2011 HOUSE FINANCE AND TAXATION

HB 1420

2011 HOUSE STANDING COMMITTEE MINUTES

House Finance and Taxation Committee
Fort Totten Room, State Capitol

HB 1420
January 31, 2011
#13679

☐ Conference Committee

Committee Clerk Signature	Mary Brucker

Explanation or reason for introduction of bill/resolution:

A Bill relating to oil extraction tax rates and exemptions; and to provide an effective date.

Minutes: *See attached testimony #1, #2,#3, #4*

Representative Shirley Meyer: Sponsor. Support. Please refer to attached testimonies #1a and b. Two years I had contemplated introducing similar legislation to this but the industry did not support the bill because oil prices were dropping so you ask yourself why? Why would the industry not support a bill that lowers the tax levied on not just the industry but on royalty owners across the state? Referred to attached testimony. Let me take you back two years ago. December 2008 saw crude oil prices dropping like a rock after record prices that summer. By January of 2009 all indications were that the trigger would activate by the end of May. With a much cheaper oil rates a significantly lower tax would be applied. Two years ago even under the much smaller production the state had at that time and it is less than half of what we are currently seeing. We came within one day in $.22 triggering a major tax reduction. If that trigger had activated the reduction would have reduced the state's revenues by well over $100 million. Under today's production and we're at 360,000 barrels a day, that loss of revenues would be much greater. It is impossible for an oil company to plan or budget or prepare for an event like that. It is also impossible for a state legislature that meets every other year to budget for an event like that. This bill would reduce but more importantly simplify the tax. As you've heard there is a fiscal note. I did not get a chance to review the fiscal note until about 10 minutes ago so I haven't really had the time to analyze it, however, I believe Representative Onstad is going to be here and hopefully would have had a little longer time to review it. I want to point out with the fiscal note that under our current tax system neither the industry nor the state can accurately forecast what that number is going to be. We live in an enviable position. You look around the nation and you look around the world and we all sit here and pat ourselves on the back on what good stewards we are and look we've created a budget surplus but you and I know that the Bakken oil was here long ago. Dean told me and I'm not sure if this is true but he said the Bakken oils have been here so long he thinks it was even here when the Democrats controlled the Senate, that's a long time ago. As a Board of Directors of the state the legislature has always struggled to maintain a fair and equitable tax base. Our tax structure is often compared to a three legged stool, we've heard it already. We have the legs that are income tax, sales tax, and property tax. However, the energy has added a fourth and now a much longer leg to that stool. There are many bills floating

around the session. We've heard most of them in here in the last three weeks. There are bills to reduce corporate tax and bills to reduce personal income tax. I personally don't feel our income tax is so very high and with our exemptions our sales taxes aren't terribly high, and property taxes are high but we are working to help local entities reduce them. Our taxes on energy production are taxed on not only the industry but on royalty owners across the state is an 11 ½%. We are putting too much dependence on one leg of that stool and someday it is going to come back and haunt us. This is a cyclical industry. Our oil tax policy is complicated. We have extraction taxes, gross production taxes, incentives for horizontal drilling, triggers, stripper well exemptions, secondary tertiary recovery allowances, and on and on. On the attachment I've passed out it lists the different exemptions. HB 1420 gives not only the oil companies more predictable, reliable tax rate it also helps the state reach a more realistic amount with which to budget. The specifics of the bill will drop the extraction tax rate from 6 ½% to 4 ½ %, it completely eliminates the trigger. The exemptions that will stay in place are production from stripper wells, the 60 month exemption from wells within boundaries of Indian reservations and incentives for secondary and tertiary recovery. I would appreciate you giving 1420 a favorable recommendation.

Chairman Wesley R. Belter: This drop was only on new wells. Was there any consideration on doing this on all oil?

Representative Shirley Meyer: We kicked that thought around for awhile and decided to go with new production so that there is this flat rate for oil companies coming in. They are not only here for the boom if we have this predictable flat rate on what they are coming in and creating new then maybe we have a chance for them to stick around and help with secondary and tertiary recovery.

Representative Onstad: Co-sponsor. Support. Please refer to attached testimony #2. We didn't know what the fiscal was until this weekend. The fiscal note assumes that incentives go away so then everything is at that 11 ½%. Everything is marked down from there, so from 11 ½% to 9 ½%, there would be a loss of $371 million to the state. In actuality if the incentives were in place we would be at a current rate of 10.25%. If we go from the 11 ½% to 10.25% the fiscal note would probably be about $231 million. If we went forward from this point on our current rate is at that 10.25% so making that assumption it is how you want to look at that fiscal note if it really is a loss. It is a loss and we have to base it on that but if we leave the discounts in place we are not at that 11 ½% currently. We are asking to lower this down and make it fair for everybody. This really becomes an actual continuation of our current rate. This new rate allows some discounts to continue but it's really not on the books. It creates fairness to a new company entering the state. A new company entering the state would pay the full 11 ½% to start new production. An established company, depending on the types of wells they have and in the formation they are at they might be receiving some discounts. 10.25% is an average so a lot of companies might be at that lower rate. We are asking to bring them all together and make it a flat rate. With all these incentives in place and over the last 30 years depending on the spike or slump in the price we've always put some incentives on to encourage that. I think with the current situation with production continuing to increase our prices are such that we don't anticipate a drop and everything looks favorable for that production. Representative Meyer talked about the trigger price and how hard it is to budget knowing that's in the

background and asking if its on or off, it is hard to do the two year budget. We look favorable to the passage of HB 1420.

Vice Chairman Craig Headland: You mentioned currently the effective rate is equal to about 10.2 to 10.3% and you're looking at dropping the extraction tax from 11 ½ to 10.25%. With maintaining the exempted oil that is produced in strippers and tertiary projects, are we to assume the effective rate is going to drop again to 1.25 points?

Representative Onstad: Over the years, because of the discounts, we were collecting around 9% average. With new production going on we don't have new incentives in that area. If that goes up and what's happening is the 9 went up to 10 ¾ and now we are 10.25 and with the continuation of that it will go up and probably reset at 11 ½%. The Tax Department says it is a complicated system to pay out all these different discounts so now is the time with production going up and moving forward to start with a clean slate and do that. We're saying to encourage new companies into the state if they saw that it would be a little bit fairer to everybody. If things are left alone that effective rate will continue to rise I suspect.

Chairman Wesley R. Belter: I believe there is one county that has considered possibly reducing the number of permits for new wells because they feel they can't handle the infrastructure caused by the number of wells being drilled. If we lower the tax I would assume that would create an incentive for more drilling to take place. Is this bill somewhat in conflict with what some of the counties are experiencing?

Representative Onstad: The counties are asking to slow the permitting process because they can't keep up with their infrastructure. It is also oil and gas division's regulatory body to monitor and carry out the duties of the oil and gas division. If you look at the request of FTDs, I think they are asking for about 20, to increase that number. We need that proper balance to regulate with current statute in place. Providing an incentive, I don't look as providing an incentive I think we are cleaning up and old tax structure and we're substituting with more of a flat rate so it's easier to administer and it's fair to the new company that is looking to come into the state versus one that is already established. Its more about fairness and cleaning up older incentives that a good portion of them aren't even being used right now.

Representative Dave Weiler: Was there any discussion when putting this bill together to reduce the production tax instead of the extraction tax? The reason I say that is because by reducing the extraction tax you are affecting the water resources, the trust fund accounts, etc. If you were to reduce the gross production tax you're going to affect the political subdivisions because they get a portion of that.

Representative Onstad: The production tax now, originally 80% of that was to go to the counties that are impacted. 20% was established for the state. We have an impact a grant and that's at 1/3 and the rest of that would go into the general fund. Over the course of time we've initiated the production tax so it's been lowered down so when a new county comes in and get the million cap from then on they are incremented up. We left that alone. We looked at increasing those trust funds to maybe 30% and the reduction would be on the state level which is 60%. We know that production is rising and if predictions are correct

we are to be at 415 or 450 barrels a day. I've seen a lot of higher predictions too. To answer your question in short, we just felt the way production is going that it will probably make up those differences in those two accounts.

Representative Dave Weiler: The effects on the political subdivisions if we pass your previous bill they could just borrow the money. You don't need to comment on that.

Representative Onstad: It's just another tool in the tool chest.

Ron Ness, President of the North Dakota Petroleum Council: Support. Please refer to attached testimony #3.

Representative Shirley Meyer: Under you assumptions is that a differential of 916 or what is that figure?

Ron Ness: You are correct on the bottom there. In the assumption we used we tried to tie it to the state budget. We used a differential from MYMEX and that is one of the issues in North Dakota, you are never really getting what you are getting in an MYMEX. As production grows your differential grows so it's $9.16 off an MYMEX.

Mike Cantrell, Continental Resources Inc.: Support. Please refer to attached testimony #4.

Chairman Wesley R. Belter: No opposition. No neutral testimony. Closed hearing on HB 1420.

2011 HOUSE STANDING COMMITTEE MINUTES

House Finance and Taxation Committee
Fort Totten Room, State Capitol

HB 1420
January 31, 2011
#13731

☐ Conference Committee

Committee Clerk Signature	Mary Brucker

Explanation or reason for introduction of bill/resolution:

A Bill relating to oil extraction tax rates and exemptions; and to provide an effective date.

Minutes:

No attachments.

Chairman Wesley R. Belter: Any concerns or any discussion?

Representative Glen Froseth: I like the provisions of both these bills that take away a lot of the exemptions and incentives and make it a lot cleaner method of figuring the taxes. I don't know if I could support a 2% reduction in the taxes. There is so much need out there in the oil patch and across the state in fixing infrastructure. Maybe 2 or 4 years from now it could be the ideal time but right now I don't think it's really a good idea. The oil companies aren't really looking for a tax break to stay here. I know everybody would like to pay fewer taxes but the oil industry is going great guns right now and I don't think it's going to affect them one way or another.

Chairman Wesley R. Belter: Let's not debate the bill today but I just wanted to bring it up in case anyone had any amendments or concerns they wanted to bring forward.

Representative Glen Froseth: I had Kathy Strombeck run some numbers for me on a flat tax and doing away with the two tiered 5% 6 ½ extraction and figured at 11%. That ½% would amount to $97 million if we got rid of all the triggers and got a flat tax across the board and kept all our funds whole. So there is a little bit of difference in the money involved with reducing taxes, it was close but there is still less money and if you went to the flat tax there would less loss to the general fund.

Representative Shirley Meyer: Just one note of caution; we really have to keep the production tax and extraction tax separate. We can't combine them. They have to be kept separate.

Chairman Wesley R. Belter: When you said 11% were you talking on all oil or just new?

Representative Glen Froseth: All oil with the exception of the stripper wells, leave them at 5%. One percent of one-fifth goes to the counties and 1% of 1/5 goes to the water

resource trust fund. I wanted to keep all those funds whole. She figured it out that by keeping it whole it gives you a flat tax rate. The proposal that the Petroleum Council wanted to come in with was a 9.25% flat tax so there must be a way to put into the code that those funds will still continue to get their share.

Representative Mark S. Owens: I will bring an amendment.

Chairman Wesley R. Belter: No further discussion.

2011 HOUSE STANDING COMMITTEE MINUTES

House Finance and Taxation Committee
Fort Totten Room, State Capitol

HB 1420
February 7, 2011
#14154

☐ Conference Committee

Committee Clerk Signature	Mary Brucker

Explanation or reason for introduction of bill/resolution:

A Bill relating to oil extraction tax rates and exemptions; and to provide an effective date.

Minutes:

No attachments.

Representative Bette Grande: Made a motion for a DO NOT PASS.

Representative Patrick Hatlestad: Seconded.

A roll call vote was taken: YES 9 NO 4 ABSENT 1
MOTION CARRIED---DO NOT PASS.

Representative Patrick Hatlestad will carry HB 1420.

FISCAL NOTE

Requested by Legislative Council
01/19/2011

Bill/Resolution No.: HB 1420

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.*

	2009-2011 Biennium		2011-2013 Biennium		2013-2015 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues				($371,000,000)		
Expenditures						
Appropriations						

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

2009-2011 Biennium			2011-2013 Biennium			2013-2015 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).*

HB 1420 reduces the oil extraction tax rate on new wells from 6.5% to 4.5%.

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 2 of HB 1420 reduces the oil extraction tax rate on new wells from 6.5% to 4.5%. This rate reduction is expected to reduce legacy fund, permanent oil tax trust fund, education funds, and water resources trust fund revenues by an estimated $371 million in the 2011-13 biennium.

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.*

Name:	Kathryn L. Strombeck	Agency:	Office of Tax Commissioner
Phone Number:	328-3402	Date Prepared:	01/28/2011

Date: 2-7-11
Roll Call Vote # 1

2011 HOUSE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. 1420

House Finance and Taxation Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number

Action Taken: ☐ Do Pass ☒ Do Not Pass ☐ Amended ☐ Adopt Amendment

☐ Rerefer to Appropriations ☐ Reconsider

Motion Made By Rep. ~~Winrich~~ Grande Seconded By Rep. Hatlestad

Representatives	Yes	No	Representatives	Yes	No
Chairman Wesley R. Belter	✓		Scot Kelsh	AB	✓
Vice Chair. Craig Headland	✓		Shirley Meyer		✓
Glen Froseth	✓		Lonny B. Winrich		✓
Bette Grande	✓		Steven L. Zaiser		✓
Patrick Hatlestad	✓				
Mark S. Owens	✓				
Roscoe Streyle	✓				
Wayne Trottier	✓				
Dave Weiler		✓			
Dwight Wrangham	✓				

Total (Yes) 9 No 4

Absent 1

Floor Assignment Rep. Hatlestad

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

REPORT OF STANDING COMMITTEE

HB 1420: Finance and Taxation Committee (Rep. Belter, Chairman) recommends **DO NOT PASS** (9 YEAS, 4 NAYS, 1 ABSENT AND NOT VOTING). HB 1420 was placed on the Eleventh order on the calendar.

2011 TESTIMONY

HB 1420

Testimony #1 A

STATE OF NORTH DAKOTA

OFFICE OF STATE TAX COMMISSIONER

Cory Fong, Commissioner

ANNUAL OIL TRIGGER PRICE ADJUSTMENT

TO: **North Dakota Oil Producers and Purchasers**

FROM: **Office of State Tax Commissioner**

SUBJECT: **Notification of Oil Trigger Price Adjustment for Calendar Year 2011**

DATE: **December 31, 2010**

In keeping with the provisions of North Dakota Century Code (N.D.C.C.) § 57-51.1-01, the Tax Commissioner has determined that the oil trigger price for the calendar year January 1, 2011, through December 31, 2011, is $46.78.

For your information, the following steps determined the trigger price for calendar year 2011:

STEP 1 - The annual average of the industrial commodities producer price index, commodity code 03 thru 15, as published by the U.S. Department of Labor, Bureau of Labor Statistics, for fiscal year 2010 was computed from the data shown below.

July	2009	174.6
August	2009	177.7
September	2009	176.9
October	2009	177.8
November	2009	180.1
December	2009	180.4
January	2010	184.6
February	2010	183.6
March	2010	185.6
April	2010	187.0
May	2010	187.2
June	2010	186.4
Annual Average		181.83

STEP 2 - A base rate adjustment of 1.31761 was computed by dividing the 2010 fiscal year average price index of 181.83 by the base rate index of 138.0, which was determined using the 2001 fiscal year average (i.e., 181.83 / 138.0 = 1.31761).

STEP 3 - The effective trigger price of $46.78 for calendar year 2011 was computed by multiplying $35.50 times the base rate adjustment of 1.31761 (i.e., $35.50 X 1.31761 = $46.78).

In accordance with N.D.C.C. § 57-51.1, if the average price of a barrel of crude oil (i.e., monthly average daily closing price for a barrel of west Texas intermediate Cushing crude oil minus two dollars and fifty cents) exceeds the trigger price for each month in any consecutive five-month period, certain exemptions and rate reductions become ineffective. The exemptions and rate reductions are subsequently reinstated if the average price is less than the trigger price for each month in any consecutive five-month period.

The trigger price adjustment is published on the Office of State Tax Commissioner's web site located at: www.nd.gov/tax. If you have any questions regarding this notification, please contact the Oil and Gas Tax Section at 701.328.3657 or by email at oiltax@nd.gov.

600 E. BOULEVARD AVE., DEPT. 127, BISMARCK, NORTH DAKOTA 568505-0599
701.328.7088 FAX: 701.328.3700 HEARING/SPEECH IMPAIRED: 800.366.6888 WWW.ND.GOV/TAX TAXINFO@ND.GOV

 Testimony #18

Prepared by the North Dakota Legislative Council staff
January 2011

Shirley

OIL TAX-RELATED INFORMATION FOR THE 2011-13 BIENNIUM

This memorandum provides information regarding statutory provisions relating to oil and gas gross production tax, oil extraction tax, the permanent oil tax trust fund, the oil and gas research fund, and the oil and gas impact grant fund; the legacy fund; oil prices and production; oil tax-related revenues and distributions for the 2009-11 biennium to date; and oil tax revenue projections for the 2011-13 biennium.

OIL AND GAS GROSS PRODUCTION TAX (NORTH DAKOTA CENTURY CODE CHAPTER 57-51)

The gross production tax on oil is 5 percent of the gross value at the well on oil produced. The gross production tax on gas is four cents times the gas base rate adjustment for each fiscal year as calculated by the Tax Department. Shallow gas produced during the first 24 months of production from and after the date of first sales of gas from a well completed or recompleted in a shallow gas zone after June 30, 2003, is exempted from the gross production tax. The oil and gas gross production tax is distributed per formula to the legacy fund, the oil and gas research fund, oil and gas impact grant fund (up to $8 million per biennium under current law), the state general fund or the permanent oil tax trust fund, and political subdivisions within producing counties.

OIL EXTRACTION TAX (CHAPTER 57-51.1)

The oil extraction tax rate is 6.5 percent, but the rate may be reduced or oil may be exempt as determined by a trigger price. The trigger price is defined in statute as $35.50 as indexed for inflation. The current trigger price is $46.79. If the average price of a barrel of oil exceeds the trigger price for each month in any consecutive five-month period, the oil extraction tax is 6.5 percent. If the average price of a barrel of oil is less than the trigger price for each month in any consecutive five-month period, the tax rate is reduced or oil is exempted for the following activities:

- For oil produced from any well drilled and completed as a vertical well after April 27, 1987, there is no extraction tax levied for the first 15 months, and thereafter the rate is 4 percent.
- For oil produced from any well drilled and completed as a horizontal well after April 27, 1987, there is no extraction tax levied for 24 months, and thereafter the rate is 4 percent.
- For incremental production from qualifying secondary recovery projects that have used up the five-year exemption from the date incremental production begins, the rate is 4 percent.
- For incremental production from qualifying tertiary recovery projects that do not use carbon dioxide which have used up the 10-year exemption from the date incremental production begins, the rate is 4 percent.
- For oil produced from a qualifying well that was "worked over" there is no extraction tax levied for 12 months, beginning with the first day of the third calendar month after the completion of the workover project, and thereafter the rate is 4 percent.
- For oil produced from a certified two-year inactive well there is no extraction tax levied for 10 years after the date of receipt of certification, and thereafter the rate is 6.5 percent.
- For oil produced from a certified horizontal reentry well there is no extraction tax levied for nine months after the date the well is completed as a horizontal well, and thereafter the rate is 6.5 percent.

The following activities are specifically exempt from the oil extraction tax without regard to the trigger price:

- Production from stripper wells.
- Incremental production from a qualifying secondary recovery project is exempt for five years from the date incremental production begins.
- Incremental production from a qualifying tertiary recovery project that does not use carbon dioxide is exempt for 10 years from the date incremental production begins.
- Incremental production from a qualifying tertiary recovery project that uses carbon dioxide is exempt from the date the incremental production begins.
- The initial production of oil from a well is exempt from any oil extraction tax for a period of 60 months if it meets any of the following conditions:

  Is located within the boundaries of an Indian reservation;

  Is on lands held in trust for an Indian tribe or individual Indian; or

  Is on lands held by an Indian tribe as of August 1, 1997.

Under the July 1, 2008, agreement between the Governor and the Three Affiliated Tribes of the Fort Berthold Reservation, wells on trust lands are subject to a tax of 11.5 percent and wells on nontrust lands are subject to a tax of 5 percent. Tax revenue from

wells on trust lands are divided evenly between the tribe and state, and tax revenue from wells on nontrust lands are allocated 80 percent to the state and 20 percent to the tribe. The effect of the agreement is to allow the exemption only for wells on nontrust lands within the reservation.

A contingent rate reduction in the oil extraction tax, which can only go into effect if the trigger price rate reduction is not in effect, reduces the oil extraction tax rate for horizontal wells from 6.5 percent to 2 percent during the time the rate reduction is in effect. The rate reduction 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 $55. The contingent rate becomes ineffective on the first day of the month following a month for which the average price of a barrel of crude oil exceeds $70. The contingent rate reduction applies to oil produced during the first 18 months after completion for a horizontal well drilled and completed after April 30, 2009, and is limited to the first 75,000 barrels or the first $4.5 million of gross value at the well of oil produced from the well. If the rate reduction is effective on the date of completion of a well, the rate reduction applies to production from that well for up to 18 months after completion, even if the price of oil rises to more than $70. If the rate reduction is ineffective on the date of completion of a well, the rate reduction does not apply to production from that well at any time. The contingent rate reduction was in effect from May 1, 2009, through October 31, 2009. During October 2009, the average price of a barrel of crude oil exceeded $70. North Dakota Century Code defines the average price of a barrel of crude oil used to determine the trigger and contingent rate reduction to be the monthly average of the daily closing price for a barrel of West Texas intermediate Cushing crude oil minus $2.50.

The oil extraction tax is allocated as follows:

- Thirty percent to the legacy fund beginning July 1, 2011.
- Twenty percent to the resources trust fund for water development projects.
- Ten percent to the foundation aid stabilization fund.
- Ten percent to the common schools trust fund.
- Sixty percent to the state general fund or the permanent oil tax trust fund after allocation to the oil and gas research fund.

The constitutional and statutory provisions for distribution of the oil extraction tax will exceed 100 percent beginning July 1, 2011. The 2011 Legislative Assembly may wish to consider statutory changes to ensure the distribution formula for the oil extraction tax does not exceed 100 percent.

PERMANENT OIL TAX TRUST FUND (SECTION 57-51.1-07.2)

Section 57-51.1-07.2 (1997 Senate Bill No. 2366) establishes a permanent oil tax trust fund and provides that all revenues deposited in the general fund during a biennium derived from taxes imposed on oil and gas under Chapters 57-51 (Oil and Gas Gross Production Tax) and 57-51.1 (Oil Extraction Tax) which exceed $71 million are to be transferred by the State Treasurer to the permanent oil tax trust fund. The State Treasurer is to transfer the interest earnings on the fund to the general fund as they accrue. The principal of the permanent oil tax trust fund may only be spent upon a two-thirds vote of the members elected to each house of the Legislative Assembly.

LEGACY FUND

The 2009 Legislative Assembly enacted House Concurrent Resolution No. 3054, which was approved by North Dakota voters in the 2010 general election and which creates a new section to Article X of the Constitution of North Dakota to create a new North Dakota legacy fund. The measure will become effective July 1, 2011. The constitutional measure provides that 30 percent of all revenues derived from taxes imposed on oil and gas be transferred to the legacy fund. The principal and earnings of the legacy fund accruing prior to June 30, 2017, may not be expended until after June 30, 2017, and then may only be spent upon a two-thirds vote of the members elected to each house of the Legislative Assembly. Expenditures from the fund are limited to 15 percent of the principal during a biennium. Earnings of the fund accruing after June 30, 2017, will be transferred to the state general fund.

OIL AND GAS RESEARCH FUND (SECTION 57-51.1-07.3)

Section 57-51.1-07.3 (2003 Senate Bill No. 2311) establishes the oil and gas research fund. Section 57-51.1-07.3 provides that 2 percent of the state's share of the oil and gas gross production tax and oil extraction tax revenues, up to $4 million per biennium, is to be deposited into the oil and gas research fund. All money deposited in the oil and gas research fund is appropriated as a continuing appropriation to the Oil and Gas Research Council.

OIL AND GAS IMPACT GRANT FUND

Section 57-51-15 (1989 House Bill No. 1302) establishes the oil and gas impact grant fund for deposit of revenue from oil and gas gross production taxes. Section 57-51-15 provides that one-third of one percent of the gross value of oil at the well, up to $8 million per biennium, is to be deposited into the oil and gas impact grant fund. Money in the oil and gas impact grant fund is disbursed by the Energy Development Impact Office of the Land Department as grants to local units of government affected by oil and gas development activity. The executive budget recommends increasing the allocation to the oil and gas impact grant fund to a maximum of $100 million.

OIL AND GAS TAX REVENUE DISTRIBUTION FLOWCHART

Attached as an appendix is a flowchart reflecting the distribution of oil and gas tax revenues for the 2011-13 biennium based on current law.

OIL PRICES AND PRODUCTION

The following table provides information from the Department of Mineral Resources relating to average North Dakota oil prices and daily production levels for the 2009-11 biennium through November 2010:

	Average North Dakota Oil Price	Average Daily Production of Barrels of Oil
July 2009	$54.87	227,880
August 2009	$61.41	232,365
September 2009	$59.26	238,172
October 2009	$65.52	240,041
November 2009	$67.06	245,854
December 2009	$63.96	242,107
January 2010	$68.57	236,176
February 2010	$67.58	261,223
March 2010	$71.20	277,454
April 2010	$71.26	284,492
May 2010	$60.10	298,283
June 2010	$63.14	314,696
July 2010	$67.35	321,163
August 2010	$69.07	328,883
September 2010	$67.95	341,385
October 2010	$74.41	342,094 (preliminary)
November 2010	$75.60 (preliminary)	342,247 (preliminary)

OIL AND GAS TAX REVENUES

The following table provides information on actual monthly distributions of oil and gas tax revenues for the 2009-11 biennium to date through December 2010:

Actual Monthly Distributions									
	General Fund	Permanent Oil Tax Trust Fund	Oil and Gas Research Fund	Oil and Gas Impact Fund	Resources Trust Fund	Common Schools Trust Fund	Foundation Aid Stabilization Fund	Political Subdivisions	Total
August 2009	$28,814,213	$89,005[1]	$588,045	$1,205,112	$3,708,878	$1,854,439	$1,854,439		$38,114,131
September 2009	14,115,128	124,131[1]	288,064	1,510,131	3,620,364	1,810,182	1,810,182	$14,452,459	37,730,641
October 2009	23,881,587	159,105[1]	487,380	1,424,978	4,266,878	2,133,439	2,133,439	10,070,975	44,557,781
November 2009	4,189,072	19,731,466	484,475	1,585,995	3,651,341	1,825,671	1,825,671	6,983,331	40,277,022
December 2009		28,942,441	585,855	1,707,402	4,147,702	2,073,851	2,073,851	6,289,856	45,820,958
January 2010		30,594,234	622,853	566,382	4,324,659	2,162,329	2,162,329	6,732,783	47,165,569
February 2010		30,856,996	625,085		4,358,550	2,179,275	2,179,275	5,695,998	45,895,179
March 2010		28,518,377	318,243		3,964,773	1,982,386	1,982,386	4,420,759	41,186,924
April 2010		40,420,799			5,245,925	2,622,963	2,622,963	6,616,346	57,528,996
May 2010		43,175,692			5,693,977	2,846,988	2,846,988	5,582,773	60,146,418
June 2010		88,721,611			11,847,487	5,923,743	5,923,743	5,648,302	118,064,886
July 2010								4,565,549	4,565,549
August 2010		43,461,105			5,600,893	2,800,447	2,800,447	4,387,448	59,050,340
September 2010		31,761,664			6,343,686	3,171,843	3,171,843	21,528,772	65,977,808
October 2010		43,241,561			6,513,183	3,256,591	3,256,591	12,084,863	68,352,789
November 2010		44,174,395			6,256,551	3,128,276	3,128,276	9,036,237	65,723,735
December 2010		52,063,832			7,520,245	3,760,123	3,760,123	9,777,874	76,882,197
Total	$71,000,000	$526,036,414	$4,000,000	$8,000,000	$87,065,092	$43,532,546	$43,532,546	$133,874,325	$917,040,923

[1]This amount reflects a portion of the first $700,000 of the state's share of oil extraction tax revenue produced from wells within the exterior boundaries of the Fort Berthold Reservation which is required to be deposited in the permanent oil tax trust fund pursuant to Section 57-51.1-07.4.

DISTRIBUTION OF OIL AND GAS GROSS PRODUCTION TAXES TO POLITICAL SUBDIVISIONS

Oil and gas gross production taxes are apportioned to the state and counties pursuant to Section 57-51-15. From the tax equal to the first 1 percent of gross value at the well of oil production, a direct allocation of $500,000 is provided for a city in an oil-producing county which has a population of 7,500 or more and more than 2 percent of its employment engaged in the mining industry. The allocation is increased to $1 million if the city's employment in the mining industry exceeds 7.5 percent of its total employment. Also from the tax equal to the first 1 percent of value of oil produced is a biennial allocation to the oil and gas impact grant fund up to $8 million. Any amounts remaining from the first 1 percent are allocated to the state general fund.

After deduction of the amounts provided for above, remaining annual revenue from the tax is allocated as follows:

1. The first $2 million is allocated to the county.

2. The next $1 million is allocated 75 percent to the county and 25 percent to the state general fund.
3. The next $1 million is allocated 50 percent to the county and 50 percent to the state general fund.
4. The next $14 million is allocated 25 percent to the county and 75 percent to the state general fund.
5. All annual revenue remaining after the above allocations is allocated 10 percent to the county and 90 percent to the state general fund.

The table below provides information on the distribution of the oil and gas gross production taxes for oil produced from July 2009 through October 2010 for oil-producing counties and oil extraction tax and oil and gas gross production tax for Fort Berthold based on information from the State Treasurer. The amounts include distributions to cities and school districts within the counties:

County	2009-11 Biennium to Date Actual Revenue for Oil Production Through October 2010
Billings	$7,349,021
Bottineau	5,314,550
Bowman	12,822,533
Burke	5,170,272
Divide	6,519,075
Dunn	13,456,243
Golden Valley	1,851,773
Hettinger	471
McHenry	89,239
McKenzie	14,406,359
McLean	423,384
Mercer	17,085
Mountrail	23,992,458
Renville	2,641,890
Slope	1,712,126
Stark	5,167,542
Ward	195,445
Williams	13,847,714
Fort Berthold	18,897,145
Total	$133,874,325

2011-13 PRELIMINARY REVENUE FORECAST

The table below presents information on estimated oil and gas tax revenue based on the Office of Management and Budget's revised revenue forecast for the 2009-11 biennium and the executive revenue forecast for the 2011-13 biennium:

	2009-11 Biennium Legislative Forecast (May 2009)[1]	Revised 2009-11 Biennium Forecast[2] (December 2010)	Executive 2011-13 Biennium Forecast[3] (December 2010)
General fund	$71,000,000	$71,000,000	$71,000,000
Permanent oil tax trust fund	323,092,000	886,261,921	607,271,039
Legacy fund			612,468,299[4]
Political subdivisions	101,211,208	168,759,700	247,196,952
Oil and gas research fund	4,000,000	4,000,000	4,000,000
Oil and gas impact grant fund	8,000,000	8,000,000	100,000,000
Common schools trust fund	25,554,341	68,472,199	99,906,177
Foundation aid stabilization fund	25,554,341	68,472,199	99,906,177
Resources trust fund	51,108,682	136,944,397	199,812,353
Total oil and gas tax revenue	$609,520,572	$1,411,910,416	$2,041,560,997

[1]The legislative forecast estimated oil prices to range from $40 to $45 per barrel in the first year of the 2009-11 biennium and $50 to $55 per barrel in the second year. The daily production rate was estimated to average approximately 213,000 barrels for the 2009-11 biennium.

[2]The revised 2009-11 biennium forecast reflects actual collections for fiscal year 2010 and revised estimates for fiscal year 2011 based on an average price per barrel of $67 and an average daily production rate of 366,250 barrels.

[3]The executive forecast for the 2011-13 biennium estimates oil prices to average from $72 per barrel in the first year of the 2011-13 biennium and $75 per barrel in the second year. The estimated average daily production rate ranges from 390,000 barrels per day to 405,000 barrels per day for the first year of the biennium and from 405,000 barrels per day to 425,000 barrels per day in the second year.

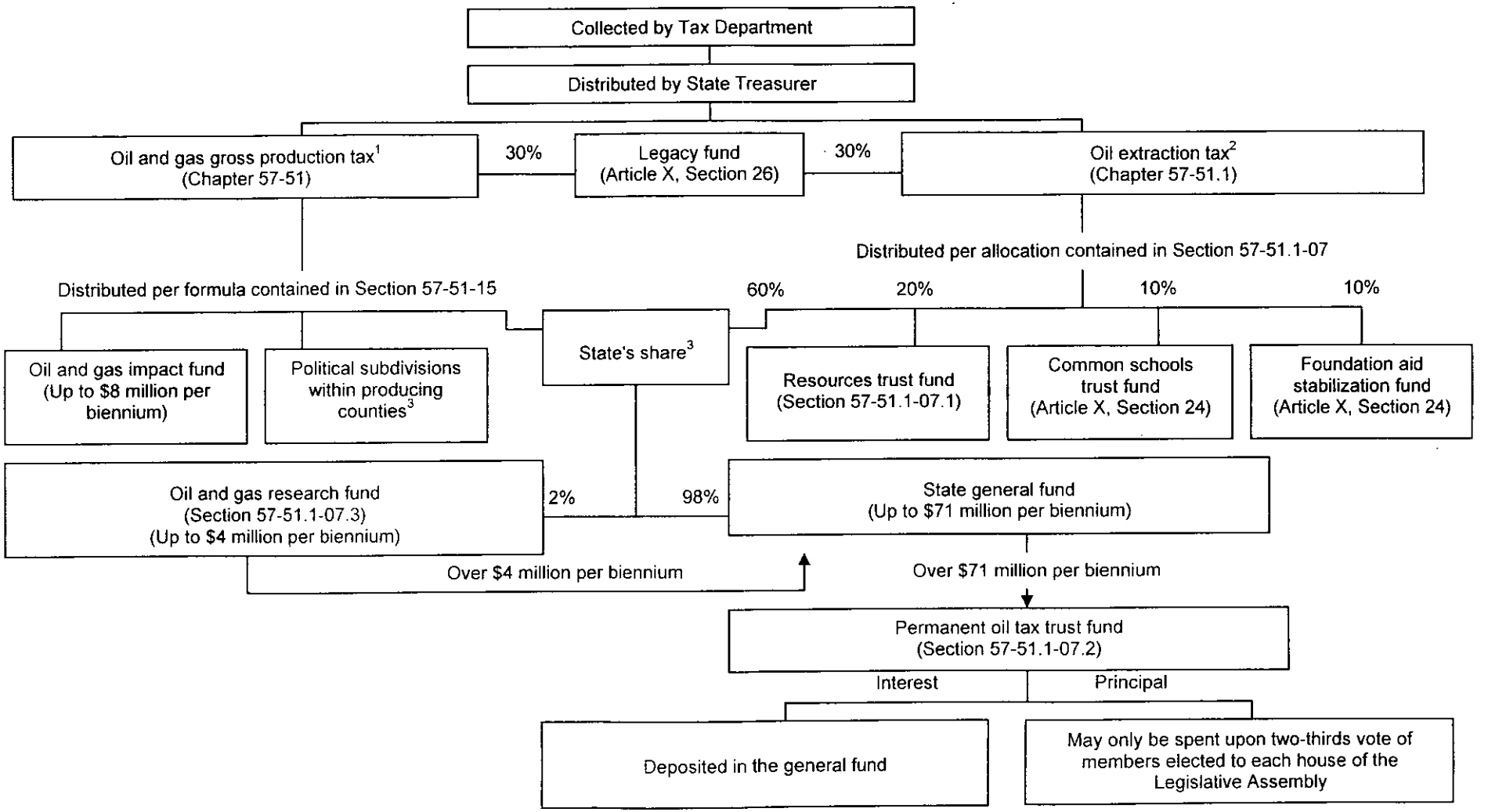
[4]Passage of constitutional measure No. 1 in the November 2010 general election resulted in the creation of a legacy fund. The legacy fund will receive 30 percent of oil and gas gross production and oil extraction taxes beginning July 1, 2011, resulting in $612.47 million estimated to be deposited in the legacy fund rather than the permanent oil tax trust fund during the 2011-13 biennium.

ATTACH:1

Prepared by the North Dakota Legislative Council staff

January 2011

Oil and Gas Tax Revenues Distribution of Funds for the 2011-13 Biennium Based on Current Law



[1]The gross production tax on oil is 5 percent of the gross value at the well on oil produced. The gross production tax on gas is four cents times the gas base rate adjustment for each fiscal year as calculated by the Tax Department.

[2]The oil extraction tax is 6.5 percent of the gross value at the well and 4 percent in certain situations.

[3]The oil and gas gross production tax is distributed to the political subdivisions and to the state general fund based on each county's production and city populations.

Testimony #2

Testimony for HB 1420

Good Morning Mr. Chairman and Members of the Finance and Tax Committee

Kenton Onstad, Parshall, District 4

HB 1420 eliminates several incentives for oil and gas extraction and lowers the extraction tax.

When the bill was drafted it was the intent of the sponsors to remove incentives and maintain the current Effective Tax rate. This would provide fairness to new companies while maintaining the same level for established companies.

We used 9.5%. The tax department states it is approximately 10.25%. We recommend you amend the bill to the 10.25%.

We didn't know exactly what the fiscal note was until this week-end and this is really the first time we have seen it.

The fiscal note assumes the incentives goes away and the current rate is 11.5%. The loss then is established from that point to the original amendment of 9.5%.

It would be $231 million if reduced to the 10.25%

If incentives are repealed and maintain the current rate of 10.25% this is actually a continuation of our current rate.

This new rate allows some discounts to actually continue. It creates fairness to new companies entering our State for oil and gas exploration.

I look at it maintains our current revenue stream with the new rate.

Mr. Chairman, I ask to amend the 9.5% to 10.25% and look favorable to the passage of HB 1420.

Thank you

Testimony #3 A p. 1

NORTH DAKOTA PETROLEUM COUNCIL

Ron Ness
President

Marsha Reimnitz
Office Manager

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House Bill 1420
House Finance & Taxation Committee
January 31, 2011

Chairman Belter 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 260 companies involved in all aspects of the oil and gas industry and has been representing the industry since 1952. Our members produced nearly 95% of the 110 million barrels of oil produced in North Dakota in 2010. I appear before you today in support of HB 1420.

The Bakken is an amazing resource, it provides great jobs, great wealth, population growth, and energy for our nation. Along with that, as we all know, it creates great challenges for our state and industry as we go forward. Fortunately, the growth in oil tax revenues has made investing in those challenges and funding the needs rather easy while nearly all other states struggle to balance their budgets. Even with our infrastructure challenges, our state is enjoying tremendous budget surpluses enabling us to increase funding to education, water projects, creating the Legacy Fund while still having the ability to provide massive tax relief to our citizens in the form of property tax and income taxes.

To put this all in perspective it was only a decade ago when we collected oil and gas production taxes at $60 million for an entire biennium, while today we are now collecting nearly $60 million per month with an expected two billion in the next biennium or even much more . Yes, it is easy for us to vote for beneficial projects and tax relief now when the surplus is there– it's great fun, but we have to be cautious and look long term .

At today's high oil prices, the great Bakken recovery rates we are seeing in many parts of western North Dakota, and with over 160 rigs drilling it is easy to paint a rosy picture. But history teaches us it is easy to become complacent and short sighted with potentially catastrophic results.

With the current level of activity and current economics, it would only be logical for you to ask why should the State consider changing its oil and gas tax policy now, and why would the industry even suggest it at this time of good economics and high prices? The short answer is this is a different time, we are developing what has become a known and vast resource that we never knew existed before, and we need a long term plan over the next several decades, not months or years, to maximize this long term, vast resource, for the benefit of everyone.

The oil and gas tax rate was raised 130% in 1980 at a time when all things seemed rosy, government spending was rising and didn't seem to be an issue and then it all crashed. High taxes and low prices effectively halted all development and the State's over reliance on production taxes sent us into a budgetary free fall. For the past 30 years ND Legislature has struggled with the right oil and gas tax policy and over time has adopted a complex tax structure with more than a dozen incentives and price triggers. These efforts over the years to adjust the tax policy since 1980 did sustain our industry and benefit the state as well, but today we have a vast resource previously unknown or unreachable which requires careful and serious evaluation of our tax policy going forward.

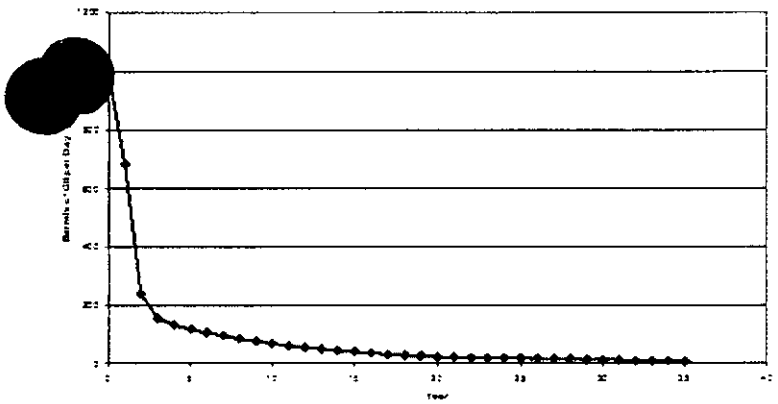
HB 1420 is similar to a plan we have been advocating, this bill or some version of putting this tax structure in place while times are good, should seriously be considered. If you solely look at today's prices and activity naturally one will wonder why lower the tax now? However, the concept is not to look just at today, next month, or next year, but to look forward in terms of decades. For the State of North Dakota it will create predictability for long-term tax collections by eliminating the 130% swing in tax rates from 5% to 11.5% and creates a flat rate of 9.5% for only new wells. Existing wells are locked in at 11.5%. In future times of low prices, and if history teaches us anything we know low prices will also occur, it will be a tax increase to the State and provide more revenue to the state when it's needed. This is what a flat rate does – it evens it out over time. Predictability and simplicity – nobody knows what the price will be in the future but if we know the tax we have reduced the uncertainity which provides more predictability which helps the state and industry.

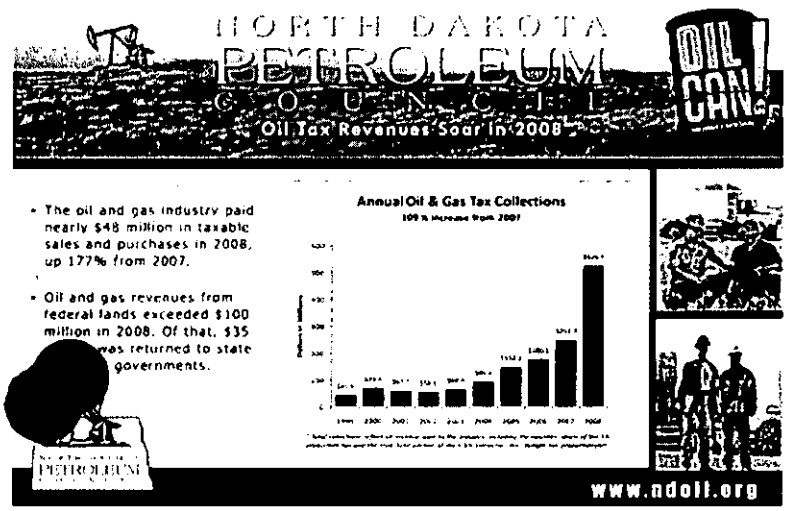
The Bakken play is an intensive capital cost venture, where companies are budgeting or hope to budget hundreds of millions and in many cases several billion dollars each over many years to come. We've seen how these investments to date have improved technology and ultimate recovery of oil. Yet, as of today, we only recover a small amount of oil from the reservoir rock. To maximize this vast resource and achieve even higher recovery rates with the continued advancement in expensive technology over the next several decades, billions and billions of dollars of capital will be required in times of both high prices and low to maintain and develop this resource. A long term fiscal tax policy, one that is fair, competitive and simplified helps companies raise and meet their capital investment requirements, which in turn will be reflected in the higher ultimate recovery of oil produced and corresponding revenue to the State of North Dakota and its citizens. Industry is going to drill many wells and produce lots of additional oil at these prices and success rate, it's the potential decades of drilling after that we should be looking at by passing this type of oil tax structure when times are good. This bill locks in all existing wells at the highest tax rate – that also provide guaranteed revenue for the state and it's a tax increase at oil prices below 50 barrel -- it establishes a new fair, competitive, and predictable tax rate that looks toward the future.

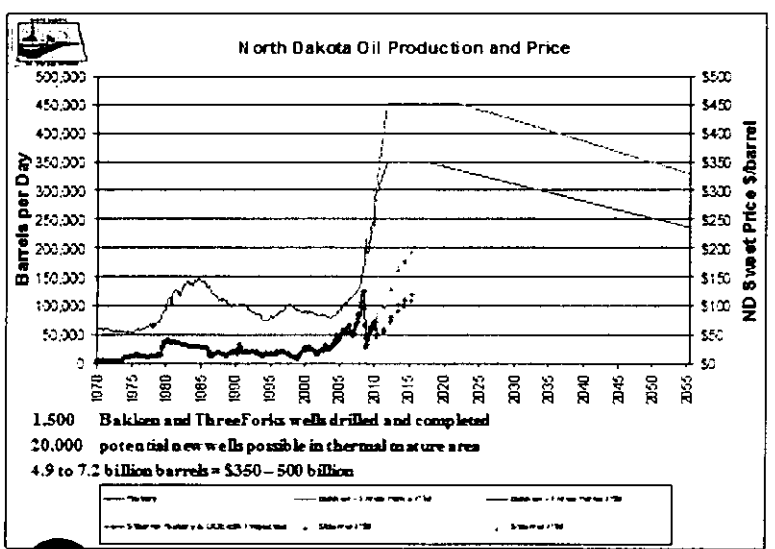
We urge you to support a change in North Dakota's oil tax structure.

Testimony #3 p.3

Typical Bakken Well Production





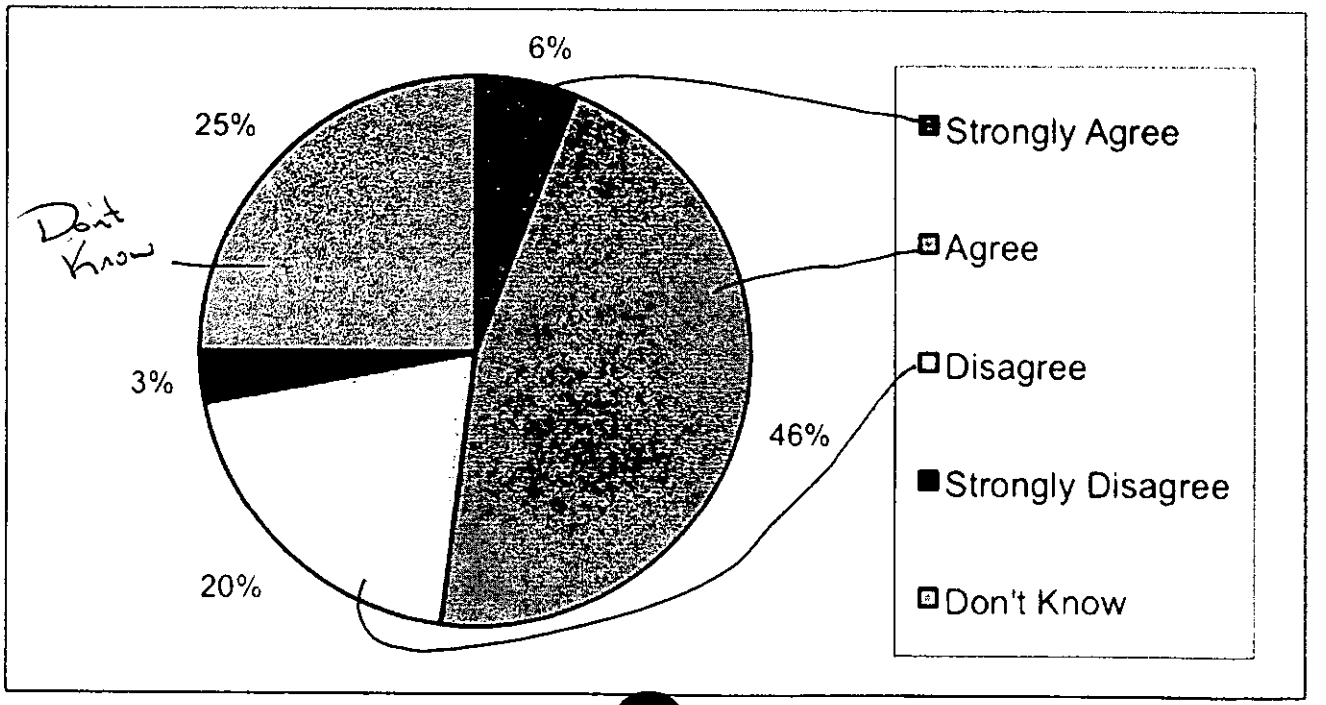


NORTH DAKOTA
PETROLEUM
COUNCIL

Testimony #3 p. 4

Tax Rate Should be Comparable to Other Oil-producing States

- Majority (52%) either agree (46%) or strongly agree (6%) that the oil industry in ND should be taxed at a rate that is comparable to the taxes charged by other oil-producing states.



Can [redacted] Current Oil Tax Structure Be Simp[redacted]ed?

Testimony #38

North Dakota - Oil Tax Evaluation

	$70 Oil Price						
	Current Structure		Proposed Structure				
Fiscal Year	Total Revenue $	Effective Tax Rate	Total Revenue $	Effective Tax Rate	Difference in Tax Revenue $	Average NYMEX Oil Price $/bbl	Forecast Average Oil Production BPD
7/2011-6/2012	1,145,178,306	10.6%	1,070,675,154	9.9%	(74,503,152)	70.00	485,979
7/2012-6/2013	1,216,995,291	10.6%	1,072,611,624	9.3%	(144,373,667)	70.00	518,202
7/2013-6/2014	1,290,236,816	10.5%	1,105,946,485	9.0%	(184,290,330)	70.00	551,890
7/2014-6/2015	1,351,259,810	10.5%	1,138,257,534	8.8%	(213,002,275)	70.00	581,889
Five Year Total	5,003,660,222		4,387,490,797		(616,169,425)		
					-12.3%		

	$45 Oil Price						
	Current Structure		Proposed Structure				
Fiscal Year	Total Revenue $	Effective Tax Rate	Total Revenue $	Effective Tax Rate	Difference in Tax Revenue $	Average NYMEX Oil Price $/bbl	Forecast Average Oil Production BPD
7/2011-6/2012	472,149,416	8.4%	567,342,708	10.1%	95,193,292	45.42	423,678
7/2012-6/2013	355,864,174	8.3%	414,608,936	9.7%	58,744,762	45.00	328,159
7/2013-6/2014	309,322,526	8.3%	353,823,733	9.5%	44,501,207	45.00	284,247
7/2014-6/2015	287,024,169	8.3%	324,158,752	9.4%	37,134,583	45.00	264,043
1,424,360,285			1,659,934,128		235,573,843		
					16.5%		

State of North Dakota Forecast - Based on the September 2010 Preliminary Forecast

Fiscal Year	Total Revenue$	Oil Price $/bbl	Average Production Rate BPD
2010 Actual	$ 572,000,000	65.90	259,171
2011 Estimated	$ 839,000,000	67.00	368,250
2012	$ 978,000,000	72.00	397,500
2013	$ 1,062,800,000	75.00	415,000

***Next Bienium:**

If prices remain high, the state could see an initial loss of $218.9 million while still receiving $2.1 Billion in total collections.

If prices drop and production remains the same, the state could see an increase of $180 Million while receiving $981 Million in total collections.

Conclusions:

The proposed oil tax structure provides a more predictable long term revenue stream for the State of North Dakota. The proposed tax structure results in a 12.3% reduction in tax revenue in a high price environment ($70/bbl). However, revenue is increased by 16.5% in a low price environment ($45/bbl) through elimination of the various incentive triggers in the current structure.

Assumptions:

Calculated oil revenue assumes a differential of $9.16/bbl from NYMEX
Total revenue and effective tax rate includes Extraction and Production tax
Production Forecast assumes a 140 rig maximum with $70 oil price
Analysis assumes incentives trigger on for current tax structure at $46/bbl
Current structure with $45 oil price excludes tax incentives for workover, re-entries
Proposed tax structure assumes effective date of 7/11
Proposed tax structure assumes tax rate of 9.25% on all new production after 7/11
The 6 month delay in the trigger going on or off is not incuded in this analysis

Testimony # 4 p. 1

Testimony North Dakota legislature 1-31-11

Mike Cantrell

Hi, I'm Mike Cantrell and I are here representing Continental Resources Inc. Continental has operations in 20 states and is a major player in the resource plays across the Country. We have roughly 864,000 acres in the Bakken shale with 686,000 in North Dakota and 178,000 in Montana. We also have 310,000 acres in the Oklahoma Woodford and 73,000 acres in the Niobrara in Colorado. I am here today in support of the idea of reducing and simplifying the oil tax in North Dakota.

I would like to tell you I understand this tax here with all the downside price protection triggers, but I have only been here for two years! It's complicated, too high and not in the best interest of North Dakota or the companies that work here.

We have a simple philosophy at Continental. We don't advocate for anything until we think we can demonstrate that it is in the best interest of the state in which we live.

So in working on this issue for at least the past two years, we have done our best to demonstrate why it is in North Dakotas best interest to have a lower, simpler, more competitive tax rate.

The Bakken oil shale play is a world class oil play. The reserves are the most significant found in the U.S. in decades. You might wonder why with all the drilling in America since Colonel Drake discovered oil over a century ago are we just now getting around to North Dakota? The reasons are simple. This shale is the source rock from which reserves migrate. Until about 5-10 years ago we were not technically able to produce oil and gas out of the shales. They are just too tight and not permeable enough (in other words a lot like granite). Even though our own internal scoping or geological analysis of these reserves is a mind boggling 24 billion bbls of oil, the price has to be above $60 to make it profitable to drill and technology has to continue to get better in order to harvest these reserves. Now to get to the heart of the matter:

Anytime a large oil or gas field is discovered there is a rush to obtain the best and largest acreage position possible. We have had several failures before we were able to figure out how to get the oil out of these hard tight rocks. This process is expense. Each well can cost upwards of 6 million dollars. Not just every company can work here. Once we have drilled initial wells enough to hold our acreage we then come back and do the development drilling phase. In that phase we drill another 4-5 more wells on each tract. This the main reason you should consider getting your tax structure in line with the other states where shale resources are being discovered and developed.

Once the exploratory wells have been drilled and the acreage held then investment capital goes where it gets the best rate of return. North Dakota has several disadvantages here. The weather is harsh resulting in higher cost. There is a lack of pipeline infrastructure to take the oil to the market so it has to be trucked or taken by rail. We/you get around $11 per bbl less for our oil here than in areas which have the pipeline infrastructure to get the oil to refineries. So we get around $11 per bbl more for oil sold in Texas and Oklahoma. The tax rate in North Dakota for these wells is 11.5% that is compared to around 7.5% in The Eagleford shale play in Texas and 7.2% for the Woodford shale play in Oklahoma. When Continental went public a few years back we should have had a come out price of $17 per share but it was $15. When we asked the analyst why they said we were discounted because the bulk of our reserves were in North Dakota where there is bad weather, a lack of infrastructure and a high tax rate.

You can't do anything about the weather, at least not yet. The infrastructure will eventually after several years catch up. The market place is just now realizing the size of the Bakken. It takes years and hundreds of millions of dollars to build pipelines that are needed here.

You can do something about your non competitive tax rate. Just bringing it in line with Montana at 9.25% would help keep investment dollars coming to North Dakota once the exploratory phase is over.

When will that be? Who knows for sure? We continue to expand the field. The best part, what we call the sweet spots, is being drilled now. As we step out and expand the production we don't know what we will find for sure. We have encountered more water with the oil the North West part of the field. That was unexpected and raises cost.

Continental Resources and our Chairman Harold Hamm are committed to North Dakota. We don't just come here and harvest the oil. We invest in North Dakota communities. Whether it's several million to help the heritage center or building an emergency room in a hospital or a myriad of things Harold does that none of us ever know about, we give back. Harold has been to four of the state's universities in the last year, taking time to encourage students to work hard and believe in themselves. That is just who we are and what we do.

Like every other independent in the U.S we drill up all our profits and borrow more to keep drilling. A lower tax rate means more wells drilled and more positive economic impact for North Dakota. That's what we do with the money. For every additional rig we can run drilling 10 wells per year it means 120 million dollars to North Dakota's economy. For the long term sustainable investment in North Dakota's growth we believe now is the time to bring the tax on oil into a more competitive range with other states.

Thank you for your consideration.