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Sixty-fourth
Legislative Assembly
of North Dakota

FIRST ENGROSSMENT
with Senate Amendments
ENGROSSED HOUSE BILL NO. 1476

Introduced by

Representatives Carlson, Belter, Headland

Senators Cook, Wardner

(Approved by the Delayed Bills Committee)

A BILL for an Act to amend and reenact subsection 4 of section 38-08-04 and sections 57-51.1-01, and 57-51.1-02, subsection 3 of section 57-51.1-03, and section 57-51.1-03 of the North Dakota Century Code, relating to oil extraction tax rates and exemptions; to provide for an exception; to provide for a legislative management study; to provide an effective date; and to provide an expiration date.

BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF NORTH DAKOTA:

SECTION 1. AMENDMENT. Subsection 4 of section 38-08-04 of the North Dakota Century Code is amended and reenacted as follows:

4. To classify wells as oil or gas wells for purposes material to the interpretation or enforcement of this chapter, to classify and determine the status and depth of wells that are stripper well property as defined in ~~subsection 8 of~~ section 57-51.1-01, to certify to the tax commissioner which wells are stripper wells as defined in section 57-51.1-01 and the depth of those wells, ~~to recertify stripper wells that are reentered and recompleted as horizontal wells,~~ and to certify to the tax commissioner which wells involve secondary or tertiary recovery operations ~~under~~as defined in section 57-51.1-01, and the date of qualification for the ~~reduced rate of~~ oil extraction tax exemption for secondary and tertiary recovery operations.

SECTION 2. AMENDMENT. Section 57-51.1-01 of the North Dakota Century Code is amended and reenacted as follows:

57-51.1-01. Definitions for oil extraction tax.

For the purposes of this chapter:

1. "Average daily production" of a well means the qualified maximum total production of oil from the well during a calendar month period divided by the number of calendar days in that period, and "qualified maximum total production" of a well means that the

well must have been maintained at the maximum efficient rate of production as defined and determined by rule adopted by the industrial commission in furtherance of its authority under chapter 38-08.

2. ~~"Average price" of a barrel of crude oil means the monthly average of the daily closing price for a barrel of west Texas intermediate cushing crude oil, as those prices appear in the Wall Street Journal, midwest edition, minus two dollars and fifty cents. When computing the monthly average price, the most recent previous daily closing price must be considered the daily closing price for the days on which the market is closed.~~

~~3.~~ ~~"Horizontal reentry well" means a well that was not initially drilled and completed as a horizontal well, including any well initially plugged and abandoned as a dry hole, which is reentered and recompleted as a horizontal well.~~

~~4.~~ "Horizontal well" means a well with a horizontal displacement of the well bore drilled at an angle of at least eighty degrees within the productive formation of at least three hundred feet [91.44 meters].

~~5.~~3. "Oil" means petroleum, crude oil, mineral oil, casinghead gasoline, and all liquid hydrocarbons that are recovered from gas on the lease incidental to the production of the gas.

~~6.~~4. "Property" means the right which arises from a lease or fee interest, as a whole or any designated portion thereof, to produce oil. A producer shall treat as a separate property each separate and distinct producing reservoir subject to the same right to produce crude oil; provided, that such reservoir is recognized by the industrial commission as a producing formation that is separate and distinct from, and not in communication with, any other producing formation.

~~7.~~5. "Qualifying secondary recovery project" means a project employing water flooding. ~~To be eligible for the tax reduction provided under section 57-51.1-02, a secondary recovery project must be certified as qualifying by the industrial commission and the project operator must have achieved for six consecutive months an average production level of at least twenty-five percent above the level that would have been recovered under normal recovery operations.~~ To be eligible for the tax exemption provided under section 57-51.1-03 ~~and subsequent thereto the rate reduction provided under section 57-51.1-02~~, a secondary recovery project must be certified as qualifying by the industrial commission and the project operator must have obtained incremental production as defined in subsection ~~5~~3 of section 57-51.1-03.

~~8.~~6. "Qualifying tertiary recovery project" means a project for enhancing recovery of oil which meets the requirements of section 4993(c), Internal Revenue Code of 1954, as amended through December 31, 1986, and includes the following methods for recovery:

a. Miscible fluid displacement.
b. Steam drive injection.
c. Microemulsion.
d. In situ combustion.
e. Polymer augmented water flooding.
f. Cyclic steam injection.
g. Alkaline flooding.
h. Carbonated water flooding.
i. Immiscible carbon dioxide displacement.
j. New tertiary recovery methods certified by the industrial commission.

It does not include water flooding, unless the water flooding is used as an element of one of the qualifying tertiary recovery techniques described in this subsection, or immiscible natural gas injection. ~~To be eligible for the tax reduction provided under section 57-51.1-02, a tertiary recovery project must be certified as qualifying by the industrial commission, the project operator must continue to operate the unit as a qualifying tertiary recovery project, and the project operator must have achieved for at least one month a production level of at least fifteen percent above the level that would have been recovered under normal recovery operations.~~ To be eligible for the tax exemption provided under section 57-51.1-03 ~~and subsequent thereto the rate reduction provided under section 57-51.1-02~~, a tertiary recovery project must be certified as qualifying by the industrial commission, the project operator must continue to operate the unit as a qualifying tertiary recovery project, and the project operator must have obtained incremental production as defined in subsection ~~5~~3 of section 57-51.1-03.

~~9.~~7. "Royalty owner" means an owner of what is commonly known as the royalty interest and shall not include the owner of any overriding royalty or other payment carved out of the working interest.

~~10.~~8. "Stripper well" means a well drilled and completed, or reentered and recompleted as a horizontal well, after June 30, 2013, whose average daily production of oil during any preceding consecutive twelve-month period, excluding condensate recovered in nonassociated production, per well did not exceed ten barrels per day for wells of a depth of six thousand feet [1828.80 meters] or less, fifteen barrels per day for wells of a depth of more than six thousand feet [1828.80 meters] but not more than ten thousand feet [3048 meters], and thirty barrels per day for wells of a depth of more than ten thousand feet [3048 meters] outside the Bakken and Three Forks formations, and thirty-five barrels per day for wells of a depth of more than ten thousand feet [3048 meters] in the Bakken or Three Forks formation.

~~11.~~9. "Stripper well property" means wells drilled and completed, or a well reentered and recompleted as a horizontal well, before July 1, 2013, on a "property" whose average daily production of oil, excluding condensate recovered in nonassociated production, per well did not exceed ten barrels per day for wells of a depth of six thousand feet [1828.80 meters] or less, fifteen barrels per day for wells of a depth of more than six thousand feet [1828.80 meters] but not more than ten thousand feet [3048 meters], and thirty barrels per day for wells of a depth of more than ten thousand feet [3048 meters] during any preceding consecutive twelve-month period. Wells which did not actually yield or produce oil during the qualifying twelve-month period, including disposal wells, dry wells, spent wells, and shut-in wells, are not production wells for the purpose of determining whether the stripper well property exemption applies.

~~12. "Trigger price" means thirty-five dollars and fifty cents, as indexed for inflation. By December thirty-first of each year, the tax commissioner shall compute an indexed trigger price by applying to the current trigger price the rate of change of the producer price index for industrial commodities as calculated and published by the United States department of labor, bureau of labor statistics, for the twelve months ending June thirtieth of that year and the indexed trigger price so determined is the trigger price for the following calendar year.~~

~~13.~~ ~~"Two-year inactive well" means any well certified by the industrial commission that did not produce oil in more than one month in any consecutive twenty-four-month period before being recompleted or otherwise returned to production after July 31, 1995. A well that has never produced oil, a dry hole, and a plugged and abandoned well are eligible for status as a two-year inactive well.~~

SECTION 3. AMENDMENT. Section 57-51.1-02 of the North Dakota Century Code is amended and reenacted as follows:

57-51.1-02. Imposition of oil extraction tax.

There is hereby imposed an excise tax, to be known as the "oil extraction tax", upon the activity in this state of extracting oil from the earth, and every owner, including any royalty owner, of any part of the oil extracted is deemed for the purposes of this chapter to be engaged in the activity of extracting that oil.

The rate of tax is ~~six and one-half~~<u>five</u> percent of the gross value at the well of the oil extracted~~, except that the rate of tax is four percent of the gross value at the well of the oil extracted in the following situations:~~

~~1.~~ ~~For oil produced from wells drilled and completed after April 27, 1987, commonly referred to as new wells, and not otherwise exempt under section 57-51.1-03;~~

~~2.~~ ~~For oil produced from a secondary or tertiary recovery project that was certified as qualifying by the industrial commission before July 1, 1991;~~

~~3.~~ ~~For oil that does not qualify as incremental oil but is produced from a secondary or tertiary recovery project that is certified as qualifying by the industrial commission after June 30, 1991;~~

~~4.~~ ~~For incremental oil produced from a secondary or tertiary recovery project that is certified as qualifying by the industrial commission after June 30, 1991, and which production is not otherwise exempt under section 57-51.1-03; or~~

~~5.~~ ~~For oil produced from a well that receives an exemption pursuant to subsection 4 of section 57-51.1-03 after June 30, 1993, and which production is not otherwise exempt under section 57-51.1-03~~.

However, if the average price of a barrel of crude oil exceeds the trigger price <u>of ninety dollars</u> for each month in any consecutive ~~five-month~~<u>three-month</u> period, then the rate of tax on oil extracted from all taxable wells is six ~~and one-half~~ percent of the gross value at the well of the oil extracted until the average price of a barrel of crude oil is less than the trigger price of ninety dollars for each month in any consecutive ~~five-month~~three-month period, in which case the rate of tax reverts to ~~four~~five percent of the gross value at the well of the oil extracted ~~for any wells subject to a reduced rate under subsections 1 through 5~~. By December thirty-first of each year, the tax commissioner shall determine an indexed trigger price under this section by applying to the current trigger price an adjustment equal to the percentage rate of change of the producer price index for industrial commodities as calculated and published by the United States department of labor, bureau of labor statistics, for the twelve months ending June thirtieth of that year and the indexed trigger price so determined is the trigger price for the following calendar year.

For purposes of this section, "average price" of a barrel of crude oil means the monthly average of the daily closing price for a barrel of west Texas intermediate cushing crude oil, as those prices appear in the Wall Street Journal, midwest edition. When computing the monthly average price, the most recent previous daily closing price must be considered the daily closing price for the days on which the market is closed.

SECTION 4. AMENDMENT. Subsection 3 of section 57-51.1-03 of the North Dakota Century Code is amended and reenacted as follows:

3. For a well drilled and completed as a vertical well, the initial production of oil from the well is exempt from any taxes imposed under this chapter for a period of fifteen months~~, except that oil produced from any well drilled and completed as a horizontal well is exempt from any taxes imposed under this chapter for a period of twenty-four months~~. Oil recovered during testing prior to well completion is exempt from the oil extraction tax. The exemption under this subsection becomes ineffective if the average price of a barrel of crude oil exceeds the trigger price for each month in any consecutive five-month period. ~~However, the exemption is reinstated if, after the trigger provision becomes effective, the average price of a barrel of crude oil is less than the trigger price for each month in any consecutive five-month period~~The reduced rate of tax under subsection 1 of section 57-51.1-02 does not apply after November 30, 2015, for oil produced from wells drilled and completed after April 27, 1987, commonly referred to as new wells, and not otherwise exempt under this section.

SECTION 5. AMENDMENT. Section 57-51.1-03 of the North Dakota Century Code is amended and reenacted as follows:

57-51.1-03. Exemptions from oil extraction tax.

The following activities are specifically exempted from the oil extraction tax:

1. The activity of extracting from the earth any oil that is exempt from the gross production tax imposed by chapter 57-51.
2. The activity of extracting from the earth any oil from a stripper well property or individual stripper well.

~~3. For a well drilled and completed as a vertical well, the initial production of oil from the well is exempt from any taxes imposed under this chapter for a period of fifteen months, except that oil produced from any well drilled and completed as a horizontal well is exempt from any taxes imposed under this chapter for a period of twenty-four months. Oil recovered during testing prior to well completion is exempt from the oil extraction tax. The exemption under this subsection becomes ineffective if the average price of a barrel of crude oil exceeds the trigger price for each month in any consecutive five-month period. However, the exemption is reinstated if, after the trigger provision becomes effective, the average price of a barrel of crude oil is less than the trigger price for each month in any consecutive five-month period.~~

~~4. The production of oil from a qualifying well that was worked over is exempt from any taxes imposed under this chapter for a period of twelve months, beginning with the first day of the third calendar month after the completion of the work-over project. The exemption provided by this subsection is only effective if the well operator establishes to the satisfaction of the industrial commission upon completion of the project that the cost of the project exceeded sixty-five thousand dollars or production is increased at least fifty percent during the first two months after completion of the project. A qualifying well under this subsection is a well with an average daily production of no more than fifty barrels of oil during the latest six calendar months of continuous production. A work-over project under this subsection means the continuous employment of a work-over rig, including recompletions and reentries. The exemption provided by this subsection becomes ineffective if the average price of a barrel of crude oil exceeds the trigger price for each month in any consecutive five-month~~

~~period. However, the exemption is reinstated if, after the trigger provision becomes effective, the average price of a barrel of crude oil is less than the trigger price for each month in any consecutive five-month period.~~

~~5.~~3. a. The incremental production from a secondary recovery project which has been certified as a qualified project by the industrial commission after July 1, 1991, is exempt from any taxes imposed under this chapter for a period of five years from the date the incremental production begins.

b. The incremental production from a tertiary recovery project that does not use carbon dioxide and which has been certified as a qualified project by the industrial commission is exempt from any taxes imposed under this chapter for a period of ten years from the date the incremental production begins. Incremental production from a tertiary recovery project that uses carbon dioxide in a well drilled and completed outside the Bakken and Three Forks formations, and ten miles [16.10 kilometers] or more outside an established field in which the industrial commission has defined the pool to include the Bakken or Three Forks formation and which has been certified as a qualified project by the industrial commission is exempt from any taxes imposed under this chapter for a period of five years from the date the incremental production begins.

c. For purposes of this subsection, incremental production is defined in the following manner:

(1) For purposes of determining the exemption provided for in subdivision a and with respect to a unit where there has not been a secondary recovery project, incremental production means the difference between the total amount of oil produced from the unit during the secondary recovery project and the amount of primary production from the unit. For purposes of this paragraph, primary production means the amount of oil which would have been produced from the unit if the secondary recovery project had not been commenced. The industrial commission shall determine the amount of primary production in a manner which conforms to the practice and procedure used by the commission at the time the project is certified.

(2) For purposes of determining the exemption provided for in subdivision a and with respect to a unit where a secondary recovery project was in existence prior to July 1, 1991, and where the industrial commission cannot establish an accurate production decline curve, incremental production means the difference between the total amount of oil produced from the unit during a new secondary recovery project and the amount of production which would be equivalent to the average monthly production from the unit during the most recent twelve months of normal production reduced by a production decline rate of ten percent for each year. The industrial commission shall determine the average monthly production from the unit during the most recent twelve months of normal production and must upon request or upon its own motion hold a hearing to make this determination. For purposes of this paragraph, when determining the most recent twelve months of normal production the industrial commission is not required to use twelve consecutive months. In addition, the production decline rate of ten percent must be applied from the last month in the twelve-month period of time.

(3) For purposes of determining the exemption provided for in subdivision a and with respect to a unit where a secondary recovery project was in existence before July 1, 1991, and where the industrial commission can establish an accurate production decline curve, incremental production means the difference between the total amount of oil produced from the unit during the new secondary recovery project and the total amount of oil that would have been produced from the unit if the new secondary recovery project had not been commenced. For purposes of this paragraph, the total amount of oil that would have been produced from the unit if the new secondary recovery project had not been commenced includes both primary production and production that occurred as a result of the secondary recovery project that was in existence before July 1, 1991. The industrial commission shall determine the amount of oil that would have been produced from the unit if the new secondary recovery project had not been commenced in a manner

that conforms to the practice and procedure used by the commission at the time the new secondary recovery project is certified.

(4) For purposes of determining the exemption provided for in subdivision b and with respect to a unit where there has not been a secondary recovery project, incremental production means the difference between the total amount of oil produced from the unit during the tertiary recovery project and the amount of primary production from the unit. For purposes of this paragraph, primary production means the amount of oil which would have been produced from the unit if the tertiary recovery project had not been commenced. The industrial commission shall determine the amount of primary production in a manner which conforms to the practice and procedure used by the commission at the time the project is certified.

(5) For purposes of determining the exemption provided for in subdivision b and with respect to a unit where there is or has been a secondary recovery project, incremental production means the difference between the total amount of oil produced during the tertiary recovery project and the amount of production which would be equivalent to the average monthly production from the unit during the most recent twelve months of normal production reduced by a production decline rate of ten percent for each year. The industrial commission shall determine the average monthly production from the unit during the most recent twelve months of normal production and must upon request or upon its own motion hold a hearing to make this determination. For purposes of this paragraph, when determining the most recent twelve months of normal production the industrial commission is not required to use twelve consecutive months. In addition, the production decline rate of ten percent must be applied from the last month in the twelve-month period of time.

(6) For purposes of determining the exemption provided for in subdivision b and with respect to a unit where there is or has been a secondary recovery project and where the industrial commission can establish an accurate production decline curve, incremental production means the difference

between the total amount of oil produced from the unit during the tertiary recovery project and the total amount of oil that would have been produced from the unit if the tertiary recovery project had not been commenced. For purposes of this paragraph, the total amount of oil that would have been produced from the unit if the tertiary recovery project had not been commenced includes both primary production and production that occurred as a result of any secondary recovery project. The industrial commission shall determine the amount of oil that would have been produced from the unit if the tertiary recovery project had not been commenced in a manner that conforms to the practice and procedure used by the commission at the time the tertiary recovery project is certified.

d. The industrial commission shall adopt rules relating to this exemption that must include procedures for determining incremental production as defined in subdivision c.

~~6.~~ ~~The production of oil from a two-year inactive well, as determined by the industrial commission and certified to the state tax commissioner, for a period of ten years after the date of receipt of the certification. The exemption under this subsection becomes ineffective if the average price of a barrel of crude oil exceeds the trigger price for each month in any consecutive five-month period. However, the exemption is reinstated if, after the trigger provision becomes effective, the average price of a barrel of crude oil is less than the trigger price for each month in any consecutive five-month period.~~

~~7.~~ ~~The production of oil from a horizontal reentry well, as determined by the industrial commission and certified to the state tax commissioner, for a period of nine months after the date the well is completed as a horizontal well. The exemption under this subsection becomes ineffective if the average price of a barrel of crude oil exceeds the trigger price for each month in any consecutive five-month period. However, the exemption is reinstated if, after the trigger provision becomes effective, the average price of a barrel of crude oil is less than the trigger price for each month in any consecutive five-month period.~~

~~8. The initial production of oil from a well is exempt from any taxes imposed under this chapter for a period of sixty months if:~~

~~a. The well is drilled and completed before July 1, 2013, on nontrust lands within the boundaries of an Indian reservation;~~

~~b. The well is drilled and completed before July 1, 2013, on lands held in trust by the United States for an Indian tribe or individual Indian; or~~

~~c. The well is drilled and completed before July 1, 2013, on lands held by an Indian tribe if the interest is in existence on August 1, 1997.~~

~~9. The first seventy-five thousand barrels or the first four million five hundred thousand dollars of gross value at the well, whichever is less, of oil produced during the first eighteen months after completion, from a horizontal well drilled and completed after April 30, 2009, and before July 1, 2015, is subject to a reduced tax rate of two percent of the gross value at the well of the oil extracted under this chapter. A well eligible for a reduced tax rate under this subsection is eligible for the exemption for horizontal wells under subsection 3, if the exemption under subsection 3 is effective during all or part of the first twenty-four months after completion. The rate reduction under this subsection becomes effective on the first day of the month following a month for which the average price of a barrel of crude oil is less than fifty-five dollars. The rate reduction under this subsection becomes ineffective on the first day of the month following a month in which the average price of a barrel of crude oil exceeds seventy dollars. If the rate reduction under this subsection is effective on the date of completion of a well, the rate reduction applies to production from that well for up to eighteen months after completion, subject to the other limitations of this subsection. If the rate reduction under this subsection is ineffective on the date of completion of a well, the rate reduction under this subsection does not apply to production from that well at any time.~~

~~10.~~<u>4.</u> The first seventy-five thousand barrels of oil produced during the first eighteen months after completion, from a well drilled and completed outside the Bakken and Three Forks formations, and ten miles [16.10 kilometers] or more outside an established field in which the industrial commission has defined the pool to include the Bakken or Three Forks formation, is subject to a reduced tax rate of two percent of the gross value at the well of the oil extracted under this chapter. ~~A well eligible for a reduced tax rate under this subsection is eligible for the exemption under subsection 3, if the exemption under subsection 3 is effective during all or part of the first twenty-four months after completion.~~

SECTION 6. TERM OF EXEMPTIONS AND RATE REDUCTIONS. The remaining term of any exemption or rate reduction eliminated in section 5 of this Act expires January 1, 2016. The remaining term of the horizontal well exemption eliminated in section 4 of this Act expires December 1, 2015.

SECTION 7. WAIVER OF LEGISLATIVE CONFIRMATION REQUIREMENT FOR CERTAIN STATE-TRIBAL TAX COLLECTION AGREEMENTS. The requirement of legislative confirmation of state-tribal tax collection agreements under section 57-51.2-01 do not apply, for adjustment of an existing agreement attributable to the changes in the oil extraction tax under this Act, and for agreements under section 54-40.2-04 do not apply, for adjustment of an existing agreement regarding application of tribal tax authority to bulk delivery of dyed or undyed special fuels within the exterior boundaries of the reservation.

SECTION 8. LEGISLATIVE MANAGEMENT STUDY - TRIBAL TAX ISSUES. During the 2015-16 interim, the legislative management shall consider studying state-tribal tax agreements and allocation of revenues from centrally assessed property and property subject to payments in lieu of property taxes which is located on tribal trust lands. The legislative management shall report its findings and recommendations, together with any legislation required to implement the recommendations, to the sixty-fifth legislative assembly.

SECTION 9. EFFECTIVE DATE - EXPIRATION DATE. Sections 1, 2, 3, and 5 of this Act are effective for taxable events occurring after December 31, 2015. Section 4 of this Act is effective for taxable events occurring after November 30, 2015. Section 7 of this Act is effective from July 1, 2015, through December 31, 2016, and is thereafter ineffective.