. Because the guides are updated annually, they also provide an important historical reference to the tax system and its changes over the years.

Maintaining an accurate guide and history of past guides can be done in various ways. One possibility is a proposal that the Department of Revenue is developing for implementation later in 2015. The department's proposal is to create on its website a single source of updated historical data from its *Mining Tax Guides*. The department would employ a service that allows users to be notified whenever the website is changed. Future updates to the site or corrections would automatically generate an e-mail to interested users notifying them of the change. Such an arrangement would allow readers access to accurate, historical information at any time. Should this proposal not happen, a second option would be to have the department correct the PDF copy of the *Mining Tax Guide* on its website whenever errors are discovered. It would have to maintain on the site a notice of the corrections so that users who have retained past editions can correct their copies.

Calculation Accuracy

Calculating the production tax is complex. Responsibility for making correct calculations lies with the Department of Revenue.

Local jurisdictions that receive production tax revenues rely heavily on the Department of Revenue to calculate the correct amounts.

Production tax recipients we interviewed told us they do not try to calculate how much of the revenue is due to them. Practically speaking, none of them could make such determinations, for the following reasons. First, the distribution is complex and is calculated using multilayered formulas in Department of Revenue spreadsheets. Second, the distribution relies on data on taconite production tonnage to which recipients do not have access. Representatives of local governments said they rely on the amounts calculated by the department; they are unable to determine on their own whether the production tax revenues they receive are accurate.

The importance of having adequately trained staff in place to complete the duties related to the production tax calculations cannot be overstated, based on our experience during this evaluation. The Department of Revenue maintains an office in Eveleth. The production tax specialist in that office is responsible for determining annually how much each mining company owes as well as calculating how much is to be allocated to each account and distributed to recipients, among other duties. This one position is key to both making the calculations and helping recipients understand them. The department does not have a second staff person in place to assume the duties for this one position, although it provided cross training among employees in the Eveleth office. The department reported that it had also initiated additional training on the subject matter with other employees. Such efforts will remain critical for the department in preparation for the current employee's retirement or absence for other reasons.

Department of Revenue calculations for allocating production tax revenues contained two relatively minor errors.

As part of this evaluation, we tested the Department of Revenue's calculations for allocations in 2014. We examined calculations made for taconite produced in 2013, which corresponds to taxes paid in 2014. To conduct the test, we first charted all of the 2013 statutory provisions relating to distributions of the production tax. We then verified major data points; we checked tons of taconite produced by each mining company required to pay taxes for the prior three years; this allowed us to calculate the three-year average tonnage used in setting tax amounts.[44] Using descriptions in statute, we calculated what each company owed in production taxes for 2014. We also calculated production tax allocations to each account. Finally, we checked our results against those of the Department of Revenue. Throughout the process, and especially when there were differences, we consulted with the department's production tax specialist.

In our test, we found that the department had correctly calculated allocations to all accounts for 2014, but two relatively minor errors had affected allocations in the mid-1990s. Both errors used incorrect guaranteed amounts from the base years used to distribute funding to the Range Association of Municipalities and Schools and a school district fund. The errors resulted in an annual loss of $420 to the Range Association of Municipalities and Schools from 1996 to 1999; they produced no loss to school districts.

[44] As described earlier, the production tax is levied on a three-year average of taconite production and on only current year production of other iron-bearing material.

We asked the department's production tax specialist (the employee responsible for calculating production tax distributions) how he verifies his data. He receives monthly reports from the mining companies with data on taconite production. At the end of a production year, he also receives an annual report on tonnage. He said he compares the monthly tonnage reports to the annual reports, and other department staff in the Eveleth office double-check the numbers.

Beyond that, the production tax specialist also sends notices to certain recipients with the amounts of revenue they can expect. Those receiving such notices are the counties, IRRRB, cities and towns receiving Taconite Municipal Aid, the Department of Education, and the Arrowhead Regional Computing Consortium (as well as anyone requesting a copy). He said recipients can use such notifications to check whether they have received the correct amount. Less than half of the local governments we interviewed told us they make this cross check; two mentioned it would be useful to receive an explanation of the calculation at the same time the check arrives. School districts we interviewed said they rely on the Arrowhead Regional Computing Consortium to track amounts of the production tax on their behalf.

List of Recommendations

- The Legislature should review whether the limited number of accounts receiving production taxes through either guaranteed allocations or allocations tied to inflation are accomplishing intended purposes. (p. 41)

- The Legislature should take steps to make annual allocations of production taxes more predictable for local taxing jurisdictions. (p. 42)

- The Legislature should establish a process to improve the use of production tax for one-time legislative grants to local jurisdictions. (p. 84)

- The Legislature should specify criteria in law for use of surplus funds in the Taconite Property Tax Relief account. (p. 87)

- The Legislature should remove the prohibition against using Taconite Economic Development Fund monies for certain mobile mining equipment. Further, it should clarify the intended uses of the fund. (p. 90)

- The Legislature should ensure that outdated mineral taxation statutes are deleted and erroneous statutes corrected. (p. 102)

- The Department of Revenue should maintain accurate historical information on mineral taxation that is broadly accessible to users and corrected in real time as errors are found. (p. 103)

Appendix A

In this Appendix, we provide three tables with series of data over time. Exhibit A.1 lists production tax rates and shows how the statutory rate differs from the actual rate that increases with inflation. Exhibit A.2 shows tons of taconite produced and taxable tons. Exhibit A.3 displays total production taxes allocated to accounts in 10-year increments starting in 1975 through the present.

Exhibit A.1: Production Tax Rate per Ton, 1941-2014

Taconite Production Year	Statutory Rate	Actual Rate[a]
1941-68	$0.05	$0.055
1969-70	0.115	0.12
1971	0.155	0.164
1972	0.185	0.203
1973	0.205	0.243
1974	0.205	0.297
1975	0.605	0.749
1976	0.605	0.765
1977	1.25	1.295
1978	1.25	1.399
1979	1.25	1.598
1980	1.25	1.733
1981	1.25	1.916
1982	1.25	2.078
1983	1.25	2.047
1984	1.25	2.107
1985	1.25	2.048
1986-88	1.90	1.90
1989	1.90	1.975
1990	1.975	1.975
1991	1.975	2.054
1992-95	2.054	2.054
1996	2.054	2.094
1997	2.054	2.141
1998-99	2.141	2.141
2000	2.141	2.173
2001-03	2.103	2.103
2004-05	2.103	2.137
2006	2.103	2.203
2007	2.103	2.258
2008	2.103	2.316
2009	2.103	2.364
2010	2.103	2.38
2011	2.103	2.412
2012	2.103	2.465
2013	2.56	2.56
2014	2.56	2.597

NOTES: The Legislature enacted the production tax in 1941. Rows with combined years indicate the statutory and actual tax rates were the same for all years listed.

[a] The actual rate indicates the actual production tax rate used to calculate annual tax amounts companies owe. To calculate the actual rate, the statutory rate has been increased based on an iron surcharge (from 1941 through 1985) or an inflation factor (since 1971). Starting in 1986, the inflation factor has been the implicit price deflator for the gross domestic product prepared by the U.S. Bureau of Economic Analysis.

SOURCE: Office of the Legislative Auditor, analysis of Minnesota Department of Revenue, *Mining Tax Guide* (Saint Paul, 2014), 24.

Exhibit A.2: Tons of Taconite Produced and Taxable Tonnage, 1977-2013

Taconite Production Year	Production Tons (in 1,000's)	Taxable Tons (in 1,000's)
1977	26,372	37,759
1978	49,545	49,614
1979	55,333	55,373
1980	43,060	50,296
1981	49,369	51,799
1982	23,445	38,624
1983	25,173	33,302
1984	35,689	35,689
1985	33,265	34,477
1986	25,451	31,468
1987	32,043	29,039
1988	39,485	32,326
1989	39,375	36,968
1990	42,522	40,461
1991	39,922	40,606
1992	38,850	40,431
1993	39,850	39,541
1994	41,677	40,126
1995	45,001	42,176
1996	43,874	43,517
1997	44,816	44,563
1998	44,324	44,338
1999	41,293	43,468
2000	37,785	36,711
2001	31,628	34,638
2002	37,512	35,575
2003	34,349	31,302
2004	39,411	37,091
2005	39,535	36,755
2006	38,948	38,335
2007	37,986	37,929
2008	39,168	38,701
2009	17,079	31,411
2010	35,049	30,438
2011	38,968	30,384
2012	39,681	38,310
2013	38,481	39,608

NOTES: 1977 was the first time the production tax rate was applied against taxable tons, which at the time was the higher of either the current year's production or the average of production for the current year and the prior two years. The taxable tons in 1984 included only the taconite produced that year. In 1985, taxable tons were calculated as the average of production in 1984 and 1985. Since 1986, the three-year average of production was used consistently on taconite. Since 2011, the production tax has also been levied on "other iron-bearing material," which is taxed on only current year production.

SOURCE: Office of the Legislative Auditor, analysis of Minnesota Department of Revenue, *Mining Tax Guide* (Saint Paul, 2011 and 2014).

Exhibit A.3: Production Tax Allocations, 10-Year Increments, 1975-2014

Account	1975-1984	1985-1994	1995-2004	2005-2014	Total, 1975-2014
710 School Bond Payment	$ 1,312,324	$ 5,239,021	$ 859,223	-	$ 7,410,567
Balkan Township	-	-	142,512	-	142,512
Biomass Energy Project Loan	-	-	-	$ 4,290,349	4,290,349
Chisholm-Hibbing Industrial Park	-	-	3,419,547	-	3,419,547
City and Township Account	36,645,242	26,376,568	29,291,847	21,785,403	114,099,060
County Fund	230,548,424	209,039,364	156,471,175	103,886,970	699,945,933
County Road and Bridge Fund	57,685,637	54,724,716	41,499,963	38,464,333	192,374,649
Department of Revenue	820,365	-	-	-	820,365
Douglas J. Johnson Economic Protection Trust Fund[a]	101,331,694	65,275,152	65,679,073	36,725,487	269,011,406
Filtration Fund	11,263,453	-	-	-	11,263,453
Hockey Hall of Fame	-	-	-	546,961	546,961
Hoyt Lakes Industrial Park	-	-	3,555,204	-	3,555,204
Iron Range Higher Education Account	-	-	-	13,007,693	13,007,693
IRRRB Account	20,840,759	-	-	-	20,840,759
IRRRB Educational Revenue Bonds	-	-	-	14,782,720	14,782,720
IRRRB Fixed Account	18,635,460	27,341,575	19,990,404	13,834,430	79,801,869
IRRRB Indexed Account	28,353,837	47,012,941	45,738,718	35,462,702	156,568,198
Levy Replacement from School Districts to Municipalities[b]	-	-	-	(4,396,595)	(4,396,595)
Levy Replacement to Municipalities from School Districts[b]	-	-	-	4,396,595	4,396,595
Mining Effects Account	-	-	11,735,306	18,736,803	30,472,109
Producer Grant and Loan Fund	-	-	-	33,789,088	33,789,088
Producer Grants	-	-	17,915,079	-	17,915,079
Public Works and Local Economic Development Fund	-	-	-	21,873,505	21,873,505
Range Association of Municipalities and Schools	1,636,379	2,102,191	1,678,403	1,359,474	6,776,448
Renewable Energy Initiative	-	-	-	6,647,585	6,647,585
School Bond Payments	-	20,448,274	63,744,889	44,002,639	128,195,801
School Building Maintenance Fund	-	-	-	8,651,938	8,651,938
School District Fund	188,181,925	202,773,560	127,035,473	71,763,341	589,754,298
School District-Regular Account	198,438,338	52,935,219	32,758,201	16,409,656	300,541,414
Special City/Township Fund[c]	-	-	-	628,147	628,147
State[d]	12,727,802	1,426,570	611,921	-	14,766,293
Taconite Economic Development Fund	-	20,365,445	126,494,766	111,177,458	258,037,669
Taconite Environmental Protection Fund	241,296,803	226,066,890	164,458,370	115,644,168	747,466,230
Taconite Levy Shortfall Payment	-	-	-	1,385,748	1,385,748
Taconite Municipal Aid Account	162,685,194	131,340,121	104,930,780	67,963,228	466,919,324
Taconite Property Tax Relief Account	389,164,636	209,661,777	208,722,179	126,096,071	933,644,664
Taconite Railroad Account	47,029,035	69,000,061	45,444,881	27,419,392	188,893,369
Taconite Referendum Fund	33,384,320	97,197,810	76,654,739	42,115,459	249,352,328
Township Fund	-	-	-	6,807,580	6,807,580
Transfer from Schools to Cities	-	-	425,979	447,642	873,621
Total	$1,781,981,627	$1,468,327,254	$1,349,258,632	$1,005,705,970	$5,605,273,483

NOTES: 1975 is the first year for which data were available. Revenue is in 2014 inflation-adjusted dollars.

[a] Prior to 2002, this fund was called the Northeast Minnesota Economic Protection Trust Fund.

[b] If the combined total of production taxes from the School District Fund, School District-Regular account, and Taconite Railroad account exceeds a school district's levy replacement amount, the excess is transferred to cities and townships within the school district.

[c] Prior to 2009, the Special City/Township amount was included in the Taconite Municipal Aid amount.

[d] The state General Fund formerly received an allocation of production taxes; in 1978 and later years, the "state" allocation went to the Department of Revenue. Allocations to the state were discontinued after taxes paid in 1999.

SOURCES: Office of the Legislative Auditor, analysis of data in Minnesota Department of Revenue, *Mining Tax Guides*, published in 1978 (p. 15-17), 1982 (p. 15), 1986 (p. 14), 1991 (p. 15), 1997 (p. 18), 2002 (p. 16), 2007 (p. 16), and 2013 (p. 16); and U.S. Bureau of Economic Analysis, *Table 1.1.4 Price Indexes for Gross Domestic Product*, revised February 27, 2015.

MINNESOTA · REVENUE

James R. Nobles
Legislative Auditor
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St. Paul, Minnesota 55155-1603

Dear Mr. Nobles:

Thank you for your program evaluation of Minnesota's mineral taxation laws. Thank you, also, for the rigor of the evaluation and the professionalism and thoroughness of your evaluation team. We welcome your review and regard it as part of an ongoing process to improve Minnesota's mineral taxation laws.

We first published a Mining Tax Guide in 1978 and have been publishing a guide annually since 1982. In these guides, we strive to simplify complex tax statutes using language that is easy to understand. We provide our customers with non-technical narratives, tables, graphs, and flowcharts. We also provide detailed information on annual production tonnages and taxes, including data on Production Tax distributions that we calculate according to the law. We currently calculate amounts used in making more than 480 distributions annually. Historically, the Mining Tax Guide was available in a printed format only. In more recent years, a copy of the printed version has also been published online at www.revenue.state.mn.us.

We share your vision that readers of the Mining Tax Guide would be best-served by real-time access to information that is regularly updated to reflect distribution changes, new laws, or data corrections. By going digital, when information changes, we can quickly update data or tables, rather than waiting to update the annual publication. We can also notify our email subscribers when we make these changes and direct them to the updates online.

To better serve our customers we have already started a plan for providing mining tax information, including the Mining Tax Guide, on our website. We are redesigning our mining web pages to provide comprehensive tax information, timely updates to data and information, and data in printer-friendly formats. Customers will begin seeing these changes this summer.

We will be using our robust email notification system to provide our customers with updates about our mining tax information. To subscribe to mining tax email updates:

- Go to www.revenue.state.mn.us
- Type "mining" in the search box
- Click "Subscribe to mining tax information"

By creating a single source of comprehensive information on our website, all interested readers will have access to timely and accurate information at any time.

Again, we appreciate the significant efforts of your team in preparing this program evaluation. Thank you for your partnership in continuously improving our services.

Sincerely,

Cynthia Bauerly
Commissioner

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