

2009 SENATE FINANCE AND TAXATION

SB 2437

## 2009 SENATE STANDING COMMITTEE MINUTES

Bill/Resolution No. SB 2437

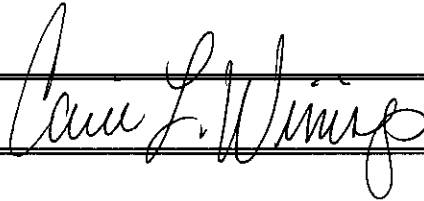
Senate Finance and Taxation Committee

Check here for Conference Committee

Hearing Date: 02/09/2009

Recorder Job Number: 8976

Committee Clerk Signature



Minutes:

**Chairman Cook:** Opened hearing on SB 2437.

**Senator David O'Connell, District 6:** Came to explain bill for those sponsors that could not get here due to weather.

**Chairman Cook:** There were a lot of people that could not come to testify that called me yesterday at home that wanted to testify against the bill as well. There may be a constitutional issue on this one too.

**Senator O'Connell:** It has been asked of me to withdraw the bill as well too, but there were certain ones that asked me to introduce the bill.

**Senator Dotzenrod:** In looking at how the bill would impact different counties around the state, if you are in a county where there is no activity in the mineral, this would have no effect, or am I wrong about that?

**Senator O'Connell:** The intent of the bill was only to share in the property taxes if there was action on that particular quarter.

**Senator Triplett:** So if I have an oil well in my property and it is one of the little stripper wells that is producing a couple of barrels a day, and I have a marginal interest in it, and I end up

getting \$400/yr maximum in royalties, I am still responsible for half the property taxes? Which may end up more than my royalty payments.

**Senator O'Connell:** You are right on.

**3.55 Aaron Birst, North Dakota Association of Counties:** Testified in opposition to bill. See Attachment #1 for additional testimony.

**4.55 Robert Harms, Northern Alliance of Independent Producers:** See Attachment #2 for testimony in opposition to the bill. There are a host of issues with this bill.

**8.20 Vice Chairman Miller:** I question when you build wells on land, say there are four wells on there, and how do they cut out that from the value of the land?

**Robert Harms:** See paragraph two of my testimony. The bill says that you would only assess the value of the land itself, not improvements and I think that adds an additional complexity to how to administer the property tax valuation that we administer in North Dakota at present.

**Vice Chairman Miller:** If the footprint of the well is on one acre, is that subtracted from the overall land?

**Robert Harms:** Are you asking if the value of the well is included in the value of the land?

**Vice Chairman Miller:** Yes.

**Robert Harms:** My understanding is yes it is but the mineral owner is also compensated for that. Gives an example.

**10.40 Tyler Rupp, North Dakota Petroleum Council:** See Attachment #3 in opposition to the bill.

**12.25 Gary Preszler, Commissioner of the Land Department and Secretary of the Board of University and School Lands:** See Attachment # 4 in opposition to the bill as well as proposed amendment. There are many legal issues with this bill. There is a lot of unclear language.

15.30 **John Val Emter, Citizen of North Dakota:** Testified in opposition to the bill. He questioned the definition of mineral rights and surface rights and gravel.

**Chairman Cook:** I am not sure that this is the correct bill to address this on.

Closed hearing on SB 2437.

**Vice Chairman Miller: Moved a Do Not Pass.**

**Senator Oehlke: Seconded.**

**A Roll Call Vote was taken: Yea 7, Nay 0, Absent 0.**

**Senator Oehlke will carry the bill.**

**FISCAL NOTE**  
**Requested by Legislative Council**  
01/28/2009

Bill/Resolution No.: SB 2437

1A. **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.*

	2007-2009 Biennium		2009-2011 Biennium		2011-2013 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues						
Expenditures						
Appropriations						

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

2007-2009 Biennium			2009-2011 Biennium			2011-2013 Biennium		
Counties	Cities	School Districts	Counties	Cities	School Districts	Counties	Cities	School Districts

2A. **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 2437 provides for the payment of a 50% share of property taxes on the surface land by the owners of severed minerals that are being produced.

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.*

If enacted, SB 2437 will shift 50% of the property tax liability for land onto the owners of severed minerals that are being produced. These payments will be provided as a property tax refund to the surface owners. There is no net change in the total amount of property tax revenue that will be paid to political subdivisions.

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 is also included in the executive budget or relates to a continuing appropriation.*

<b>Name:</b>	Kathryn L. Strombeck	<b>Agency:</b>	Office of Tax Commissioner
<b>Phone Number:</b>	328-3402	<b>Date Prepared:</b>	01/31/2009

Date: 02/09/09

Roll Call Vote #: 1

2009 SENATE STANDING COMMITTEE ROLL CALL VOTES  
BILL/RESOLUTION NO. : 2437

Senate Finance and Taxation Committee

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Legislative Council Amendment Number \_\_\_\_\_

Action Taken  Do Pass  Do Not Pass  Amended

Motion Made By Senator Miller Seconded By Senator Oehlke

Senators	Yes	No	Senators	Yes	No
Sen. Dwight Cook - Chairman	/		Sen. Arden Anderson	/	
Sen. Joe Miller - Vice Chairman	/		Sen. Jim Dotzenrod	/	
Sen. David Hogue	/		Sen. Constance Triplett	/	
Sen. Dave Oehlke	/				

Total: Yes 7 No 0

Absent 0

Floor Assignment Senator Oehlke

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

**REPORT OF STANDING COMMITTEE**

**SB 2437: Finance and Taxation Committee (Sen. Cook, Chairman) recommends DO NOT PASS (7 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING). SB 2437 was placed on the Eleventh order on the calendar.**

2009 TESTIMONY

SB 2437

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#1  
TESTIMONY GERMANE TO SB2437

(PROPERTY TAX PAYMENTS BY OWNERS OF SEVERED MINERAL INTEREST  
RECEIVING OIL OR GAS ROYALTY PAYMENTS)

09FEBRUARY09

TO: ND SENATE FINANCE AND TAXATION COMMITTEE

FM: DEWEY OSTER, McLEAN COUNTY RECORDER  
NORTH DAKOTA COUNTY RECORDER'S ASSOCIATION LEGISLATIVE COMMITTEE

Good morning Chairman Cook and members of the Senate Finance and Taxation Committee

The members of ND County Recorder's Association go on record in total opposition to this bill.

My association testified against a similar bill last Wednesday,....HB1281....relating to the  
taxation of severed minerals.

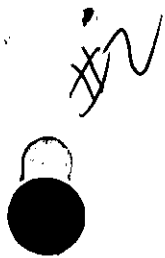
Activity involving taxation of severed minerals and royalty interest owners has been on the  
legislative agenda for many decades. It has always failed. And most certainly the biggest  
issue, is that it is impossible to tax minerals and do it fairly and equitable, without first compiling  
complete abstracts of title on all lands within the state of North Dakota. This point alone renders  
this bill impossible....simply not feasible....not do-able....cost prohibitive.

The question the recorders have is....who is going to do the title work....who is going to  
determine these "royalty folks" for the county auditor and treasurer to levy/collect the tax. Does  
this mean that the task would rest on the shoulders of the recorders? Probably.

Recorders, while being well-versed and knowledgeable when it comes to the real estate  
records, are not qualified to complete such abstracting work, nor do we have the time or  
adequate staffing. We are not licensed abstractors nor attorneys with oil/gas expertise. (NDCC  
43-01-14 & 15 and 27-11-01 & 11-18-01 are applicable.)

Presently....as you are well aware....minerals are taxed in North Dakota when there is mining  
and production....that seems to work....and that is the way it should stay.

We ask that this bill receives a "Do Not Pass".



# **Northern Alliance** *of* **INDEPENDENT PRODUCERS**

January 9, 2009

SB 2437 (royalty owner to pay 50% property taxes) OPPOSED

Chairman Cook and Members of the Finance and Taxation Committee

The Northern Alliance opposes SB 1281, which mandates the owner of severed mineral interests who are receiving royalty payments must pay 50% of the property taxes of the surface owner. The bill embarks on a cumbersome process for the county recorders and auditors that is unwieldy and unworkable. Specifically, we oppose the bill for the following reasons:

1. The bill ignores current tax policy, and the significant payment of taxes producing minerals are currently subject to in North Dakota. If minerals are not producing they impose little if any tax burden to the surface owner. Once oil is produced, then the mineral estate (including the tens of thousands of North Dakota residents) is subject to an 11.5% tax on gross receipts. (In 2007, those taxes produced \$250 million alone).
2. Secondly, the bill includes any severed mineral interest that receives royalty, which makes the administrative challenge of the bill even greater, because the term includes over-riding royalty owners (who often reserve 1-2% of the working interest as part of the fee for assembling the leases upon which exploration may take place). At a recent hearing, McKenzie County reported that on one 320 acre tract, there were 55 mineral owners and 150 royalty owners. (The administrative nightmare that the fractional ownership pattern in western North Dakota makes the notice and collection of 50% of the real estate taxes simply unworkable). (The bill contemplates a tax for the surface only, not improvements--again complicating the property tax system).
3. The 50% of the surface owner's tax liability bears no relationship to the amount of royalty received, and is completely arbitrary and unfair. (The property tax liability could well exceed the royalty payment, depending on the size of the well, and amount of minerals owned).
4. Additionally, the joint and several liability of the mineral owners for tax liability further confounds the property tax structure making it more unworkable and producing unfair results. (For example, if a large mineral owner fails to pay his share of the 50% of the property tax, then the remaining mineral owners are liable for the tax. Failure to pay

their co-owners property tax may jeopardize the ownership of their own minerals. And if they pay the tax of another no mechanism is defined to describe how they might recover the payment of another's tax liability).

5. Because of the sometimes fractional nature of severed minerals in North Dakota, the collection of the tax by the County is unwieldy and will impose an enormous burden upon the County Treasurer and Recorder's offices.
6. Finally, and perhaps most importantly the bill produces an unfair consequence that threatens mineral ownership in North Dakota, and for what end, is unclear. An example will help illustrate the point:
  - a. Grandma died in 1985, owning 1400 acres of land and minerals in McKenzie Co.
  - b. She had 7 children, all of whom had children, most of whom live in ND.
  - c. The farmland was inherited by a son.
  - d. The minerals were "severed" from the farmland in her estate, and distributed to her children, who now have production and receive royalty payments.
  - e. Under the current proposal, the children are liable for 50% of the property taxes for the farm inherited by their brother. If one child fails to pay the taxes, then the remaining siblings are responsible for them, and their brother (as the surface owner) would have the right of first refusal to acquire the minerals in a tax foreclosure.

We recommend a DO NOT PASS on SB 2437.

*Robert W. Harms*

Robert W. Harms

President

Northern Alliance of Independent Producers

#3a



Ron Ness  
President  
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**Senate Bill 2437**  
**Senate Finance & Taxation Committee**  
**February 9, 2009**

Chairman Cook and Members of the Committee, my name is Ron Ness. I am the President of the North Dakota Petroleum Council. The North Dakota Petroleum Council represents 160 companies involved in all aspects of the oil and gas industry and has been representing the industry since 1952. We appear before you today in opposition to SB 2437.

Legislation attempting to tax minerals has been attempted for more than 100 years with the first bill in 1907. Laws attempting to tax severed minerals have been overturned twice by the North Dakota Supreme Court in 1928 and 1951. Minerals are valued and taxed when they are produced and a portion of North Dakota's gross production tax is considered in lieu of property taxes. Royalty owners pay a considerable production tax on their royalties as well as personal and corporate income taxes.

The following examples indicate the problems with passage of SB 2437:

- If the state or federal government own severed minerals, the associated value of their minerals would be exempt from property tax, reducing revenue to counties. The federal government and State of North Dakota were the first to begin severing minerals. Those entities would not be impacted by this tax.
- Under any section in western North Dakota, there may be 1 to 300 mineral owners. Who is to find them and determine their fractional share of the payable tax? The administrative burdens and costs would likely far outweigh the benefit in many counties.
- This is double taxation. The minerals are already taxed when produced and pay personal and corporate income taxes. The gross production tax and extraction tax are paid by severed

mineral owners under producing properties, in lieu of a severed mineral property tax. Another tax would be double taxation and unconstitutional when and if these properties become productive.

- Minerals have been severed for a variety of reasons over our state's history. The primary reason is economics. Minerals have value and are sold or retained for that reason. Surface owner's value of their land has acknowledged that perceived or real value as ownership has transferred.
- What if the well is marginal or the royalties paid are a fraction of a percent, which is often the case. Some owners don't make enough to pay their proportionate share.
- What happens to minerals where owners cannot be found, have died, etc? Does the county foreclose on the minerals?
- Severed mineral owners use very few, if any, government and community services to justify their paying taxes on non-producing minerals.

The North Dakota Petroleum Council opposes this bill and urges a Do Not Pass recommendation. I would be happy to answer any questions.

ownership, there was not a taking of property that required compensation under the 14<sup>th</sup> Amendment of the United States Constitution.

### TAXATION OF SEVERED MINERAL INTERESTS <sup>100 YRS.</sup>

For more than 100 years, periodic attempts have been made in North Dakota to tax severed mineral interests out of existence. In 1907 the Legislative Assembly enacted what is now codified as NDCC Section 57-02-24, which requires assessors to list and assess severed mineral interests for property tax purposes. The law is still in existence, but the law is not followed because it is impossible as a practical matter to locate the owners and to assess the value of minerals in place in the earth.

In 1923 the Legislative Assembly enacted an annual state tax of three cents per acre for severed mineral interests. The revenue from the tax was to be paid into the state general fund. If the tax was delinquent for three years, proceedings were instituted to declare the title to the mineral interest forfeited to the state. The North Dakota Supreme Court in *Northwestern Improvement Co. v. State*, 220 N.W.2d 436 (1928) ruled that the tax on severed minerals was unconstitutional. The court concluded that the law provided an unreasonable and arbitrary classification for property tax purposes based on severance of ownership of minerals. The court concluded that the statute violated the uniformity of taxation within a class of property requirement of Section 176 (now Article X, Section 5) of the Constitution of North Dakota.

In 1947 the Legislative Assembly again attempted to tax severed mineral interests. The 1947 law attempted to avoid the Supreme Court objections from 1928 by not imposing a "property" tax. The 1947 law provided for an "excise tax" of three cents per acre on severed mineral interests. The tax did not apply when mineral rights are developed or for mineral leases held for development purposes. The North Dakota Supreme Court in *Northwestern Improvement Co. v. County of Morton*, 47 N.W.2d 543 (1951) ruled the 1947 legislation unconstitutional. The court ruled that the standard of uniformity under Section 176 (now Article X, Section 5) of the state constitution is substantially the same as the standard of equality under the 14<sup>th</sup> Amendment to the United States Constitution. The court concluded that the limitation on the power of the Legislative Assembly to classify property is equivalent to the limits of the 14<sup>th</sup> Amendment to the United States Constitution which, by requiring equal protection of the laws, precludes purely arbitrary classification. The court stated "It is obvious to this court that the manner or method by which mineral rights are severed from the surface of the land cannot be made the full basis of the classification of such mineral rights for taxation purposes."

In 1953 another attempt was made to impose a tax to eliminate severed mineral interests. This time, the attempt was made to avoid the Supreme Court's conclusion that tax cannot be levied against only severed mineral interests. The Legislative Assembly passed a bill that would have taxed all mineral interests and conveyed severed mineral interests to the owners of the surface estate in the event of tax foreclosure. The bill was vetoed by the Governor, who pointed out that the opportunity for the surface owner to regain mineral interests would be at the expense of property owners who had retained their mineral rights and who would have been taxed on those interests.

A mineral tax of 25 cents per acre for severed mineral interests would have been imposed by 1981 Senate Bill No. 2421. The bill was defeated in the Senate.

A mineral tax of 25 cents per acre, which could be increased to 35 cents per acre by the board of county commissioners, would have been imposed by 1983 Senate Bill No. 2410. The bill was defeated in the Senate.

A tax of 25 cents per acre on severed mineral interests would have been imposed by 1989 House Bill No. 1361. The bill was withdrawn before its first committee hearing.

In addition to the constitutional impediments to imposing a tax on severed minerals, numerous practical problems exist. According to an attorney engaged in oil and gas title work, there are more than 70,000 square miles of property in the state for which title work would be required if severed mineral interests were taxed and there are approximately 2.5 million severed mineral interest owners who would need to be identified and taxed by county officials. The potential existence of severed mineral interests under city lots, rights of way, lakes and streams, and platted lands would further complicate the title work and administrative problems. In addition to administrative problems for county officials, title attorneys working for the oil and gas industry would face an increased workload because it would be necessary to check the status of paid or unpaid taxes on severed mineral interests. This increase in title work and the resulting increase in costs would cause counties and the oil and gas industry to oppose legislation to impose taxes on severed mineral interests.

### SEVERED MINERALS TAXES IN OTHER STATES

It was requested that this memorandum review provisions of law in Colorado and any other states that impose taxes on severed mineral interests. Contacts with officials in other states have not provided any reliable information on whether the following provisions of law are enforced in other states and how effective they are in reuniting severed mineral interests with the ownership of the surface estate.

The following is a summary of provisions of law in other states which we have been able to identify.

### Colorado

Colorado imposes a property tax on severed mineral interests. The owner of the surface estate from which a mineral interest has been severed may require the assessor of the county to assess and tax severed mineral interests underlying the property (Colorado Revised Statutes (CRS) 39-1-104.5). If property taxes on severed minerals remain unpaid, upon a sale of the tax lien for the severed mineral interests, the surface owner has the right of first refusal to acquire the mineral interests.

Colorado property taxes on severed mineral interests are imposed at different rates depending on whether the property is producing oil and gas. Nonproducing severed mineral interests are valued at 29 percent of actual value in the same manner as other real property (CRS 39-1-104). The valuation for assessment of producing oil and gas properties is set by the legislature and is determined by reference to the prior year's production and a specified year's prices (CRS 39-1-103, 39-1-104, 39-7-102).

### Alabama

Alabama levies a stamp tax upon recording of every lease, deed, instrument, transfer, or evidence of sale of severed mineral interests. The rate of the tax is 5 cents per acre conveyed for terms of 10 years or less, 10 cents per acre for terms of 10 years to 20 years, and 15 cents per acre for terms of more than 20 years. The tax must be paid before an instrument may be recorded so there is no possibility of forfeiture of the property to reunite the surface and mineral estates.

### Florida

Florida law subjects subsurface mineral rights to separate taxation. Subsurface mineral rights that have been sold or otherwise transferred or acquired by reservation are treated as an interest in realty subject to taxation separate and apart from the surface ownership of the property.

### Indiana

Indiana law provides that all property in the state is subject to taxation unless expressly exempt. Indiana law defines real property to include an estate, right, or privilege in mines or minerals, if the estate, right, or

privilege is distinct from the ownership of the surface of the land.

### Kentucky

Kentucky law requires all property to be assessed at its fair cash value. The Kentucky Revenue Cabinet values and assesses unmined coal, oil, and gas reserves, and any other mineral or energy resources owned, leased, or otherwise controlled separately from the surface real property, at no more than fair market value in place.

### Mississippi

Mississippi imposes a stamp tax on filing and recording of any instrument relating to leasing, conveying, transferring, excepting, or reserving a mineral or royalty interest. The rate of tax is three cents per acre for a term of 10 years or less, six cents per acre for a term of 10 years to 20 years, and eight cents per acre for a term of more than 20 years. Like the Alabama stamp tax, there is no possibility of forfeiture to reunite the surface and mineral estates.

### New Mexico

New Mexico imposes a tax on each person owning a complete or fractional interest in any oil, gas, or carbon dioxide at the time of production. The tax is imposed on the assessed value, which is an amount equal to 150 percent of the value of the product after deductions for royalties and transportation and application of the uniform assessment ratio for property. The rate of the tax is different in each taxing district because the rate applied is the property tax rate for nonresidential property in the taxing district.

### Ohio

Ohio law provides for imposition of property taxes on mineral rights owned separately from the surface.

### Tennessee

Tennessee law provides for imposition of property taxes against mineral interests and all other interests in real property which are owned separately from the surface estate.

### Texas

Texas law provides for assessment and taxation of taxable leaseholds, mineral interests not being produced, and oil or gas interests.

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Gary D. Preszler, Commissioner

**TESTIMONY OF GARY D. PRESZLER  
STATE LAND COMMISSIONER  
North Dakota State Land Department**

**IN OPPOSITION OF SENATE BILL NO. 2437**

**SENATE FINANCE AND TAXATION COMMITTEE  
February 9, 2009**

Chairman Cook, members of the Finance and Taxation Committee, I am Gary Preszler, Commissioner of the Land Department and Secretary of the Board of University and School Lands.

Senate Bill 2437 provides that severed minerals owners pay the equivalent of fifty percent of the property taxes. Since 1939 when the Board sold land they reserved a mineral interest. That mineral reservation initially was a 5% interest, which was increased to 50% in 1941 and since 1960, as provided by the Constitution, the Board reserves 100% of the minerals. Further, a 50% mineral interest is retained when foreclosed properties are sold. Consequently, the state is a substantial severed mineral interest owner.

The Board manages over 700,000 surface acres. These acres are not subject to local property taxes, although a county services payment for roads and bridges and an in-lieu property tax on foreclosed, or deed in lieu of foreclosure, is paid to the counties.

The language in SB2437 starting on line 11, "[A]ll provisions of law governing property taxes apply" is ambiguous as to whether any properties managed by the Board are subject to the tax. The in-lieu property tax and the county services payment, along with the Board being immune from other property tax levies, create the confusion.

Payments representing property taxes to counties are effectively offsetting since the lion's share of property taxes are for schools, and on the other hand, distributions from the trust funds directly benefit the public school system. If the trust funds have an additional property tax expense, distributions will have to be similarly reduced.

A proposed amendment is requested that exempts trust fund properties from the severed mineral tax.

I ask the committee to grant SB2437 a "do not pass" recommendation if the proposed amendment is not adopted.



State Land Department  
February 9, 2009

PROPOSED AMENDMENTS TO SENATE BILL NO. 2437

Page 1, line 13, after the period insert "Mineral interests managed by the board of university and school lands are exempt from this Act."

Renumber accordingly