15.8062.01000

FISCAL NOTE
Requested by Legislative Council
12/19/2014

Bill/Resolution No.: SB 2069

1 A. **State fiscal effect:** *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

	2013-2015 Biennium		2015-2017 Biennium		2017-2019 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues						
Expenditures						
Appropriations						

1 B. **County, city, school district and township fiscal effect:** *Identify the fiscal effect on the appropriate political subdivision.*

	2013-2015 Biennium	2015-2017 Biennium	2017-2019 Biennium
Counties			
Cities			
School Districts			
Townships			

2 A. **Bill and fiscal impact summary:** *Provide a brief summary of the measure, including description of the provisions having fiscal impact (limited to 300 characters).*

SB 2069 reduces the withholding tax rate for recipients of oil and gas royalty payments.

B. **Fiscal impact sections:** *Identify and provide a brief description of the sections of the measure which have fiscal impact. Include any assumptions and comments relevant to the analysis.*

Section 1 reduces the required withholding rate from the top marginal individual income tax rate to one that is three-fourths of one percent less than the top marginal rate. This is expected to reduce the amount of refunds made to royalty recipients by more accurately reflecting the income tax they eventually owe. This bill does not alter the income tax liabilities of royalty recipients so there is no direct fiscal impact. It merely reduces the overpayments received in advance of the filing of the tax returns and reduces refund amounts.

3. **State fiscal effect detail:** *For information shown under state fiscal effect in 1A, please:*

A. **Revenues:** *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*

B. **Expenditures:** *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*

C. **Appropriations:** *Explain the appropriation amounts. Provide detail, when appropriate, for each agency and fund affected. Explain the relationship between the amounts shown for expenditures and appropriations. Indicate whether the appropriation or a part of the appropriation is included in the executive budget or relates to a continuing appropriation.*

Name: Kathryn L. Strombeck
Agency: Office of Tax Commissioner
Telephone: 328-3402
Date Prepared: 12/23/2014

2015 SENATE FINANCE AND TAXATION

SB 2069

2015 SENATE STANDING COMMITTEE MINUTES

Finance and Taxation Committee
Lewis and Clark Room, State Capitol

SB2069
1/7/2015
Job Number 21750

☐ Subcommittee
☐ Conference Committee

Committee Clerk Signature	Alice Grove

Explanation or reason for introduction of bill/resolution:

Relating to the tax base and rate of withholding for recipients of oil and gas royalty payments; and to provide an effective date.

Minutes: | Testimony Attached |

Chairman Cook opened the hearing on SB2069.

Matt Peyerl, Associate Director, Office of State Tax Commissioner, presents supporting testimony on behalf of the tax commissioner. (See testimony #1)

Chairman Cook -- Has a penpall in Texas with substantial oil holdings in ND who has no problem paying his taxes. He has a problem with getting a large refund. His issue is depletion and that got a lot of the money back from it. So he's going to pay at 2.47%, right?

Matt Peyerl -- If this were to pass, the rate instead of being withheld at 3.22% on him would be at 2.47% so it would be about a 12-15% reduction compared to what was happening this year.

Senator Oehlke -- Can you explain depletion?

Matt Peyerl -- Depletion is a deduction that is allowed to producers of natural resources of many kinds and it's kind of one of those things where producers can take two different types of depletion. They can choose to take the most beneficial one. There's cost depletion where all of your costs for drilling a well are segregated. There's percent depletion which is, for most taxpayers, about 15% of your gross income and you can take that every year.

Senator Oehlke -- So you can take that 15% and it can exceed 100%. Is that what you are saying?

Matt Peyerl -- It can exceed 100% of your costs, eventually.

Senator Triplett -- Given that we just enacted this withholding in the last session, other than these very specific concerns that you've heard as feedback from the payors and the recipients, is the system working pretty well for you as a department?

Matt Peyerl -- I believe so although it just began January 1, 2014, so we have 3 quarters of returns that have been filed and it's administered much like employers withholding where the royalty payors file quarterly returns and make quarterly remittances and at the end of the year, February 28, is the due date for their annual return. That will be our first big look into all of the 1099's that will be submitted.

Chairman Cook -- Any other questions?

Senator Dotzenrod -- Will any of the way that this functions be affected by different rates that are applied to the oil from the standpoint of the gross production tax or the oil extraction tax if we go through triggering on and off of rates?

Matt Peyerl -- It won't affect the ultimate income tax liability of any royalty owner but it does impact the figures that I've thrown out on this written testimony. When I say it's a 23% reduction -- that's from where it is now, that's as compared to something that has the 11.5% tax on it so if that were to drop down to 5% this reduction would probably overshoot on the low side as far as withholding.

There was no further testimony.

Chairman Cook closed the hearing on SB2069.

Motion by **Senator Oehlke for Do Pass**

Seconded by **Senator Laffen**

Senator Triplett -- I want to thank the tax department for their response to concerns from the real world and for responding promptly, given that this is a new program.

Roll Call Vote 7-0-0

Carried by **Senator Bekkedahl**

Date: 1-7-2015

Roll Call Vote #: 1

2015 SENATE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO 2069

Senate Finance and Taxation Committee

☐ Subcommittee

Amendment LC# or Description:

Recommendation: ☐ Adopt Amendment
☑ Do Pass ☐ Do Not Pass ☐ Without Committee Recommendation
☐ As Amended ☐ Rerefer to Appropriations
☐ Place on Consent Calendar

Other Actions: ☐ Reconsider ☐

Motion Made By Sen. Oehlke Seconded By Sen. Laffen

Senators	Yes	No	Senators	Yes	No
Chairman Dwight Cook	✓		Senator Jim Dotzenrod	✓	
Vice Chairman Lonnie Laffen	✓		Senator Connie Triplett	✓	
Senator Brad Bekkedahl	✓				
Senator Dave Oehlke	✓				
Senator Jessica Unruh	✓				

Total (Yes) 7 No 0

Absent 0

Floor Assignment Sen. Bekkedahl

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

SB 2069: Finance and Taxation Committee (Sen. Cook, Chairman) recommends **DO PASS** (7 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING). SB 2069 was placed on the Eleventh order on the calendar.

2015 HOUSE FINANCE AND TAXATION

SB 2069

2015 HOUSE STANDING COMMITTEE MINUTES

Finance and Taxation Committee
Fort Totten Room, State Capitol

SB 2069
3/11/2015
24643

☐ Subcommittee
☐ Conference Committee

Committee Clerk Signature Mary Brucker

Explanation or reason for introduction of bill/resolution:

A bill relating to the tax base and rate of withholding for recipients of oil and gas royalty payments.

Minutes: Attachment #1

Chairman Headland: Opened hearing.

Matt Peyerl, Office of State Tax Commissioner: Distributed testimony. See attachment #1. (Ended testimony at 6:35)

Representative Haak: What percentage of tax we're collecting now is taxed at the corporate rate and what percentage is taxed at the individual rate?

Matt Peyerl: We don't have that information yet. The program began January 1, 2014 and is administered as employee's wage withholdings. Every quarter the oil company remits what they withheld. The year-end filings were due February 28, 2015 so we are receiving that information now. The overwhelming majority is withheld at that individual income tax rate.

Representative Froseth: Can you explain the depletion deduction?

Matt Peyerl: It's a federal deduction built into the tax code. It's probably what you hear at the federal level as one of those tax expenditures or one of the incentives that are available to oil companies that aren't available to other types of taxpayers. It's a tax deduction you get based on producing oil or other certain natural resources extracted from the ground. Depreciation is when you buy an asset you get to depreciate it over time down to zero and that's where it stops. The one benefit of depletion is that you can take 15% every year to infinity so you can deplete more than you've actually paid for something.

Representative Froseth: Why isn't that allowed in the state?

Matt Peyerl: Because it's a federal deduction North Dakota's income taxes begin with your federal taxable income so whatever deductions the IRS allows are already built into our starting point.

Chairman Headland: Is there any support for SB 2069? Is there any opposition? Seeing none we will close the hearing on SB 2069.

2015 HOUSE STANDING COMMITTEE MINUTES

Finance and Taxation Committee
Fort Totten Room, State Capitol

SB 2069
3/11/2015
24683

☐ Subcommittee
☐ Conference Committee

Committee Clerk Signature	Mary Brucker

Explanation or reason for introduction of bill/resolution:

A bill relating to the tax base and rate of withholding for recipients of oil and gas royalty payments.

Minutes: No attachments.

Vice Chairman Owens: Made a motion for a do pass.

Representative Haak: Seconded.

Roll call vote: 13 yes 0 no 1 absent

Motion carried for a do pass.

Representative Klein will carry this bill.

Date: 3-11-15
Roll Call Vote #: 1

2015 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 2069

House Finance and Taxation Committee

☐ Subcommittee

Amendment LC# or Description:

Recommendation:
☐ Adopt Amendment
☒ Do Pass ☐ Do Not Pass ☐ Without Committee Recommendation
☐ As Amended ☐ Rerefer to Appropriations
☐ Place on Consent Calendar

Other Actions: ☐ Reconsider ☐

Motion Made By Rep. Owens Seconded By Rep. Haak

Representatives	Yes	No	Representatives	Yes	No
CHAIRMAN HEADLAND	√		REP HAAK	√	
VICE CHAIRMAN OWENS	√		REP STRINDEN	√	
REP DOCKTER	√		REP MITSKOG	√	
REP TOMAN	√		REP SCHNEIDER	√	
REP FROSETH	√				
REP STEINER	√				
REP HATLESTAD	√				
REP KLEIN	√				
REP KADING	AB				
REP TROTTIER	√				

Total (Yes) 13 No 0

Absent 1

Floor Assignment Rep. Klein

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

SB 2069: Finance and Taxation Committee (Rep. Headland, Chairman) recommends **DO PASS** (13 YEAS, 0 NAYS, 1 ABSENT AND NOT VOTING). SB 2069 was placed on the Fourteenth order on the calendar.

2015 TESTIMONY

SB 2069

1-7-15
#1

TESTIMONY OF THE OFFICE OF STATE TAX COMMISSIONER BEFORE THE SENATE FINANCE AND TAXATION COMMITTEE

SENATE BILL 2069

January 7, 2015

Chairman Cook, members of the Senate Finance and Taxation Committee, my name is Matt Peyerl, Associate Director, Tax Administration, for the Office of State Tax Commissioner. I am here on behalf of the Tax Commissioner to explain and testify in support of Senate Bill 2069. This bill amends N.D.C.C. § 57-38-59.4 regarding the requirement to withhold income tax on certain oil and gas royalty payments received by nonresidents and non-North Dakota domiciled business entities. This statute was enacted by the 2013 Legislature. Based on feedback we have received from taxpayers and royalty payors (remitters), this bill proposes three changes to the withholding program.

PROPOSED CHANGES

- Withhold tax on the "gross" royalty amount instead of the "net" amount
- Withhold at a single rate
- Lower the rate used for withholding

REASONS FOR THE PROPOSED CHANGES AND EXPLANATION OF THE BILL

Section 1 - Proposal Number 1 (Line 8). Current law requires income tax be withheld on the "net" royalty payment. The amendment proposed on line 8 of the bill would change the withholding to be on the "gross" royalty. We believe this change will simplify the reporting requirements for royalty payors and the affected royalty recipients. The "gross" amount is always easily identifiable on the federal Form 1099, whereas the "net" amount must be separately calculated and is not specifically identified on the recipient's Form 1099. The gross amount is roughly 12% higher than the net amount. Because tax would be withheld on a higher amount, this change when considered alone will result in an increase of tax to be withheld. However, this increase is negated with a lower withholding rate (Proposal Number 3).

Proposal Number 2 (Line 10). Current law requires the royalty payor to withhold at different tax rates, depending on the type of recipient - either the top individual income tax rate (currently 3.22%) or the top corporate income tax rate (currently 4.53%). The change on line 10 of the bill striking the reference to the corporate tax rates under section 57-38-30 simplifies the requirement to withhold for payors because they would only need to withhold using one tax rate. The Tax Commissioner is proposing this change based on feedback from royalty payors who have indicated that using two different rates and identifying the type of each royalty owner is problematic and in some cases not possible. The overwhelming majority of nonresident royalty owners are individuals, so it is being proposed to simply withhold at the top individual income tax rate. Most other states with similar withholding programs also use only one rate.

Proposal Number 3 (Lines 10-11). The third change is to lower the rate for withholding to a rate that is three-fourths of a percent less than the top individual income tax rate. Currently the top rate is 3.22%, so this would change the withholding rate to 2.47% (3.22% minus 0.75% = 2.47%). This change is approximately a 23% reduction in the rate of withholding. This reduction more than offsets the proposed change to withhold on the "gross" amount so the overall amount withheld will be reduced. Most royalty owners are able to deduct some expenses (such as severance taxes and depletion) against their royalty income, so this withholding rate reduction proposal is an attempt to withhold an amount that is overall more accurate, although individual circumstances may vary.

Section 2 – Effective date. The three proposed changes would be effective for withholding periods beginning on or after January 1, 2016. This delayed effective date will give royalty payors time to implement these proposed changes to the withholding requirements.

CONCLUSION

The Tax Commissioner respectfully requests your favorable consideration of SB 2069. Thank you for your time and consideration.

SB 2069
3-11-15
#1 p.1

TESTIMONY OF THE OFFICE OF STATE TAX COMMISSIONER
BEFORE THE
HOUSE FINANCE AND TAXATION COMMITTEE

SENATE BILL 2069

March 11, 2015

Chairman Headland, members of the House Finance and Taxation Committee, my name is Matt Peyerl, Associate Director, Tax Administration, for the Office of State Tax Commissioner. I am here on behalf of the Tax Commissioner to explain and testify in support of Senate Bill 2069. This bill amends N.D.C.C. § 57-38-59.4 regarding the rate of income tax to withhold on certain oil and gas royalty payments received by nonresidents and non-North Dakota domiciled business entities. This statute was enacted by the 2013 Legislature. Based on feedback we have received from taxpayers and royalty payors (remitters), this bill proposes three changes to the withholding program.

PROPOSED CHANGES

- Withhold tax on the "gross" royalty amount instead of the "net" amount
- Withhold at a single rate
- Lower the rate used for withholding

REASONS FOR THE PROPOSED CHANGES AND EXPLANATION OF THE BILL

Section 1 - Proposal Number 1 (Line 8). Current law requires income tax be withheld on the "net" royalty payment. The amendment proposed on line 8 of the bill would change the withholding to be on the "gross" royalty. We believe this change will simplify the reporting requirements for royalty payors and the affected royalty recipients. The "gross" amount is always easily identifiable on the federal Form 1099, whereas the "net" amount must be separately calculated and is not specifically identified on the recipient's Form 1099. The gross amount is roughly 12% higher than the net amount. Because tax would be withheld on a higher amount, this change when considered alone will result in an increase of tax to be withheld. However, this increase is negated with a lower withholding rate (Proposal Number 3).

Proposal Number 2 (Line 10). Current law requires the royalty payor to withhold at different tax rates, depending on the type of recipient - either the top individual income tax rate (currently 3.22%) or the top corporate income tax rate (currently 4.53%). The change on line 10 of the bill striking the reference to the corporate tax rates under section 57-38-30 simplifies the requirement to withhold for payors because they would only need to withhold using one tax rate. The Tax Commissioner is proposing this change based on feedback from royalty payors who have indicated that using two different rates and identifying the type of each royalty owner is problematic and in some cases not possible. The overwhelming majority of nonresident royalty owners are individuals, so it is being proposed to simply withhold at the top individual income tax rate. Most other states with similar withholding programs also use only one rate.

Proposal Number 3 (Lines 10-11). The third change is to lower the rate for withholding to a rate that is three-fourths of a percent less than the top individual income tax rate. Currently the top rate is 3.22%, so this would change the withholding rate to 2.47% (3.22% minus 0.75% = 2.47%). This change is approximately a 23% reduction in the rate of withholding. This reduction more than offsets the proposed change to withhold on the "gross" amount so the overall amount withheld will be reduced. Most royalty owners are able to deduct some expenses (such as severance taxes and depletion) against their royalty income, so this withholding rate reduction proposal is an attempt to withhold an amount that is overall more accurate, although individual circumstances may vary.

Section 2 – Effective date. The three proposed changes would be effective for withholding periods beginning on or after January 1, 2016. This delayed effective date will give royalty payors time to implement these proposed changes to the withholding requirements.

CONCLUSION

The Tax Commissioner respectfully requests your favorable consideration of SB 2069. Thank you for your time and consideration.

#1 p.3

Illustration of Changes
SB 2069

Illustration of Changes	Current Law	SB 2069	
Gross Royalty (Form 1099)	$10,000	$10,000	
Less: Production Taxes 11.5% Withheld	($1,150)		
= Net Royalty Paid To Owner	$8,850		
x N.D. Withholding Rate	3.22%	2.47%	(3.22% - 0.75%)
= N.D. Tax Withheld	$285	$247	

Overall Reduction To Tax Withheld: 13%

Individual's Income Tax Return	
Gross Royalty (Form 1099)	$10,000
Less: Production Taxes 11.5% Withheld	($1,150)
= Net Royalty Paid To Owner	$8,850
Less: Depletion Deduction 15% (estimated)	($1,500)
= Net Taxable Income (after deductions)	$7,350
x N.D. Highest Tax Rate	3.22%
= Approximate N.D. Tax Owed	$237

Attachment to SB 2069 testimony
Matt Peyerl
Office of State Tax Commissioner
3/11/2015