2013 SENATE FINANCE AND TAXATION

SB 2336

2013 SENATE STANDING COMMITTEE MINUTES

Senate Finance and Taxation Committee
Lewis and Clark Room, State Capitol

SB 2336
2/5/2013
Job Number 18265

☐ Conference Committee

Committee Clerk Signature	Angela Rittmiller

Explanation or reason for introduction of bill/resolution:

A BILL for an Act to create and enact a new section to chapter 57-38 and subsection 10 of section 57-51.1-03 of the North Dakota Century Code, relating to income tax withholding on oil and gas royalty payments to nonresidents and an oil extraction tax exemption for wells completed outside the Bakken and Three Forks formations; to amend and reenact sections 57-51.1-01, 57-51.1-02, 57-51.1-03, and 57-51.1-03.1 of the North Dakota Century Code, relating to oil extraction tax rates and exemptions; to provide an effective date; and to provide an expiration date.

Minutes: Testimony Attached

Chairman Cook opened the hearing on SB 2336.

Chairman Cook introduced SB 2336 and provided a slide presentation, attachments 1-6.

Senator Triplett - You mentioned that a large part of the bill here is removing the exemptions. If we do that, approve this bill, remove the exemptions and drop the top down from 11.5 to 9.5, what protection is there from future legislatures simply adding the exemptions back in again?

Chairman Cook - It's something that could happen but it would certainly be something that would have to be justified as a benefit to the state of North Dakota.

Senator Triplett - You referenced the $2 billion of potential loss if there is a dramatic shift, dramatic drop in the price of oil. Have you made any effort to calculate what the loss would be to the state from 2017 going forward for the next 20 years?

Chairman Cook - I can honestly say that I didn't, but I know others have. I got the fiscal note, and I think this gets to the question you are asking. That is an analysis that was done by Alan Knutson and I think that's the reference that was made to the press about the impact of this reduction, and it shows that in the first year, 2017, we would lose $49 million in revenue. Is that the one you are referring to?

Senator Triplett - I wasn't referring to anything in particular, I was asking if you had done any analysis.

Chairman Cook - Well this is the analysis I have done. You will see for the 5 years there there's close to $600 million in lost revenue, but there's something that is missing from this slide. It did not take in to consideration the increased revenue that the state will be getting because of the stripper property fix. You can see production in 2013-15 you'll recognize the $84 million increase in oil revenue which is what is projected to happen in this biennium. That fix is going to continue to offer more revenue to the state in years coming. (12:30)

Senator Miller - In essence, your bill, its intention is to curb the uncertainty for the state and provide some long term certainty to our forecast.

Chairman Cook - From the very beginning I was looking for something that would be a win, win. A win for the tax people of the state of North Dakota, a win for the oil industry, I don't look at the oil industry as being big bad villains, I look at them as being a tremendous partner with the state. They are employing a whole lot of people in our state.

Senator Dotzenrod - How important is that 2% reduction for the 6.5 down to 4.5? If we were to pass the bill and not have that in there, we did all the other things the bill asked for, but not that.

Chairman Cook - You would be having a pass in legislation then that as going to impose a considerable tax increase on the oil industry.

Senator Burckhard - Can you talk a little about what this kind of affect is on the states that we compete with for oil production?

Chairman Cook - We hear a lot of conversation about where our tax is relative to other states taxes. I think if you look at just our tax rate we probably will appear high, when you look at all the taxes, we are probably the only state that does not impose a property tax on this industry. I think when you put all the taxes on the table we are probably in the middle of the pack.

Senator Triplett - You said a moment ago that you want the oil industry to be successful. Do you have any evidence for us to suggest that the oil industry is not currently successful in North Dakota?

Chairman Cook - This isn't about today, it's about the future.

Senator Miller - How do you think this does as far as fairness or leveling the field?

Chairman Cook - I'm not too sure I dare even speak to that question, but again, it's a question that can be posed to the actual industry people behind me.

Senator Triplett - You mentioned the boom and bust of the 1980's, do you understand geologically the distinction between oil development going on in the 80's and what is going on now in the Bakken?

Chairman Cook - Yes I do.

Representative Drovdal spoke of this bill leveling the playing field, and this being a fairness issue.

Senator Triplett - You referenced the fact that you have a stripper bill of your own on the House side. Between your stripper bill and Chairman Cook's bill section, which do you prefer?

Representative Drovdal - I think a package deal is by far fair all the way through the industry. We are going to change some definitions in mine and there may be some definitions in this so they are the same. In the end we will only need one bill.

Senator Triplett - That really wasn't my question. My question was, your stripper well bill compared to the stripper well section of this bill, there are some differences between them. Could you speak to that?

Representative Drovdal - I have an amendment for mine to take it up to 50 barrels, the other is 45 so that is close and one of the differences.

Chairman Cook - This is just Three Forks and Bakken only.

Senator Triplett - My next question is about the loophole. You referred to it before and just again as a loophole, is it your understanding that the stripper well exemption was created and identified for the days of vertical well drilling where there was a question about whether or not the next well might be successful.

Representative Drovdal -Yes

Senator Triplett - So it was an exemption that was not ever intended to be by the legislature when they created it.

Representative Drovdal - Nobody foresaw these types of drilling wells. I don't believe there was intent in those days and I called it a loophole and probably shouldn't because we created it. It isn't something they did.

Senator Triplett - You made the suggestion that the tax incentives that we have done in the past somehow made the difference in the development of the Bakken. Do you believe that is true?

Representative Drovdal - I do believe it's true. I think we have to show a good business attitude to businesses before they are going to invest in our state and that investment is what kept going.

Senator Triplett - You don't think it had a whole lot more to do with the fact that the oil industry figured out how to crack the code of the Bakken and do the fracking and such, you don't think that the fact that the oil is there and they figured out the technology, had a whole lot more to do with it than our tax policy?

Representative Drovdal - That technology is also working in a number of other states and they could have developed that technology in those states too. They chose to do it in North Dakota first. I think it did help. Was it the only answer, no, was it the only thing, no, but I do believe that it was certainly constructive to their decision making.

Senator Triplett - Do you have any evidence to back that up that our tax policy drove decisions?

Representative Drovdal - I don't know if there would be evidence.

Chairman Cook - I think we could go down this road on a whole lot of things. It's been well established that tax policy does have reactions.

Senator Dotzenrod - It appears that the bill on page 6 and other places sets up these 2 separate definitions for what a stripper well is. One definition is 30 barrels a day and the other definition is 45 barrels a day and depending on where that is. Do we need in this bill 2 separate definitions?

Representative Drovdal - You can put any amendment you want on a bill and see where it goes.

Ron Ness, North Dakota Petroleum Council - I stand in support of this bill today although our membership is not unanimous in support of this bill it does hold the discussion that we have urged this body to have over the past several legislative sessions. When you look at the oil and gas industry and the perception in North Dakota, it's always been a boom bust industry. The Bakken as we know is a unique resource. What we have strived for is we've got a tax policy that has been cobbled together, really since January 1981.

Ron Ness then provided some statistical information on the history of the oil industry in North Dakota, (36:20) and then of the provisions in the bill. (44:57)

Senator Triplett - You referenced that the stripper well properties have been part of our tax policy for 33 years. Isn't it correct that that stripper well exemption, both the wells and the properties was put into place at a time before horizontal drilling?

Ron Ness - Yes it was put into place before horizontal drilling came of the landscape in the early 1990's, but the intention was to encourage people to go back in and drill those offset wells in order to try to tap the resource and not waste the resource instead of walking away from the asset. I don't think the intent has changed. (52:10)

Senator Triplett - Isn't it the case that the Bakken wells that are now on stripper status are for the most part wells that were drilled before the multi-stage fracking was developed? These are mostly single-stage fracks that are now on stripper status.

Ron Ness - I think there would be a mix of those. (53:01)

Senator Triplett - You stated this is an effort to try to eliminate the boom and bust cycles of the past. You know better than most people that the Bakken play is inherently very different from the boom and bust cycles of the past. Don't you?

Ron Ness - I'm pretty well aware of that. (54:09)

Senator Triplett - You mentioned the costs being up for Bakken wells. Isn't it the case that the costs have really skyrocketed in large part because of the rush over the past several years to hold leases and now that that phase of holding leases is mostly done that we could expect some slowing down of development which would then help to drop the cost because there wouldn't be quite so much competition for employees and all of the products that are required.

Ron Ness - That certainly is the hope of industry but in addition you're also seeing substantial amounts of money being put in to the local infrastructure.

Senator Triplett - You and I have both worked personally outside of our legislative and professional areas to help get the legacy fund in place. The legacy fund is going to help to some degree to offset any potential swings in prices is it not?

Ron Ness - I think the legacy fund, I don't think you can assess that money until July 1, 2019 so the concept of that is certainly that it would help to ensure that it's here for the future generations but I don't know that in the near term here that that's going to be capable of helping.

Chairman Cook - I don't think we want to assume that the legacy fund is in place to kick in if oil revenue falls below what we expect. That's a whole policy question.

Senator Triplett - You invited the committee to consider moving the time frame from 2017 closer in time to the present. Do you expect if we leave this, if we pass this bill the way that Chairman Cook has drafted it, starting a reduction of extraction taxes in 2017, do you expect the oil companies to lay their rigs down and leave between now and then?

Ron Ness - I can't answer that. From a board room standpoint I don't think that can really happen. (58:20)

Senator Triplett - You referenced that the industry is giving up this safety net by getting rid of the exemptions. What is the guarantee for this legislature that the industry won't be right back in here asking for those exemptions to go on again 2, 4, 5 years down the road?

Ron Ness - I don't know what guarantee the industry has.

Blu Husley, Director of Government Affairs, Continental Resources Inc. - See attached testimony 7, opposed to SB 2336.

Chairman Cook - Yesterday there was a bill in the other chamber that brought the rate down instead of a time certain, it came down based on production levels, enabling that rate

to hit 9.5% possibly sooner possibly later, is that an approach that Continental finds more acceptable to this one, or does that not solve your problems either?

Blu Husley - We did support Representative Streyle's bill. However, I don't know the specifics; I think it's all workable. I think we do support the fact that it would be a production based, but all of the production would go down. I think you have a more simplified structure at that point in time also.

Kayla Pulvermacher, North Dakota Education Association - We are opposed, specifically the 2% reduction in the extraction tax. NDEA is concerned with the implications for future revenue that this may have for the common schools and foundation aide stabilization funds. As an association we have to concern ourselves with the cost of education and how the state will pay for it in future generations.

Chairman Cook - What do you think the projected revenue loss to the state is going to be?

Kayla Pulvermacher - We realize that the crystal ball is hazy at this point. No one can say for sure, but it is a decrease and we have finally hit that 70% of education funding. In order to do that for future generations it is a hefty cost. A cost for our children a cost for our teachers, cost for our schools. That is something we have to concern ourselves with.

Stewart Savelkoul, North Dakota Public Employees Association - We share some of the concerns of the North Dakota Education Association, but all I would speak to is that we've got a lot of concerns out west as everybody talks about all the time. Any time you open the newspaper you hear about this challenge or that challenge facing western communities because of the impact of the oil industry. We represent state employees and those in higher education and I can tell you that right now there are at least 30 job openings for folks at Dickinson State University and Williston State University and the human service centers out there, and D.O.T. and we are struggling to hire for those jobs because of the great work the oil industry has done. They are driving up the market which can be good thing for salaries in some respects but a difficult thing when it comes to recruiting and retaining quality employees. (1:10:14)

Kristi Schlosser Carlson, North Dakota Farmers Union - I represent the policies developed democratically by our 40,000 members. Our concern with this bill, while we appreciate legislation that looks comprehensively at solutions, our primary issue with this bill is one that we were hoping this legislature would spend a significant amount of time talking about, property tax relief. This mechanism is one that could provide property tax relief and we are hopeful that we can talk about that before we get to the point of talking about reducing extraction taxes. (1:14:30)

Chairman Cook closed the hearing on SB 2336.

2013 SENATE STANDING COMMITTEE MINUTES

Senate Finance and Taxation Committee
Lewis and Clark Room, State Capitol

SB 2336
2/13/2013
Job Number 18873

☐ Conference Committee

Committee Clerk Signature

Explanation or reason for introduction of bill/resolution:

A BILL for an Act to create and enact a new section to chapter 57-38 and subsection 10 of section 57-51.1-03 of the North Dakota Century Code, relating to income tax withholding on oil and gas royalty payments to nonresidents and an oil extraction tax exemption for wells completed outside the Bakken and Three Forks formations; to amend and reenact sections 57-51.1-01, 57-51.1-02, 57-51.1-03, and 57-51.1-03.1 of the North Dakota Century Code, relating to oil extraction tax rates and exemptions; to provide an effective date; and to provide an expiration date.

Minutes:

Committee Work

Chairman Cook opened discussion on SB 2336.

Chairman Cook - The threshold for stripper wells goes from 45 to 40, it puts a requirement to annually certify stripper wells for wells that are in the Three Forks and the Bakken formation, if at any time those wells reach 150 barrels of oil production per day they will lose that stripper well classification, and then on line 25 it sets another time at which the rate reduction from 6.5% to 4.5% could kick in other than January 1, 2017 and that would be the first day of the first calendar quarter after 3 consecutive months in which the average statewide daily production exceeds 1 million barrels of oil per day. I put these amendments together for the sole purpose of trying to get this to be a little bit better bill for the state of North Dakota. I think we all should have some concerns for some of these stripper wells that have the opportunity to come in at a pretty high production level. I do not have a new fiscal note for this but I would consider that, I have seen a fiscal note done on the recertification of stripper wells and they reported in that one that they could not put a dollar amount on that. It's not to be a positive amount; it certainly isn't going to be a negative amount. The first day of the first calendar, I doubt if that will change the fiscal note because they don't have anything that will produce ever reaching a million barrels of oil a day in the state of North Dakota. There is no budget forecast that generates fiscal notes that will show that ever happening, and the 45 to 40 is simply going to increase the positive impact it has on the state. I would guess that the fiscal note with these amendments should be somewhere upward of $30 million in increased tax revenues.

Senator Dotzenrod - The date in there, that June 30, 2013, this loophole thing that we've been working on and there have been several sessions now when legislators have tried to figure out a way to get that loophole closed.

Chairman Cook - Which loophole?

Senator Dotzenrod - The stripper property loophole.

Chairman Cook - That is closed immediately with this bill.

Senator Dotzenrod - But what I'm asking about is, they've got, and I think it's accomplished in these lines we've just been reading, but what they've been doing in order to take advantage of that loophole is getting these properties declared as stripper well properties and then they go back in later, and because it has the status of stripper well property they are exempt from the 6.5% tax. With this date in here of June 30, 2013 does that mean that if you a year ago or 2 years ago got this property to be considered stripper well property and since you've got that declaration prior to June 30, 2013 that you can come back a year from now, 2 years from now and start developing and producing oil on that property and your exempt from the 6.5% because you got that status before June 30, 2013?

Chairman Cook - If the well was completed before June 30, 2013 and is a stripper well then, it stays a stripper well and the property is gone, so new wells that are drilled after 2013 just because they are drilling into what used to be a stripper property that has stripper wells in it will not be a stripper well. After June 30th any well drilled in the Bakken and Three Forks will have to be stripper well status on its own. It does not take wells that are currently on stripper well status and they are over 30 barrels a day, it does not take that away.

Senator Dotzenrod - And a new well drilled in the future after the 30th of June, even though it's on a property that got that designation of stripper well property, they are not going to get that exemption on that new well.

Chairman Cook - That is correct.

John Walstad, Legislative Council - That is correct. Now, if you're well was drilled just before that cutoff date that would be grandfathered in under existing law that would be a stripper well property exemption even if it's producing 1,200 barrels a day, but if you drill beginning in July right next to that same hole that would not become grandfathered in, in to that stripper well status, that well would be taxable under the full extraction tax until the individual production from that hole drops to 40.

Senator Triplett - I have an amendment as well.

Senator Dotzenrod - On this same section that are taking about here, if you look on line 14 it says 'effective after December 31, 2016' so we have an effective date on that section that's later than the date that's in the section. If you're in there in 2014-15 this section is not effective.

John Walstad - No, there is a different one that is. The current section that we are operating on here has 2 versions in law. One of which is delayed, one of which is currently in effect but expires on June 30th of this year and the subsection that we are talking about here is at the bottom of page 7 of your bill. That is the section that is currently in effect; this amendment would extend that out to that end of 2016 date.

Senator Triplett - May I hand out .04003 and have Mr. Walstad explain as it relates to timing?

John Walstad - I prepared this amendment for Senator Triplett and it doesn't contain a lot of language but it has an interesting effect. It relates to when these provisions we were talking about will kick in. The section 5 of the act is the one that we were just referring to, the one that would take effect right away and would apply to wells drilled after June 30th of this year and would say those are not stripper wells unless their production is below the numbers. This would only apply to production beginning June 1, 2013 but it doesn't grandfather in all of the wells that are out there that are not strippers on their own production numbers.

Chairman Cook - What is the fiscal impact?

Senator Triplett - I don't know. I assumed that if you guys liked it, it would get addressed. You all know that some of the members of the legislature tried to fix the stripper well problem in 2007, I don't remember in 2009, but again in 2011 and in 2011 Lynn Helms stated rather unequivocally to the committees that were considering this issue that it wasn't a problem yet, it was something that could wait a couple years and could get fixed in 2013. And based on what he said, the committee killed the effort to try to fix this problem 2 years ago. I think everyone kind of acknowledged that it was getting to be a problem, going to be a problem; just people weren't sure when it was going to be a problem. Maybe there aren't a lot of them but I just think that everyone knew this problem should have been fixed 2 years ago.

Chairman Cook - I pretty much agree with your analysis of what happened 2 years ago. There was also as I said the timing issue, bad timing in the process. We didn't know what the Bakken was, but you're right we were lead to believe to some degree that we could wait 2 years; it gave us an easier escape. Together these 2 amendments are a major move.

Senator Dotzenrod - This is a bill that reduces the 6.5% to 4.5% and it's a tradeoff, it achieves a lot of good things that we really should have been doing a long time ago and it's really improvement in the law, but the price tag that we are going to pay to get this done and get it done right seems high to me, so as it stands now I'm not going to be supporting the bill.

Chairman Cook - The price tag for the next biennium will be a tax increase on the oil industry. You're aware of that?

Senator Dotzenrod - I'm aware of that because we phase in, we separate the timing between the fixing of the stripper tax problem and stepping down the 6.5% to the 4.5%.

Chairman Cook - Stripper property happens immediately.

Senator Dotzenrod - But if we put them together, if we implemented both features at the same time it would be a revenue loss. So we are achieving a net positive in the short term for a long term negative consequence.

Chairman Cook - We are also removing in 2017 all of the other exemptions that exist out there for these wells. I look at the stripper property fix that we are doing now with other issues of the bill to get it done now and then I look at 2017 we have a rate reduction and also all of the other exemptions going off that quite frankly scare me more than anything. There is a good part of me that would like to move them all up ahead of time just for the benefit of getting rid of all of these exemptions. I fear the day where our effective tax rate could be 7%. The reliance the state has now acquired for oil revenue.

Senator Dotzenrod - There is some reason to be concerned about what would happen if we hit these triggers but when those triggers were put in place the idea was that if the industry reaches a point where we've got, out in the field, thousands of workers and wells and their trying to make some money on oil that isn't worth very much the state is going to be willing to make some concessions to get this industry in a position where they can do better. I think that was the argument at the time that we adopted all these triggers, and it is a mess, I agree it's gotten to be a lot more triggers and things and I'm glad to see that this bill does get rid of a lot of that but I do think if we do enter a realm of pricing in the oil field where we are down in these levels where these triggers are I do think we are going to have a lot of problems with companies and it's going to be a difficult environment out there for them. They were designed to try to help ease some of the problems that would occur if that should happen, and we are going to get rid of those so I think we will hear some people come in and talk about the problems they are having if we get in to low oil prices and with no triggers. I can see why we have them there and I can see why they could become a fairly good trade for the state to make. This is an expensive business and if we start getting low prices down where these triggers are, what we heard during these earlier hearings is that, especially the smaller companies, they could really use some help so I think they were put in there for a reason, I agree with it's gotten to be really complicated, but I think that what we are doing is creating a new lower tax on oil that over time in the long run is a pretty big price to pay.

Chairman Cook - I would think that a lower tax rate on oil is more likely to keep this industry producing oil in this state. I find it interesting you and I both have strong memories of the last oil crash. You were sitting at this table, I was sitting in Williston. We both have memories of the pain of that and I hope we both have the common desire to see that the state of North Dakota never feels that pain again. That drives a lot of my thought process.

Senator Miller - I'll move amendments 13.0417.04005.

Seconded by **Senator Oehlke**.

Roll Call Vote on Amendments 7-0-0

Senator Triplett - I will move amendment 13.0417.04003.

Seconded by Senator Oehlke.

Roll Call Vote on Amendment 7-0-0

Senator Oehlke - I'll move a **Do Pass as Amended and re-refer to Appropriations**.

Seconded by **Senator Burckhard**.

Roll Call Vote 5-2-0

Carried by **Chairman Cook**.

FISCAL NOTE
Requested by Legislative Council
01/28/2013

Bill/Resolution No.: SB 2336

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

	2011-2013 Biennium		2013-2015 Biennium		2015-2017 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues			$4,200,000	$24,600,000		
Expenditures						
Appropriations						

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

	2011-2013 Biennium	2013-2015 Biennium	2015-2017 Biennium
Counties			
Cities			
School Districts			
Townships			

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

SB 2336 makes several changes to the oil extraction tax and authorizes income tax withholding on oil royalty payments to nonresidents.

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

Section 1 of SB 2336 authorizes income tax withholding on oil royalty payments of nonresidents. Section 2 expands the stripper designation to more Bakken and Three Forks wells by allowing the stripper exemption for wells producing 45 barrels of oil per day (BOPD), up from the existing 30 BOPD. Section 5 closes a loophole for higher producing wells drilled in stripper properties in the Bakken and Three Forks formations by requiring that each well meet the stripper production requirements before it receives the stripper exemption. Section 6 creates an incentive for new wells drilled outside the Bakken and Three Forks formations.

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.*

If enacted, SB 2336 is expected to increase state general fund revenues by an estimated $4.2 million in the 2013-15 biennium, due to a speed-up of income tax collections from the withholding on royalty payment provisions. The provisions expanding the stripper exemption for Bakken and Three Forks wells to 45 BOPD is expected to reduce oil extraction tax revenues by an estimated $24.2 million in the 2013-15 biennium. The closing of the stripper property loophole for new wells in the Bakken and Three Forks formations is expected to increase oil extraction tax revenues by an estimated $84.2 million in the 2013-15 biennium. The incentive for new wells drilled outside the Bakken and Three Forks formations is expected to reduce oil extraction tax revenues by an estimated $35.4 million in the 2013-15 biennium. The net impact of these changes is an expected increase in oil extraction tax revenues totaling +$24.6 million in the 2013-15 biennium. This will result in expected increased revenues in the legacy, resources trust, foundation aid stabilization, common schools trust, and strategic investment and improvements funds. Two other provisions of SB 2336 take place in the 2015-17 biennium: a removal of the low-price triggered incentives and a

permanent lowering the the oil extraction tax rate from 6.5% to 4.5% on production from wells drilled on and after January 1, 2017.

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

Telephone: 328-3402

Date Prepared: 02/02/2013

13.0417.04007
Title.05000

Adopted by the Finance and Taxation Committee

February 13, 2013

2-13-13
1 of 2

PROPOSED AMENDMENTS TO SENATE BILL NO. 2336

Page 1, line 4, after "reenact" insert "subsection 4 of section 38-08-04 and"

Page 1, after line 9, insert:

"**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 annually classify and determine the status and depth and average daily oil production of wells that are stripper well property as defined in ~~subsection 8 of~~ section 57-51.1-01, to annually certify to the tax commissioner which wells are stripper wells and the depth and average daily oil production of those wells, and to certify to the tax commissioner which wells involve secondary or tertiary recovery operations under section 57-51.1-01, and the date of qualification for the reduced rate of oil extraction tax for secondary and tertiary recovery operations. The requirement of annual classification and certification under this subsection applies only for wells drilled and completed in the Bakken or Three Forks formation and for other wells the classification and certification is required only once."

Page 3, line 15, replace "forty-five" with "forty"

Page 4, line 1, remove the overstrike over "~~"Average~~"

Page 4, line 5, after "~~closed~~" insert "statewide production" means the number of barrels of oil produced from wells within this state during a calendar month divided by the number of calendar days in that month, as determined by the industrial commission"

Page 4, line 5, remove the overstrike over the overstruck period

Page 4, line 12, after "~~5.~~" insert "2."

Page 4, line 15, replace "2." with "3."

Page 4, line 21, replace "3." with "4."

Page 5, line 1, overstrike the seventh period, remove "4." and insert immediately thereafter "5."

Page 5, line 29, replace "5." with "6."

Page 6, line 1, replace "6." with "7."

Page 6, line 8, replace "forty-five" with "forty"

Page 7, line 25, after "2016" insert ", or beginning on the first day of the first calendar quarter beginning after a period of three consecutive calendar months in which average statewide daily production exceeds one million barrels per day, whichever occurs first"

Page 7, line 27, replace "after" with "through"

Page 7, line 29, replace "2013" with "2011"

2 of 2

Page 8, line 2, after the underscored period insert "An individual well on a stripper well property which exceeded an average of one hundred fifty barrels of oil production per day, according to its annual certification by the industrial commission under section 38-08-04, is not eligible for the exemption under this section until the production from that well individually meets the requirements of the definition for stripper well status under section 57-51.1-01."

Page 8, line 19, remove "and which was spud"

Page 8, line 22, after the underscored period insert "An individual well on a stripper well property which exceeded an average of one hundred fifty barrels of oil production per day, according to its annual certification by the industrial commission under section 38-08-04, is not eligible for the exemption under this section until the production from that well individually meets the requirements of the definition for stripper well status under section 57-51.1-01."

Page 15, line 16, replace "1" with "2 "

Page 15, line 17, replace "2, 5, 6, and 8" with "3 and 9 and section 57-51.1-03, as effective through June 30, 2013, and as amended by sections 6 and 7"

Page 15, line 19, replace "3, 4, 7, and 9" with "4, 5, 8, and 10"

Page 15, line 20, after the period insert "Section 6 of this Act is effective for wells completed after June 30, 2011, but applies only to production after June 30, 2013."

Renumber accordingly

Date: 2-13-13
Roll Call Vote #: 1

2013 SENATE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 2336

Senate Finance & Taxation Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number 13.0417.04005

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

☐ Rerefer to Appropriations ☐ Reconsider

Motion Made By Senator Miller Seconded By Senator Oehlke

Senators	Yes	No	Senator	Yes	No
Chariman Dwight Cook	X		Senator Jim Dotzenrod	X	
Vice Chairman Tom Campbell	X		Senator Connie Triplett	X	
Senator Joe Miller	X				
Senator Dave Oehlke	X				
Senator Randy Burckhard	X				

Total (Yes) 7 No 0

Absent 0

Floor Assignment

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

Date: 2-13-13
Roll Call Vote #: 2

2013 SENATE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 2336

Senate Finance & Taxation Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number 13.0417.04003

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

☐ Rerefer to Appropriations ☐ Reconsider

Motion Made By Senator Triplett Seconded By Senator Oehlke

Senators	Yes	No	Senator	Yes	No
Chariman Dwight Cook	X		Senator Jim Dotzenrod	X	
Vice Chairman Tom Campbell	X		Senator Connie Triplett	X	
Senator Joe Miller	X				
Senator Dave Oehlke	X				
Senator Randy Burckhard	X				

Total (Yes) 7 No 0

Absent 0

Floor Assignment

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

Date: 2-13-13
Roll Call Vote #: 3

2013 SENATE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 2336

Senate Finance & 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 Senator Oehlke Seconded By Senator Burckhard

Senators	Yes	No	Senator	Yes	No
Chariman Dwight Cook	X		Senator Jim Dotzenrod		X
Vice Chairman Tom Campbell	X		Senator Connie Triplett		X
Senator Joe Miller	X				
Senator Dave Oehlke	X				
Senator Randy Burckhard	X				

Total (Yes) 5 No 2

Absent 0

Floor Assignment Senator Cook

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

REPORT OF STANDING COMMITTEE

SB 2336: Finance and Taxation Committee (Sen. Cook, Chairman) recommends **AMENDMENTS AS FOLLOWS** and when so amended, recommends **DO PASS** and **BE REREFERRED** to the **Appropriations Committee** (5 YEAS, 2 NAYS, 0 ABSENT AND NOT VOTING). SB 2336 was placed on the Sixth order on the calendar.

Page 1, line 4, after "reenact" insert "subsection 4 of section 38-08-04 and"

Page 1, after line 9, insert:

"**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 annually classify and determine the status and depth and average daily oil production of wells that are stripper well property as defined in ~~subsection 8 of~~ section 57-51.1-01, to annually certify to the tax commissioner which wells are stripper wells and the depth and average daily oil production of those wells, and to certify to the tax commissioner which wells involve secondary or tertiary recovery operations under section 57-51.1-01, and the date of qualification for the reduced rate of oil extraction tax for secondary and tertiary recovery operations. The requirement of annual classification and certification under this subsection applies only for wells drilled and completed in the Bakken or Three Forks formation and for other wells the classification and certification is required only once."

Page 3, line 15, replace "forty-five" with "forty"

Page 4, line 1, remove the overstrike over "~~"Average~~"

Page 4, line 5, after "~~closed~~" insert "statewide production" means the number of barrels of oil produced from wells within this state during a calendar month divided by the number of calendar days in that month, as determined by the industrial commission"

Page 4, line 5, remove the overstrike over the overstruck period

Page 4, line 12, after "~~5.~~" insert "2."

Page 4, line 15, replace "2." with "3."

Page 4, line 21, replace "3." with "4."

Page 5, line 1, replace "4." with "5."

Page 5, line 29, replace "5." with "6."

Page 6, line 1, replace "6." with "7."

Page 6, line 8, replace "forty-five" with "forty"

Page 7, line 25, after "2016" insert ", or beginning on the first day of the first calendar quarter beginning after a period of three consecutive calendar months in which average statewide daily production exceeds one million barrels per day, whichever occurs first"

Page 7, line 27, replace "after" with "through"

Page 7, line 29, replace "2013" with "2011"

Page 8, line 2, after the underscored period insert "An individual well on a stripper well property which exceeded an average of one hundred fifty barrels of oil production per day, according to its annual certification by the industrial commission under section 38-08-04, is not eligible for the exemption under this section until the production from that well individually meets the requirements of the definition for stripper well status under section 57-51.1-01."

Page 8, line 19, remove "and which was spud"

Page 8, line 22, after the underscored period insert "An individual well on a stripper well property which exceeded an average of one hundred fifty barrels of oil production per day, according to its annual certification by the industrial commission under section 38-08-04, is not eligible for the exemption under this section until the production from that well individually meets the requirements of the definition for stripper well status under section 57-51.1-01."

Page 15, line 16, replace "1" with "2 "

Page 15, line 17, replace "2, 5, 6, and 8" with "3 and 9 and section 57-51.1-03, as effective through June 30, 2013, and as amended by sections 6 and 7"

Page 15, line 19, replace "3, 4, 7, and 9" with "4, 5, 8, and 10"

Page 15, line 20, after the period insert "Section 6 of this Act is effective for wells completed after June 30, 2011, but applies only to production after June 30, 2013."

Renumber accordingly

2013 SENATE APPROPRIATIONS

SB 2336

2013 SENATE STANDING COMMITTEE MINUTES

Senate Appropriations Committee
Harvest Room, State Capitol

SB 2336
02-20-2013
Job # 19281

☐ Conference Committee

Committee Clerk Signature	Alice Delzer

Explanation or reason for introduction of bill/resolution:

Regarding income tax withholding on oil & gas royalty payments.

Minutes: See attached testimony.

Chairman Holmberg called the committee to order on Wednesday, February 20, 2013 at 4:00 pm in regards to SB 2336. All committee members were present except Senator Mathern. Brady Larson and Joe Morrissette

Senator Cook, District 34, Mandan, asked for support for this bill a provided Testimony attached # 1. Production from Wells. Drilled in stripper properties. He explained the bill. It does 2 things, it will change the number of wells that and reduce the extraction tax to 4 ½ %. That mechanism to all the extraction tax to go down, before 2017 if production of 1 million barrels per day for 3 consecutive months and then the first day of the following quarter, and only for new production, the extraction tax. 1million barrels, $80M we will be getting a whole lot more than what we are getting today. Take a look at Testimony attached # 1. The first handout shows the fiscal impact, of the stripper properties, positive of $84M, so as you move that money out throughout the next biennium it goes down each biennium. More wells that will pay on the full rather than the 0 tax. He explained the testimony provided. It comes up just short of 500M. And that makes the assumption that we have 1750 wells drilled every year you will see a tax reduction under those assumptions. I've got friends that still don't like this bill. The oil industry has not stood up and said they look at this bill. If you look at the last chart, it shows the effective tax rate has been for the last 12 years. The hope of this bill is to level this line off to provide certainty and predictability we should have a line that floats between 9% and 10%, if you we stay at the full 6 ½% taxes we should slowly come down. (Ends at 0:06:35)

Chairman Holmberg One of the goals for this restructuring to eliminate triggers can you tell me a little more about that.

(0:06:58) Senator Cook only 1 trigger, only 1 time, with the rate decrease. We are offering an incentive for wells outside the Bakken there is merit in getting oil activity down in Bowman's country. All the other triggers would be gone.

Chairman Holmberg because we have one of our members that could not be here we will not be passing on this bill today.

(0:08:32) Vice Chairman Bowman: some of the old vertical wells that were drilled, they went in and they are doing do they lose their stripper status with their production numbers.

Senator Cook, this bill does not affect the stripper wells outside of the Bakken.

(0:09:34) Ron Ness, ND petroleum Council stands in support of this bill today. We have advocated for many years. You cannot predict what the oil prices are going to be, and trying to make plans for years out, you cannot predict what is going to happen the price today, because of rail transportation get to markets on the east coast, every dollar we narrow that discount, the concept of trying to eliminate a very complex tax and providing a fair tax for the industry. We have a lot of members think it goes too far, look at the tax e those are the safety nets, those safety nets are somewhat broken, due to an below average for 5 months, that means you will be trending down, from 98 rigs to 32 rigs, the damage was done. Then tax rate falls and declining production, then the state is nervous about budgets, in other committees this is only one issue that will bring you back to special session. We feel there are many loop holes in tax, you pay about $330,000 per well in sales tax, was it ever the intent of legislative to tax for all the inputs that are going into the wells. That is a loop hole that is $600,000 a biennium if you drill 2,000 wells. This bill does lock in that production at a very high rate. This only effects new production. The bill as amended has a claw back, this is very unique, stripper law goes back to Aug. 1, of 2011, those wells have been drilled, and we think that is an overreach in this bill. It does require holding tax from non-residents, providing a tax incentive to those that work outside of the Bakken, where there is no or very little activity. Just a little bit of history about stripper taxes they were exempted in 1980. In 1981 the legislature approved a house bill adding properties to stripper wells. So stripper properties have always been exempt from taxes they have never been taxed that's the reason for the reference. Stripper oil was, the gypsy rose lee rule was federal price control rules, were to provide an incentive to develop property and to prevent abandoned of wells. That was accomplished maintaining stripper well properties as status of new wells. Keep those wells drilling. There is a lot of give and take, this bill is part of a package, we will not support an additional increase, the industry will pay, we represent over 4100 employees, whether it is the 80 businesses in GF, this bill needs some work yet, this is a bill to set the stage for industry critically important to ND. This changes a lot of things for them when they are trying to cut costs. We have so many of these issues that we have conceded. (Ends at 0:17:55)

Senator O'Connell how much money will be put back?

(0:18:15) Mr. Ness: We are going to release an economic impact study, when you look at these bills, ND that own royalties, pay this tax right off the top. We don't know what the price will be in 2017 when the bill will trigger, and if we don't' get to $1M and the tax trigger all those special the special items that are funded out of the tax provisions they get 0% of every new well for the first two years. Every well that has been drilled goes back 24 months and get 0% of all those wells, plus every well that has been drilled since 1987 drops from 9% from 11½%, all of the incentives would also drop the rate to 5% or 7% for 18 months.

This is a collage of piece work tax structure, over the last 33 years; it would be pretty simple once you pass this bill. The rate would be locked in. It takes out a lot of questionable, you want to know what they tax rate is going to be. We want it fair.

(0:20:34) Ladd Erickson, lives up by Washburn, don't represent any group. Neutral for this bill. Whether what the tax should be or if there should be a reduction. I have shared my concern with Senator Cook. My message I don't think you can base policy on any of these numbers. Out as far as these models are, 2019 -2021 biennium , current biennium's there off by 300% , is really the margin of error there is a lot of guess work that has to be done. My primary concern is dealing with stripper wells. There is one it's is annual recertification because every state in the nation, examines stripper wells every year, national standard for stripper wells is 10 barrels a day. We have had this liberal policy of 30, way beyond what other states do. In 1987, to incentivize deeper drilling, I support totally the properties and recertification. Here is my concern, I believe there is an ant production incentive created in this langue, when you can pretty much average they are producing about 100 barrels a day, you are telling companies to stay below that. A lot of federal policy to refurbish these wells, based on 10 barrels a day. I have never seen a state stay just below 150 barrels a day, you can mechanically keep those wells like that, I think in 2021 that you have a 500 million tax benefit, that is fiction, and if you are averaging 100 barrels a day what make you think that these will produce revenue. The other concern I have about policy As the productive wells are going down towards stripper status, they're going to taxed under the extraction tax, let's say they produced 90 barrels a day, that is taxed, you get down below trigger , and rework the well and get production to go back up and get to 90 barrels a day. Why is one production rate taxed at full rate when production going up is not worth taxing the full rate? What I would recommend for policy do what every other state does, make them stripper wells, If you make reduce the tax by 1% it would be very competitive, we don't have property tax on wells, we have very low corporate tax, you have to compare apples to apples, adjust these to modern times, they have been set with oil prices that will never come back. I am concerned about the math, making policy on a wild guess.

Chairman Holmberg thank you for bringing those points to this committee.

(0:26:46) Mike Donahue, representing myself, resident of Bismarck, to oppose that part of the bill. I applaud Senator Cooks work, but I don't' like taking the tax rate down by 2%. I don't hear any support for this. That is my concern.

Vice Chairman Bowman: With your statement, when more stripper wells become taxable, and you reduce the rate, you still get more money for the state, so how bad is generating more money for the state and more stability for the oil companies, and us changing the stripper well policy, it should have been changed, we are learning more about it, did you follow this to know it is generating this money instead of losing money?

Mike Donahue: I did not follow this bill. I don't know the first thing about stripper wells.

Chairman Holmberg: We are not going to move on this bill today. We will take the bill up tomorrow. Testimony # 2 submitted after hearing by Ladd Erickson.

2013 SENATE STANDING COMMITTEE MINUTES

Senate Appropriations Committee
Harvest Room, State Capitol

SB 2336
February 21, 2013
Job # 19299

☐ Conference Committee

Committee Clerk Signature Rose Laning

Explanation or reason for introduction of bill/resolution:

Relating to income tax withholding on oil and gas royalty payments to nonresidents and an oil extraction tax exemption for wells completed outside the Bakken and Three Forks formations;

Minutes:

Chairman Holmberg said this bill relates to stripper wells. It eliminates triggers, but also on new wells after 2017, it reduces the tax which is 2% on those new wells after 2017.

V.Chairman Grinberg moved Do Pass on SB 2336.
Senator Erbele seconded the motion.

A roll call vote was taken. Yea: 10 Nay: 2 Absent: 1

The bill goes back to Finance & Tax and Senator Cook will carry the bill on the floor.

FISCAL NOTE
Requested by Legislative Council
02/14/2013

Amendment to: SB 2336

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

	2011-2013 Biennium		2013-2015 Biennium		2015-2017 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues			$4,200,000	$35,200,000		
Expenditures						
Appropriations						

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

	2011-2013 Biennium	2013-2015 Biennium	2015-2017 Biennium
Counties			
Cities			
School Districts			
Townships			

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

SB 2336 makes several changes to the oil extraction tax and authorizes income tax withholding on oil royalty payments to nonresidents.

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 engrossed SB 2336 authorizes income tax withholding on oil royalty payments of nonresidents. Section 3 expands the stripper designation to more Bakken and Three Forks wells by allowing the stripper exemption for wells producing 40 barrels of oil per day (BOPD), up from the existing 30 BOPD. Section 5 lowers the oil extraction tax rate by 2% effective on new production after January 1, 2017 or when average daily production reaches 1 million BOPD. Section 6 closes a loophole for higher producing wells drilled in stripper properties in the Bakken and Three Forks formations by requiring that each well meet the stripper production requirements before it receives the stripper exemption. It also requires annual recertification of stripper wells drilled from FY 2012 onward. Section 7 creates an incentive for new wells drilled outside the Bakken and Three Forks formations.

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.*

If enacted, engrossed SB 2336 is expected to increase state general fund revenues by an estimated $4.2 million in the 2013-15 biennium, due to a speed-up of income tax collections from the withholding on royalty payment provisions. The provisions expanding the stripper exemption for Bakken and Three Forks wells to 40 BOPD is expected to reduce oil extraction tax revenues by an estimated $13.6 million in the 2013-15 biennium. The closing of the stripper property loophole for new wells in the Bakken and Three Forks formations is expected to increase oil extraction tax revenues by an estimated $84.2 million in the 2013-15 biennium. The incentive for new wells drilled outside the Bakken and Three Forks formations is expected to reduce oil extraction tax revenues by an estimated $35.4 million in the 2013-15 biennium. The net impact of these changes is an expected increase in oil extraction tax revenues totaling +$35.2 million in the 2013-15 biennium. This will result in expected increased revenues in the legacy, resources trust, foundation aid stabilization, common schools trust, and strategic investment and

improvements funds. Two other provisions of engrossed SB 2336 take place in the 2015-17 biennium: a removal of the low-price triggered incentives and a permanent lowering the the oil extraction tax rate from 6.5% to 4.5% on production from wells drilled on and after January 1, 2017, or when average daily production reaches 1 million barrels per day. This is not forecasted to occur until the 2015-17 biennium.

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
Telephone: 328-3402
Date Prepared: 02/15/2013

FISCAL NOTE
Requested by Legislative Council
01/28/2013

Bill/Resolution No.: SB 2336

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

	2011-2013 Biennium		2013-2015 Biennium		2015-2017 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues			$4,200,000	$24,600,000		
Expenditures						
Appropriations						

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

	2011-2013 Biennium	2013-2015 Biennium	2015-2017 Biennium
Counties			
Cities			
School Districts			
Townships			

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

SB 2336 makes several changes to the oil extraction tax and authorizes income tax withholding on oil royalty payments to nonresidents.

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

Section 1 of SB 2336 authorizes income tax withholding on oil royalty payments of nonresidents. Section 2 expands the stripper designation to more Bakken and Three Forks wells by allowing the stripper exemption for wells producing 45 barrels of oil per day (BOPD), up from the existing 30 BOPD. Section 5 closes a loophole for higher producing wells drilled in stripper properties in the Bakken and Three Forks formations by requiring that each well meet the stripper production requirements before it receives the stripper exemption. Section 6 creates an incentive for new wells drilled outside the Bakken and Three Forks formations.

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.*

If enacted, SB 2336 is expected to increase state general fund revenues by an estimated $4.2 million in the 2013-15 biennium, due to a speed-up of income tax collections from the withholding on royalty payment provisions. The provisions expanding the stripper exemption for Bakken and Three Forks wells to 45 BOPD is expected to reduce oil extraction tax revenues by an estimated $24.2 million in the 2013-15 biennium. The closing of the stripper property loophole for new wells in the Bakken and Three Forks formations is expected to increase oil extraction tax revenues by an estimated $84.2 million in the 2013-15 biennium. The incentive for new wells drilled outside the Bakken and Three Forks formations is expected to reduce oil extraction tax revenues by an estimated $35.4 million in the 2013-15 biennium. The net impact of these changes is an expected increase in oil extraction tax revenues totaling +$24.6 million in the 2013-15 biennium. This will result in expected increased revenues in the legacy, resources trust, foundation aid stabilization, common schools trust, and strategic investment and improvements funds. Two other provisions of SB 2336 take place in the 2015-17 biennium: a removal of the low-price triggered incentives and a

permanent lowering the the oil extraction tax rate from 6.5% to 4.5% on production from wells drilled on and after January 1, 2017.

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

Telephone: 328-3402

Date Prepared: 02/02/2013

Date: 2-21-13

Roll Call Vote # 1

2013 SENATE STANDING COMMITTEE
ROLL CALL VOTES

BILL/RESOLUTION NO. 2336

Senate Appropriations Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number

Action Taken Do Pass

Motion Made By Grindberg Seconded By Erbele

Senators	Yes	No	Senator	Yes	No
Chariman Ray Holmberg	✓		Senator Tim Mathern		
Co-Vice Chairman Bill Bowman	✓		Senator David O'Connell	✓	
Co-Vice Chair Tony Grindberg	✓		Senator Larry Robinson		✓
Senator Ralph Kilzer	✓		Senator John Warner		✓
Senator Karen Krebsbach	✓				
Senator Robert Erbele	✓				
Senator Terry Wanzek	✓				
Senator Ron Carlisle	✓				
Senator Gary Lee	✓				

Total (Yes) 10 No 2

Absent 1

Floor Assignment F + T Cook

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

REPORT OF STANDING COMMITTEE

SB 2336, as engrossed: Appropriations Committee (Sen. Holmberg, Chairman) recommends **DO PASS** (10 YEAS, 2 NAYS, 1 ABSENT AND NOT VOTING). Engrossed SB 2336 was placed on the Eleventh order on the calendar.

2013 HOUSE FINANCE AND TAXATION

SB 2336

2013 HOUSE STANDING COMMITTEE MINUTES

House Finance and Taxation Committee
Fort Totten Room, State Capitol

SB 2336
March 19, 2013
Job #20131

☐ Conference Committee

Committee Clerk Signature	Mary Brucker

Explanation or reason for introduction of bill/resolution:

A Bill relating to income tax withholding on oil and gas royalty payments to nonresidents and an oil extraction tax exemption for wells completed outside the Bakken and Three Forks formations; relating to oil extraction tax rates and exemptions.

Minutes: *Attached testimony #1, 2, 3*

Chairman Belter: Opened hearing on SB 2336.

Senator Cook: Introduced bill. See attached testimony #1 email from Shane Molander and testimony from Senator Cook #2. (Ended testimony at 12:45)

Chairman Belter: On the recertification, how much does that involve as far as the state recertifying them?

Senator Cook: I think that's a good question for Lynn Helms.

Vice Chairman Headland: Currently we don't have any incentives for drilling outside the Bakken. I think a lot of the problems associated with rapid oil development could be eased if we moved this incentive forward. Could you give the committee from your recollection what happened with oil expansion the last time we offered a similar type of incentive?

Senator Cook: All of the incentives on here that we are now going to remove were put in place for a reason. They were put in place by the legislature because we all understand that people react to tax policy and we wanted a positive reaction and we got it. That's what I believed opened up the Bakken. When we created the incentive we enticed oil developers to move into the Bakken when the code hadn't been cracked yet. They cracked the code and it became very profitable. I would argue that today those incentives are not needed because the benefit that was offered at the time does not exist today. If we put an incentive outside the Bakken we are going to get activity out there and that would be beneficial to the state of North Dakota.

Representative Zaiser: Could you explain why we left the Bakken and Three Forks play out of this package?

Senator Cook: The Bakken and the Three Forks drilling is pretty lucrative. Once they cracked that code they are getting wells that produce just short of 1,000 barrels a day. There's been a race to secure all the leases for that and that is what really drove up the price of drilling in the Bakken. I think the race is over now and you'll see an industry that is trying hard to reduce the cost. I think this is a good question to ask the oil industry; how they view the economics of the Bakken and Three Forks.

Representative Zaiser: It seems like this is a moving target and not many people agree with projections and existing situations which has been a big frustration of mine. I'm trying to get established what those set of facts are and to make sure we go forward on a sustainable basis.

Senator Cook: I think the one fact that we all need to agree on is that we don't know what the facts are going to be in 2017 or 2019. I think the fact that we all have to agree on is that this is a commodity and there are a lot of factors that can cause the price of oil to go up or down, cause production to go up or down, but we just don't know. It is dangerous when we try to make projections on what the future might be and then come up with facts to present to people under those projections because then we are misleading; we don't know what will happen in the future. We can know what will happen if the tax rate goes to 7% and we should know there would be a benefit to the state revenue stream if we do something that sees it will never go below 9 percent.

Representative Zaiser: One of the most important factors in extracting oil from the ground and making it into a commodity with significant profit is sustaining it and that the property owners are adequately compensated for all the impacts.

Senator Cook: Without a doubt that is always a factor to me. This legislation doesn't deal with that it deals with a steady stream of revenue so we can afford to do some of the things that we need to do.

Representative Drovdal: One of the differences between our bill and yours is that you require annual certification on stripper wells. Do you know of any circumstances where wells that have qualified for a stripper by producing less than 30 barrels a day for over a year would all of a sudden increase production without having to re-work or re-drill?

Senator Cook: No I don't. This was an amendment that was offered in committee. Senator left a copy of the email from Lynn Helms, Director of Mineral Resources. See attached testimony #3.

Representative Haak: When you're talking about the stripper wells of over the 20 formations we have and 13 that are economically feasible why did you only apply it to the Bakken and Three Forks formations?

Senator Cook: As I look at the different formations out there I see the economics of the Bakken and Three Forks being entirely different than the economics of all the other formations out there. I think it would be wise tax policy to address those different formations but if you feel otherwise this is your bill.

Representative Kelsh: You stated that two years you thought it was too late in the game and we would give it another two years to see where this Bakken play was going. Why are we delaying the sunrise on this bill until two years from now?

Senator Cook: The first part of the bill dealing with stripper properties is going to be effective immediately. I would feel more comfortable if we moved the effective and incentives dates closer. We are hedging on the future and I'm hedging on the effective date that we're going to make it until 2017 before we ever see a big dip in oil prices. I'm hoping we're going to have higher rates going to the needs of the state of North Dakota. If I'm wrong I'm going to regret it. If the triggers kick in 2016 I'm going to wish that I had moved it up and I'd be happy to consider moving it up. I also put in the million barrels as an amendment to the house but if production goes fine we could hit a million barrels in a year and then we would get that rate at an earlier date. That question needs to be discussed and weighed out very carefully as we go forward.

Vice Chairman Headland: On page 13 it looks like the industrial commission is still going to have some flexibility. Can you elaborate on this?

Senator Cook: I worked with Mr. Walstad on this. This is a complicated tax policy. This doesn't take the industrial commission out of there.

Vice Chairman Headland: The industrial commission would still have flexibility on offering exemptions?

Senator Cook: No, not on offering exemptions.

Representative Haak: Do you have any evidence that oil will go below $55 a barrel?

Senator Cook: None whatsoever. All we have is history.

Representative Froseth: Every section has an effective date except section 1 so will that take effect June 30, 2013?

Senator Cook: Good eye.

Representative Drovdal: On page 9 it talks about the stripper well and June 30, 2013.

Senator Cook: Ok. When I started I shed a note about what happened 30 years ago. We always talk about tax policy in North Dakota as being a three legged tax stool; sales, income, and property tax. I would argue today that we have a one legged pedestal and it's a one legged revenue from the oil tax. This one legged pedestal has raised our three legged tax stool off the ground. We're getting tremendous sales tax collections and income tax collections all because of this pedestal. You take this pedestal out and something happens then this pedestal disappears and we're going to be hurting. I moved to Mandan in 1982 at the peak of the oil boom and have seen the last crash. I told the people of Williston that this is your last paycheck and told my wife to go back to work. I've seen the value of my home go down and the taxable value even went down too. This is a very volatile source of income and if we take this pedestal out of here again we're going to have

a whole lot of homes with for sale signs in front of them. We have to make sure we are doing the right thing for the future of North Dakota.

Senator O'Connell: I live in the Spearfish formations area and there are thousands of jobs here. When we did research going down from 11 ½% to 9 ¼%and revenue neutral was the name of the game. The oil producers asked us to give them one tax and forget about all the incentives which is why I came on to this bill. I would like to see this expand farther out to some areas. We need a uniform tax code so everybody knows where we're going.

Chairman Belter: Further testimony in support of 2336?

Lexis Brinkman, North Dakota Petroleum Council: We are asking support of a less complicated and more predictable tax structure. Industry is not asking for a reduction in taxes but rather a revenue neutral predictable fix. Our effective tax rate has been on the steady increase for a few years now. Most of the provisions in this bill are increases until 2017. As competition increases and other shale plays continue to develop I think it's very important to remember that we're competing for capital in the rest of these shale plays and we need to remain competitive and not have a tax increase.

Representative Zaiser: In your testimony you said it is revenue neutral until 2017. Can you tell me what happens after 2017?

Lexis Brinkman: My intent is that we are searching for a revenue neutral solution and most of these provisions in this bill are increases on industry other than the non-Bakken incentives and extraction reduction that would go into effect in 2017 or after the million barrel trigger.

Representative Zaiser: I don't think it is revenue neutral. Why can't we look long term and perhaps have some additional revenue rather than flatten it out?

Lexis Brinkman: I would agree with you in that funding these things in western North Dakota is very important and we've been supportive of that. Unless we remain competitive the revenue won't be there for us to collect.

Representative Zaiser: How could the revenue not be competitive? The rates were competitive with other states in the area and from all the projections there's oil in the Bakken play for many decades. I think this is a fear tactic from my perspective. It's a rhetorical question I guess.

Lexis Brinkman: Fair enough.

Vice Chairman Headland: When we look at domestic production and how it's increased substantially over the past couple years and we look back to the last time when we were one day away from the trigger being put in place so how does that tie to policy out of Washington? I think commodities are always stronger when the dollar is weak and that's the position we're currently in. I think the dollar is weak because of federal policy so if congress acts to strengthen the dollar with the ramp up of production not only in the

Bakken but across the country do we really place ourselves in a position with the possibility of the trigger being implemented?

Lexis Brinkman: I don't know that I dare predict the future and attempt to answer that question but I know that we've been a day away before. It certainly seems to be a real possibility.

Representative Drovdal: The infrastructure money comes out of the 5% production tax only and not out of the extraction tax. We are currently getting about 12% out of that 5% when most states get about 35 percent. This bill has an $84 million increase in stripper wells for the next four years and it would double the next biennium so it would be a tax increase for the oil industry. Your organization came in on HB1234 and resent out pretty close to a revenue neutral bill and yet you opposed it so could you comment on that?

Lexis Brinkman: My statement was never to imply the bill was revenue neutral or wasn't revenue neutral but ideally we would find a simpler revenue neutral solution. HB1234 was not necessarily a simpler structure.

Representative Haak: What happens when an oil well goes completely dry? Who's responsible to clean that up?

Lexis Brinkman: I think Lynn Helms could answer that question better but I believe the operator is responsible for plugging that well and it is monitored by DMR.

Representative Haak: What does it cost to maintain an oil well a month after it has been all set up and it's pumping?

Lexis Brinkman: I can't answer that question.

Chairman Belter: Any other testimony in support of 2336? Any opposition to 2336?

Stuart Savelkoul, Director of the North Dakota Public Employees Association and appearing on behalf of the North Dakota Education Association: It isn't that we have any objection to seeking greater predictability in the collection of oil taxes and we sympathize with industries desire to attain that. But we still have massive needs out west; we have hundreds of vacant public employee positions across the state and a lot of that has to do with the changing economy of North Dakota and the changing job market. If you can drive a snowplow at $35,000 a year you are fully qualified to drive an oil truck for industry at $85,000 a year so who do we hire to drive our snowplows? We are all for predictability in the market and making sure oil taxes continue to benefit the state for a long time but we're terrified at the prospect of continuing the problems of having unfilled positions while simultaneously reducing revenue in the form of oil extraction tax. The current stripper well policy is bad tax policy so fix that but to reduce the extraction tax at this point in the game is really putting the cart before the horse. We would respectfully ask that you solve the needs of the west before reducing the tax.

Chairman Belter: Your organization and particularly the NDEA were instrumental in supporting Measure 6. Would you like to refresh the committee's memory on just how

successful Measure 6 was and how that contributed to the success of the state of North Dakota?

Stuart Savelkoul: The pedestal that Senator Cook alluded to wouldn't exist were it not for the efforts of the folks that passed Measure 6 back in 1980. All I would say is that North Dakota has tremendous potential right now and a lot of that has to do with the oil tax revenue that we get from this industry. It's not just the extraction tax there is personal income tax revenue and corporate tax revenue and other areas where this industry benefits our communities but we also have to look at the facts that there are areas where this industry is having a detrimental effect on our community. When you have vacant public employee positions you're putting public safety at risk. We shouldn't rush into rash tax policy.

Chairman Belter: As I remember it measure 6 was a political boondoggle that caused a lot of heartache and financial problems for the state and sent the oil industry running from this state. I would hope that in the future you would go back and review some of the things that took place with Measure 6. We certainly don't want to repeat that in the future. I've been here for 15 sessions and I think we've made some pretty good decisions to ensure that our oil industry stays here and that's created a lot of opportunities not only for our oil industry but also for other business sectors in the state. I would suggest that you're being a little too critical of some of the activities that the legislature has done.

Stuart Savelkoul: Obviously there seems to be some differences of opinion regarding the success or failure of Measure 6. According to our polling the public at large is very much in support of keeping the tax rates the way they are for the oil companies. The public is largely supportive of the results of Measure 6. Prove me wrong by passing this bill and forcing us to take this to the initiated measure process and we'll see where the public is in 2013.

Representative Drovdal: I'm kind of astonished of your testimony using some of the great things that are happening because of oil as a ledge against them getting a fair tax policy. We have people coming in from out of state for jobs, income is the fastest growing in the nation, and yet you're using those excuses we can't hire people because of that. You also said this is not the time and when we first started working on income tax reductions and property tax rebates NDEA said it wasn't time to give any of that away because they wanted more money for schools and teachers. When would be the time to have a fair tax policy?

Stuart Savelkoul: When we get our public employees' salaries to 100% of market and we have 100% of our jobs filled. When our teachers are paid competitively by region and national standards and 100% of those positions are filled and when we're assured that the infrastructure out west is adequately funded so that roads aren't crumbling beneath the trucks that are transporting people to work and product from there then I would say that would be an excellent time to consider reducing the burden. It comes back to the point that North Dakota is booming and at minimum status quo seems to be just fine for industry. The oil industry seems to be doing just fine under the present policy and this bill seeks to radically change that. I would question why now if so much seems to be going right for that particular industry.

Representative Drovdal: I think you're using your words a little too extravagantly. I remember a time when teachers were better paid and we didn't reduce their wages because of that. I also remember a time when city employees were the jobs with the best benefits and we didn't go after them for that either. The whole reason for this bill isn't because oil companies are leaving but to be a firm and stable tax policy for the future. Teachers are still going to get their salary increase regardless of what we do on this bill. I'm surprised of the attitude of your organization towards this.

Stuart Savelkoul: When the state employee compensation was before this chamber before crossover the appropriations committee decided to reduce it by 40% from what the governor proposed. When our public employees are not even paid at 95% of market why would we consider reducing that while simultaneously reducing our tax structure on the other side. They would get their wage increases but it wouldn't be enough. You always have to bring it back to the qualifications that we're asking of the folks that are filling those vacant positions. We require higher standards for teachers, state or county employees to get employed then sometimes it will result in higher compensation than folks in the private sector.

Representative Drovdal: You say truck drivers only get 95% but that has risen dramatically because of the oil industry and the jobs created out there with the trucking. The lowest trucking jobs are now taking a 20% cut so I think you need to be careful when doing those comparisons.

Stuart Savelkoul: The truck drivers aren't nearly at 95% but are considerably short of that but as an aggregate that's where they rest.

Vice Chairman Headland: You had mentioned that your polling indicates North Dakota citizens don't want an oil tax reduction. If we poll and it indicates that North Dakota citizens don't favor state employees getting a fully funded benefit package as well as a fully funded health insurance package would you accept the citizens polling in that effort?

Stuart Savelkoul: The job of making policy rests with the legislature and not with the lobbyists. We are simply here to advise you as best we can on where we think our members lie. I can assure you there are interest groups out there that champion the very thing you suggested. When issues for defined benefit versus defined contribution retirement discussions arise the chamber of commerce is always there to remind you that private sector would like to see that changed. We are always going to advocate the interest of our members and where appropriate we will speak to the public data we have.

Vice Chairman Headland: You essentially also threatened our actions with an initiated measure. Can you tell us how that helps the legislative decision making process?

Stuart Savelkoul: I don't think I'm outside the realm of common sense when I say that if the public overwhelming feels one way and the legislators take action the other way that the public will then attempt to use initiated measure to get their policy through. That's the next logical step.

Vice Chairman Headland: I don't see it being an effective practice and I don't see how it helps us do our work when somebody stands at the podium and threatens us.

Representative Froseth: Our fiscal note shows a $39,400,000 increase in the 2013-15 biennium. I think this bill can be worked to be revenue neutral. If we could prove this bill would be revenue neutral would your organization be in favor of it?

Stuart Savelkoul: The problem we have with that is that you're taking something that literally almost everybody agrees with in fixing the stripper tax loophole and fixing the bad tax policy. Even the fix that this bill suggests and the fix you guys attempted with HB1234 and sent to the senate doesn't reduce the classification of stripper wells to the national average. National average is 10 barrels or less according to stripperwells.com and this particular fix doesn't go anywhere near that classification. It seems like we're forcing the citizens of North Dakota to negotiate with themselves.

Chairman Belter: Your organization and the NDEA have huge political clout at the national level and energy independence is at the forefront of economic recovery in the United States. Currently there seems to be resistance from administration on the development of the Keystone pipeline. We see a move to take some of the benefits away from the oil industry at the national level that every other industry enjoys which is going to decrease the profits of oil industry and probably take away some of their incentives to do more exploring. What is your organization doing at the national level to help encourage the administration to push forward on energy independence and to develop the tremendous oil potential that we have in this country?

Stuart Savelkoul: During the middle of the legislative session I am focused on the state issues and not the federal issues. The American Federation of Teachers and the NDEA are dealing with huge issues across the country when it comes to teacher layoffs. I will find out what we are doing with energy policy and let you know.

Chairman Belter: Any further testimony in opposition?

Kristi Schlosser-Carlson, North Dakota Farmer's Union: We stand in opposition today primarily because at our last convention we passed a special order of business that was titled "Replenish and Invest." We recognize the economy here is strong because of agriculture and oil production. We understand in the past decades we've gone through budgetary shortfalls and a lot of our infrastructure needs remained unmet at that time. We ask that we continue to replenish as you have done in the last couple sessions, the needs of the infrastructure needs and address property tax relief. I have seen some numbers floating around about the long term impacts of this bill and I agree with Representative Zaiser that it is difficult to figure out what basis to begin from and that's the very point. Maybe this is so unknown that to try to strike something here without having more of those facts in front of us would be a difficult and dangerous thing. We have policy opposing exemptions so it makes sense we find some middle ground between what our tax policy is now and what is proposed in this bill. In agriculture we are familiar with the ups and downs of the market and it makes sense to have policy to match that. I'm not sure a flat rate will provide the certainty we're looking for because 4 ½% of 0 is still 0 so I would offer that for

your consideration. We need to make sure the needs that aren't yet met are met first before we move forward.

Chairman Belter: Does your organization oppose the entire bill or are there certain provisions in this bill you would like to see passed?

Kristi Schlosser-Carlson: I think the stripper well tax policy is broad based in nature and I think that we could draw from that in that it is updated. It is my understanding that the stripper wells are based on incentives that were provided for technology that's moving quickly forward. I think we would support the stripper well exemption loophole elimination and look for a more stable response to the extraction tax reduction.

Vice Chairman Headland: You're here representing an organization that is commodity based and you talked about how commodities work. You know what happens when we overproduce wheat and the dollar is strong, prices go in the tank. You talked about the stripper provision so would you support us fixing the trigger and the current exemptions as well?

Kristi Schlosser-Carlson: Our policy speaks directly that we don't support exemptions. We need to make sure we are meeting our infrastructure needs.

Representative Drovdal: You suggested that you support getting rid of exemptions. Would your organization support a bill that would correct the stripper provision which is a tax increase and get rid of the trigger exemptions and have a tax correction of about the same amount as the increase so the bill would be attributed to a zero tax increase or decrease?

Kristi Schlosser-Carlson: The difficulty here is that we're looking at the revenue increase in the short term without the balance of the revenue decrease in the long term and no one knows what the long term decrease is going to be so to try and figure out what revenue neutral is will be difficult.

Representative Drovdal: We do have projections of what a ½% drop in the overall tax rate would be for the next cycle and the increase in the stripper well for the next cycle and project that on out.

Kristi Schlosser-Carlson: Great.

Representative Trottier: You deal a lot with agriculture, farming and grains. I look at this bill as somewhat of a crop insurance bill where we're looking at revenue assurance. You lock in a price based on your guaranteed production in crops. This does a little bit of this. As long as we have a stable pricing mechanism the state will only grow in income.

Kristi Schlosser-Carlson: I have not thought of it in that way. This would provide some certainty that everyone is looking for.

Representative Trottier: But we do take the pitfall out of the trigger price so it gives us a little more assurance. The public survey shows that a majority of the people don't agree with lowering oil taxes. Do you agree with that?

Kristi Schlosser-Carlson: I've only heard that and I'm not comfortable speaking on things that I haven't read.

Representative Trottier: Of all the people I've talked to that have agreed with lowering oil prices, when they find out about getting rid of that trigger price they think it is probably alright so we need to do a better job at educating people.

Representative Froseth: I haven't heard anybody comment on the royalty payments.

Kristi Schlosser-Carlson: I'm probably not the best person to address this but I am happy to look into it and tell you what Farmer's Union position is on it.

Representative Haak: I know your organization held legislative forums in December so did the issue of the trigger price or lowering the extraction tax ever come up?

Kristi Schlosser-Carlson: The highlights that came out of our convention were reflected in those district meetings that we did around the state to focus on property taxes and infrastructure.

Chairman Belter: Further testimony in opposition to 2336? Any neutral testimony to 2336?

Scott Rising, Soybean Growers in North Dakota: We are in favor of the tax law simplification process. We are supportive of the idea of reducing the threat to revenue flow. We're not clear on the longer term implication of reducing extraction tax by a full two percent. I ask the committee to take an average well and understand how many barrels are taxed before the 50 barrel extraction rate and what is left over after that which will not be taxed under this proposal then make an informed decision as best you can. We trust that you will do that. On the issue of overproduction in the oil industry today in America we are on a positive trend toward self-sufficiency. The clinker here is our ability to refine and not the strength of the dollar today.

Vice Chairman Headland: When refining capacity is bottlenecked and we still have ramped up production what happens?

Scott Rising: I think that provides some opportunity for North Dakota to move in that direction.

Vice Chairman Headland: I think we all know what happens when there is too much crude out there then the price is going to drop.

Scott Rising: Eventually we drive the price down and that's the nature of the commodity business.

Representative Zaiser: Would you say that a portion of us getting to the point of being self-sufficient would factor in greater efficiency in terms of conservation measures and utilization of renewable fuels?

Scott Rising: My comment on renewable fuels is where that is practical and affordable certainly. Where we are engaged heavily in the research then absolutely we need to fund that because that is a potentially longer term solution to a longer term problem. As far as fuel conservation the research to reduce our uses is important but we have to see where that takes us.

Representative Drovdal: I'm fortunate enough to share in a few mineral acres that my grandfather worked very hard in the 30s to hold on to so I'm happy to get a check every now and then. I'm not in the high tax bracket but I pay about 50% into the state and federal government for taxes. Could you tell me any other commodity where 50% goes in for taxes?

Scott Rising: When you hit a point in the progressive tax bracket it is what it is. If you're going to succeed in reducing my property tax and you're going to succeed in reducing some other taxes I don't find it totally strange that we would reduce the tax on the folks in the oil business as well or the holders of those mineral rights.

Representative Zaiser: Isn't it true at least at the federal level the United States government has given out rebates or tax relief payments?

Scott Rising: I don't have a clue what the federal government is giving or not giving to the oil industry.

Chairman Belter: I think you're talking about the depletion allowance. It really isn't anything different than a depreciation account that I get on my farm or any other business gets. It's just been used as a political weapon to make a political issue out of it.

Chairman Belter: Any other neutral testimony on 2336? If not, we will close the hearing on 2336.

2013 HOUSE STANDING COMMITTEE MINUTES

House Finance and Taxation Committee
Fort Totten Room, State Capitol

SB 2336
March 20, 2013
Job #20261

☐ Conference Committee

Committee Clerk Signature Mary Brucker

Minutes:

Chairman Belter: We heard this yesterday and is Senator Cook's bill dealing with oil.

Vice Chairman Headland: I've looked at this bill long and hard. There are a lot of things in here I like but we passed a better bill over to the senate. **Made a motion for a Do Not Pass.**

Representative Dockter: Seconded.

Representative Drovdal: This bill has a lot of good provisions. For an example I took a barrel of oil at $100 and a good royalty percentage now is 20% some at 12% but the average is around 17%. At 20% that royalty owner pays $2.30 in taxes to the state and also pays at an older rate $5.61 federal taxes and $.50 state tax so that's $12 the state gets. By the time you subtract all that it means the royalty owner gets $11.59 and the state of North Dakota gets $12.00. This issue is about fairness in taxes. Quoted J. Paul Getty. When you don't support a fair tax policy and tax a higher tax on the oil industry you are hurting everybody. Ninety seven percent of stock in oil industries is owned by individuals and that's who you're hurting by a higher tax and the royalty owners. You're also hurting job creation because these industries are creating jobs all over North Dakota right now. When you lower taxes you're encouraging new research to continue. You're not creating fewer investments with higher taxes and we need the investments and the infrastructure and the new drilling to get America on stable grounds. This is an industry that has provided us with the dollars to give property tax reduction the last two to three sessions and that gives income tax reductions to individuals and corporations. This industry has allowed us to fund our schools and increase our teacher salaries. I'm really disappointed that we are allowing politics to get in front of policy. There are press releases before we even have hearings in the house about tax bills. We are here to listen, work, and compromise. There is a way to get this bill neutral but I don't see it because the politics has been thrown out there. I think the people don't just want us to work on politics I think they want us to work on good, fair, and balanced policies. I'm going to vote against the Do Not Pass.

Vice Chairman Headland: I agree with Representative Drovdal and everything he said. The only area of this bill that I don't care for is the 2% reduction on January 1, 2017. I think the bill we sent over gave us some protections of our revenue stream from the oil tax.

This particular language the way it is drafted doesn't do that. We have the other bill in the senate now that is the better bill and is my choice of the direction we go.

Representative Froseth: I will support the Do Not Pass. There are a lot of good parts to this bill that we should try to correlate to the other bill. This fixes the stripper well problems and takes out all those exemptions that I don't think are needed anymore. It adds an exemption that we probably do need and this is an exemption that's below 10,000 feet outside the Bakken. There are other formations outside the Bakken that are producing oil and do have potential. The trigger price coming out is a good safeguard of oil income in the future. We have to make sure those amendments are incorporated in the other bill.

Chairman Belter: I am going to support the Do Not Pass. We are getting to the end of the session and we have two oil bills. I think the one we passed over to the senate is a better bill and some of the provisions in this one that aren't in the other tax bill should get put in. I think the senate will be very cooperative in working with us in that.

ROLL CALL VOTE: 11 YES 2 NO 1 ABSENT

Vice Chairman Headland will carry this bill.

FISCAL NOTE
Requested by Legislative Council
02/14/2013

Amendment to: SB 2336

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

	2011-2013 Biennium		2013-2015 Biennium		2015-2017 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues			$4,200,000	$35,200,000		
Expenditures						
Appropriations						

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

	2011-2013 Biennium	2013-2015 Biennium	2015-2017 Biennium
Counties			
Cities			
School Districts			
Townships			

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

SB 2336 makes several changes to the oil extraction tax and authorizes income tax withholding on oil royalty payments to nonresidents.

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 engrossed SB 2336 authorizes income tax withholding on oil royalty payments of nonresidents. Section 3 expands the stripper designation to more Bakken and Three Forks wells by allowing the stripper exemption for wells producing 40 barrels of oil per day (BOPD), up from the existing 30 BOPD. Section 5 lowers the oil extraction tax rate by 2% effective on new production after January 1, 2017 or when average daily production reaches 1 million BOPD. Section 6 closes a loophole for higher producing wells drilled in stripper properties in the Bakken and Three Forks formations by requiring that each well meet the stripper production requirements before it receives the stripper exemption. It also requires annual recertification of stripper wells drilled from FY 2012 onward. Section 7 creates an incentive for new wells drilled outside the Bakken and Three Forks formations.

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.*

If enacted, engrossed SB 2336 is expected to increase state general fund revenues by an estimated $4.2 million in the 2013-15 biennium, due to a speed-up of income tax collections from the withholding on royalty payment provisions. The provisions expanding the stripper exemption for Bakken and Three Forks wells to 40 BOPD is expected to reduce oil extraction tax revenues by an estimated $13.6 million in the 2013-15 biennium. The closing of the stripper property loophole for new wells in the Bakken and Three Forks formations is expected to increase oil extraction tax revenues by an estimated $84.2 million in the 2013-15 biennium. The incentive for new wells drilled outside the Bakken and Three Forks formations is expected to reduce oil extraction tax revenues by an estimated $35.4 million in the 2013-15 biennium. The net impact of these changes is an expected increase in oil extraction tax revenues totaling +$35.2 million in the 2013-15 biennium. This will result in expected increased revenues in the legacy, resources trust, foundation aid stabilization, common schools trust, and strategic investment and

improvements funds. Two other provisions of engrossed SB 2336 take place in the 2015-17 biennium: a removal of the low-price triggered incentives and a permanent lowering the the oil extraction tax rate from 6.5% to 4.5% on production from wells drilled on and after January 1, 2017, or when average daily production reaches 1 million barrels per day. This is not forecasted to occur until the 2015-17 biennium.

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

Telephone: 328-3402

Date Prepared: 02/15/2013

FISCAL NOTE
Requested by Legislative Council
01/28/2013

Bill/Resolution No.: SB 2336

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

	2011-2013 Biennium		2013-2015 Biennium		2015-2017 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues			$4,200,000	$24,600,000		
Expenditures						
Appropriations						

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

	2011-2013 Biennium	2013-2015 Biennium	2015-2017 Biennium
Counties			
Cities			
School Districts			
Townships			

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

SB 2336 makes several changes to the oil extraction tax and authorizes income tax withholding on oil royalty payments to nonresidents.

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

Section 1 of SB 2336 authorizes income tax withholding on oil royalty payments of nonresidents. Section 2 expands the stripper designation to more Bakken and Three Forks wells by allowing the stripper exemption for wells producing 45 barrels of oil per day (BOPD), up from the existing 30 BOPD. Section 5 closes a loophole for higher producing wells drilled in stripper properties in the Bakken and Three Forks formations by requiring that each well meet the stripper production requirements before it receives the stripper exemption. Section 6 creates an incentive for new wells drilled outside the Bakken and Three Forks formations.

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.*

If enacted, SB 2336 is expected to increase state general fund revenues by an estimated $4.2 million in the 2013-15 biennium, due to a speed-up of income tax collections from the withholding on royalty payment provisions. The provisions expanding the stripper exemption for Bakken and Three Forks wells to 45 BOPD is expected to reduce oil extraction tax revenues by an estimated $24.2 million in the 2013-15 biennium. The closing of the stripper property loophole for new wells in the Bakken and Three Forks formations is expected to increase oil extraction tax revenues by an estimated $84.2 million in the 2013-15 biennium. The incentive for new wells drilled outside the Bakken and Three Forks formations is expected to reduce oil extraction tax revenues by an estimated $35.4 million in the 2013-15 biennium. The net impact of these changes is an expected increase in oil extraction tax revenues totaling +$24.6 million in the 2013-15 biennium. This will result in expected increased revenues in the legacy, resources trust, foundation aid stabilization, common schools trust, and strategic investment and improvements funds. Two other provisions of SB 2336 take place in the 2015-17 biennium: a removal of the low-price triggered incentives and a

permanent lowering the the oil extraction tax rate from 6.5% to 4.5% on production from wells drilled on and after January 1, 2017.

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

Telephone: 328-3402

Date Prepared: 02/02/2013

Date: 3-20-13
Roll Call Vote #: 1

2013 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 2336

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. Headland Seconded By Rep. Dockter

Representatives	Yes	No	Representatives	Yes	No
Chairman Wesley Belter	✓		Rep. Scot Kelsh	✓	
Vice Chairman Craig Headland	✓		Rep. Steve Zaiser	AB	
Rep. Matthew Klein	✓		Rep. Jessica Haak	✓	
Rep. David Drovdal		✓	Rep. Marie Strinden		✓
Rep. Glen Froseth	✓				
Rep. Mark Owens	✓				
Rep. Patrick Hatlestad	✓				
Rep. Wayne Trottier	✓				
Rep. Jason Dockter	✓				
Rep. Jim Schmidt	✓				

Total (Yes) 11 No 2

Absent 1

Floor Assignment Rep. Headland

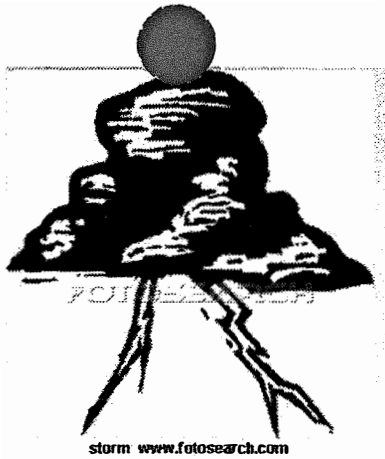
If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

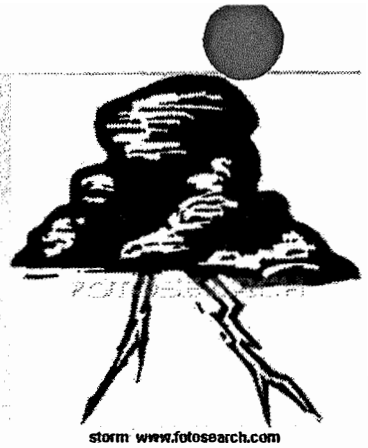
SB 2336, as engrossed: Finance and Taxation Committee (Rep. Belter, Chairman) recommends **DO NOT PASS** (11 YEAS, 2 NAYS, 1 ABSENT AND NOT VOTING). Engrossed SB 2336 was placed on the Fourteenth order on the calendar.

2013 TESTIMONY

SB 2336



Draft BLM Hydraulic Fracturing rule could double federal drilling permit approval time or worse. New rule likely in Q2 2013

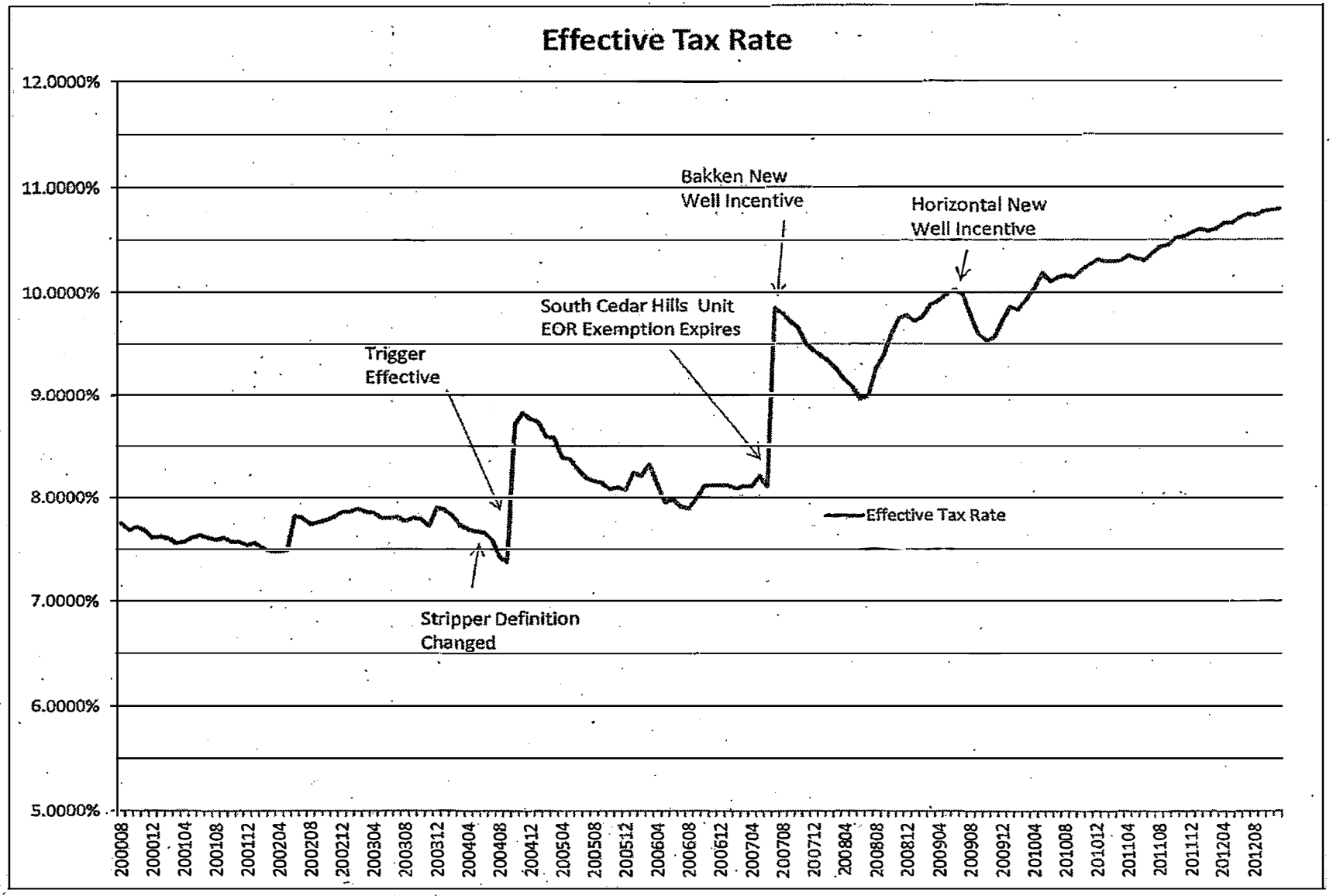


Draft EPA guidance on diesel fuel in hydraulic fracturing could triple drilling permit approval time or worse. Final rule planned spring 2013.

Current administration budget contains tax changes that could reduce drilling capital 35-50%

The future looks promising for sustained Bakken/Three Forks development

World and U.S. economies continue to struggle. If China joins the downward spiral oil price could fall enough to make most areas uneconomic


Effective Tax Rate
12.0000%
11.0000%
10.0000%
9.0000%
8.0000%
7.0000%
6.0000%
5.0000%
Bakken New Well Incentive
Horizontal New Well Incentive
South Cedar Hills Unit EOR Exemption Expires
Trigger Effective
Stripper Definition Changed
Effective Tax Rate
200008
200012
200104
200108
200112
200204
200208
200212
200304
200308
200312
200404
200408
200412
200504
200508
200512
200604
200608
200612
200704
200708
200712
200804
200808
200812
200904
200908
200912
201004
201008
201012
201104
201108
201112
201204
201208

- Require oil companies to withhold income taxes from royalty payments to out of state mineral rights holders. This is a 4.1M benefit to the state.

- Eliminates stripper well properties exemptions in The Bakken and Three Forks Formation.

- Changes the definition of a Certified Stripper Well for Bakken and Three Forks Wells of 10,000 ft. or more rom 30 barrels to 45 barrels per day.

- Creates an incentive to explore for oil outside The Bakken and Three Forks Formations.

- Eliminates 10 production incentives which trigger "on" and "off" on oil prices.

- Changes the extraction tax rate from 6.5% to 4.5% permanently.

FISCAL NOTE
Requested by Legislative Council
01/28/2013

Bill/Resolution No.: SB 2336

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

	2011-2013 Biennium		2013-2015 Biennium		2015-2017 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues			$4,200,000	$24,600,000		
Expenditures						
Appropriations						

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

	2011-2013 Biennium	2013-2015 Biennium	2015-2017 Biennium
Counties			
Cities			
School Districts			
Townships			

Calendar Year	Estimated Barrels per day from new wells	Barrels per year	Revenue subject to taxes at $80 per barrel	Oil extraction tax revenue at 6.5%	Oil extraction tax revenue at 4.5%	Estimated reduction in oil extraction tax collections
2017	85,000	31,025,000	$2,482,000,000	$161,330,000	$111,690,000	($49,640,000)
2018	155,000	56,575,000	$4,526,000,000	$294,190,000	$203,670,000	($90,520,000)
2019	215,000	78,475,000	$6,278,000,000	$408,070,000	$282,510,000	($125,560,000)
2020	260,000	94,900,000	$7,592,000,000	$493,480,000	$341,640,000	($151,840,000)
2021	305,000	111,325,000	$8,906,000,000	$578,890,000	$400,770,000	($178,120,000)

Production from Wells

Drilled in Stripper Properties	Production In 2013-15 Biennium	Production in 2015-17 Biennium	Production in 2017-19 Biennium	Production in 2019-21 Biennium
Drilled in 2013-15	16,154,000	8,077,000	4,038,500	2,019,250
Drilled in 2015-17		17,769,400	8,884,700	4,442,350
Drilled in 2017-19			19,546,340	9,773,170
Drilled in 2019-21				21,500,974

OET Due on Barrels Formerly Exempt as Stripper Wells (Assume Average Price of $80):

OET on Barrels Taxed at 6.5%	$84,000,800	$42,000,400	$21,000,200	$10,500,100
OET on Barrels Taxed at 6.0% /1		85,293,120	42,646,560	21,323,280
OET on Barrels Taxed at 4.5%			70,366,824	35,183,412
				77,403,506
Total Gain from Stripper "Fix"	**$ 84,000,800**	**$127,293,520**	**$ 134,013,584**	**$ 144,410,298**

Finance and Taxation Committee Hearing
North Dakota State Senate
Testimony in Opposition of SB 2336

My name is Blu Hulsey and I am here today in my capacity as Director of Government affairs at Continental Resources Inc. to offer comments regarding SB 2336 . We are not in agreement with the bill in its current form but believe it can be a catalyst for a discussion of long term tax policy in North Dakota that we should all be having.

The majority of our company's assets are in North Dakota so we have a long term vested interest in the state . We intend to be a longterm operator in this state and to be an integral partner with you in the development of this states significant oil and gas assets

First of all let me say we applaud the leadership of the authors for taking a long view for North Dakota by engaging in a discussion about over all energy tax policy and what is in the best interest of North Dakota in the long view. We appreciate getting the opportunity to discuss it with you and hope to be able contribute to this process.

The Bakken is a large and prolific resource play. It represents a tremendous opportunity to North Dakota, its citizens and in fact the entire country. The question is what policies do we need to insure it is harvested in the best interest of North Dakota and her citizens. While this resource is significant there are also challenges that come with it. It is a high cost resource play. Wells cost between 9 and 12 million each and that cost continues to escalate. We currently are able to get 3-8% of the resource. It will take a long-term commitment and continuous investment in order to keep industry here working to advance the technology the harvest more.That's the real long term generational value is to the state. This means long-term careers and production which ignites an economy vs boom bust and over-tax and over-regulate mentality of the past . We simply have to look back in North Dakota history and recently in California and Alaska to see the error in this "short view" thinking

Investment capital always goes where it can get the best return. Today we have similar resource plays for both oil and gas all across the country. Our company has significant interest in Oklahoma and Texas ,which are probably the two most significant competitors for capital. Both of these states have a significantly lower cost structure ,due too less challenging climates as well as a less costly regulatory environment and a much lower tax structure. And the price the oil receives is $8-$10 dollars a barrel more because of closer proximity to markets.

Just to put this into perspective lets look at the major oil and gas basins in the U.S. There are 1764 rigs running in the country today. The permian basin in west Texas has 466 while the Eagleford shale in south texas has 239. Oklahoma currently has 196 with 180 rigs running in the Williston Basin in North Dakota.

Rig counts are important because you must have continuous drilling to keep production from declining. Production from all fields declines unless you keep drilling wells. You cant do anything about the weather. So you are challenged with making sure you are competitive with these other plays ,over the long run, by having a reasonably competitive tax and regulatory structure. This is even more important as we enter the development stage where the majority of leases are held by production and the pressure to validate the leases is off. Then drilling money follows the best rate of return no matter where it is.

North Dakota has passed California and Alaska in oil production. What happened to them? Today California has 34 rigs running and Alaska has only 9. Those states present examples of what a high tax structure coupled with runaway regulatory cost does to a states oil and gas industry. Those two states are an example of what not to do in tax and regulatory policy. They have made oil and gas exploration non cost competitive and are seeing their rig counts dwindle and as a result their oil and gas production decline yet they still have tremendous reserve potential.

I read the other day where North Dakota's state revenues are 42% dependent on oil and gas taxes. That should be a concern. What happens to state revenues when the price fluctuates downward? The price of oil needs to be somewhere between sixty and seventy dollars per barrel in order for drilling to make economic sense in the Bakken; due to the cost factors we discussed. Should the price fall for any length of time and drilling be significantly curtailed the states revenues would fall.

Now, the complicated tax code we are all wrestling with here does have price protection factored in. While that is complicated for you it does afford a safety net for industry and therefore state revenues. If those triggers are to be maintained they should be raised to $70 per bbl to encourage drilling to continue in a down price environment. Of course lowering the overall rate could negate the necessity for them. We can see where the stripper well rate might need adjusting. But we view the current rate for stripper wells as a minor offset to a high rate for all other production.

In summary you are right to have this discussion now . Thomas Paine talked about the sunshine patriot. That is someone who is a patriot enjoying good times without consideration for when they may not be so good in the future. Facing these issues now, while they don't present an immediate threat to North Dakota will prevent our children and grandchildren from having to make much tougher decisions in the future.
Thank you for the opportunity to join in the discussion. Continental Resources wants to be your partner for the duration.

13.0417.04003
Title.

Prepared by the Legislative Council staff for
Senator Triplett
February 12, 2013

PROPOSED AMENDMENTS TO SENATE BILL NO. 2336

Page 7, line 29, replace "2013" with "2011"

Page 15, line 20, after the period insert "Section 5 of this Act is effective for wells completed after June 30, 2011, but applies only to production after June 30, 2013."

Renumber accordingly

13.0417.04005
Title.

Prepared by the Legislative Council staff for
Senator Cook
February 13, 2013

PROPOSED AMENDMENTS TO SENATE BILL NO. 2336

Page 1, line 4, after "reenact" insert "subsection 4 of section 38-08-04 and"

Page 1, after line 8, insert:

"**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 annually classify and determine the status and depth and average daily oil production of wells that are stripper well property as defined in ~~subsection 8 of~~ section 57-51.1-01, to annually certify to the tax commissioner which wells are stripper wells and the depth and average daily oil production of those wells, and to certify to the tax commissioner which wells involve secondary or tertiary recovery operations under section 57-51.1-01, and the date of qualification for the reduced rate of oil extraction tax for secondary and tertiary recovery operations. The requirement of annual classification and certification under this subsection applies only for wells drilled and completed in the Bakken or Three Forks formation and for other wells the classification and certification is required only once."

Page 3, line 15, replace "forty-five" with "forty"

Page 4, line 1, remove the overstrike over "~~"Average~~"

Page 4, line 5, after "~~closed~~" insert "statewide production" means the number of barrels of oil produced from wells within this state during a calendar month divided by the number of calendar days in that month, as determined by the industrial commission"

Page 4, line 5, remove the overstrike over the overstruck period

Page 4, line 12, after the stricken period insert "2."

Page 4, line 15, replace "2." with "3."

Page 4, line 21, replace "3." with "4."

Page 5, line 1, replace "4." with "5."

Page 5, line 29, replace "5." with "6."

Page 6, line 1, replace "6." with "7."

Page 6, line 8, replace "forty-five" with "forty"

Page 7, line 25, after "2016" insert ", or beginning on the first day of the first calendar quarter beginning after a period of three consecutive calendar months in which average statewide daily production exceeds one million barrels per day, whichever occurs first"

Page 7, line 27, replace "after" with "through"

Page 8, line 2, after the underscored period insert "An individual well on a stripper well property which exceeded an average of one hundred fifty barrels of oil production per day, according to its annual certification by the industrial commission under section 38-08-04, is not eligible for the exemption under this section until the production from that well individually meets the requirements of the definition for stripper well status under section 57-51.1-01."

Page 8, line 19, remove "and which was spud"

Page 8, line 22, after the underscored period insert "An individual well on a stripper well property which exceeded an average of one hundred fifty barrels of oil production per day, according to its annual certification by the industrial commission under section 38-08-04, is not eligible for the exemption under this section until the production from that well individually meets the requirements of the definition for stripper well status under section 57-51.1-01."

Page 15, line 16, replace "1" with "2"

Page 15, line 17, replace "2, 5, 6, and 8" with "3 and 9 and section 57-51.1-03, as effective through June 30, 2013, and as amended by sections 6 and 7"

Page 15, line 19, replace "3, 4, 7, and 9" with "4, 5, 8, and 10"

Renumber accordingly

2-20-13 Attachment #1

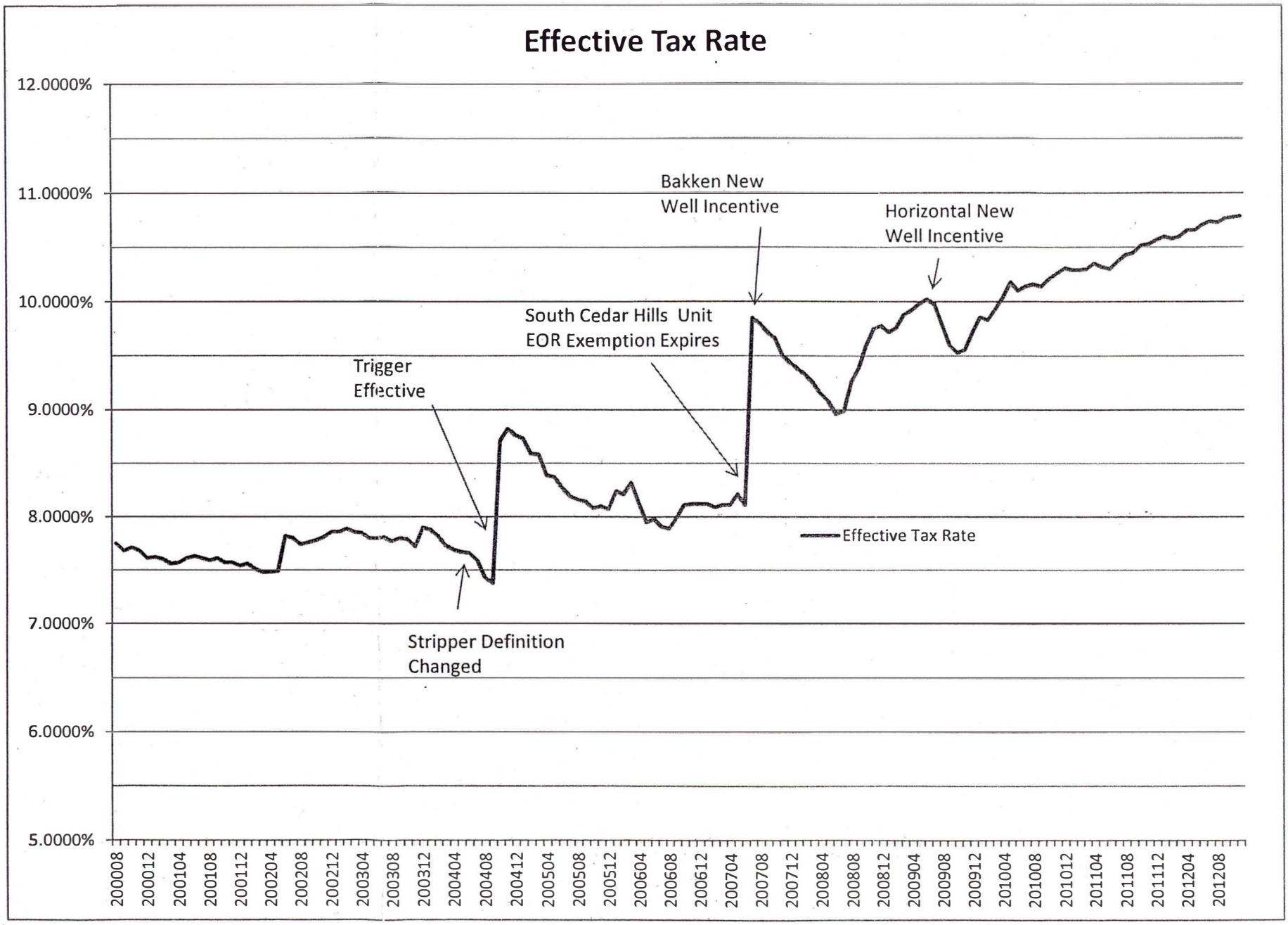
Production from Wells

Drilled in Stripper Properties	Production In 2013-15 Biennium	Production in 2015-17 Biennium	Production in 2017-19 Biennium	Production in 2019-21 Biennium
Drilled in 2013-15	16,154,000	8,077,000	4,038,500	2,019,250
Drilled in 2015-17		17,769,400	8,884,700	4,442,350
Drilled in 2017-19			19,546,340	9,773,170
Drilled in 2019-21				21,500,974

OET Due on Barrels Formerly Exempt as Stripper Wells (Assume Average Price of $80):

OET on Barrels Taxed at 6.5%	$84,000,800	$42,000,400	$21,000,200	$10,500,100
OET on Barrels Taxed at 6.0% /1		85,293,120	42,646,560	21,323,280
OET on Barrels Taxed at 4.5%			70,366,824	35,183,412
				77,403,506
Total Gain from Stripper "Fix"	**$ 84,000,800**	**$127,293,520**	**$ 134,013,584**	**$ 144,410,298**

Calendar Year	Estimated Barrels per day from new wells	Barrels per year	Revenue subject to taxes at $80 per barrel	Oil extraction tax revenue at 6.5%	Oil extraction tax revenue at 4.5%	Estimated reduction in oil extraction tax collections
2017	85,000	31,025,000	$2,482,000,000	$161,330,000	$111,690,000	($49,640,000)
2018	155,000	56,575,000	$4,526,000,000	$294,190,000	$203,670,000	($90,520,000)
2019	215,000	78,475,000	$6,278,000,000	$408,070,000	$282,510,000	($125,560,000)
2020	260,000	94,900,000	$7,592,000,000	$493,480,000	$341,640,000	($151,840,000)
2021	305,000	111,325,000	$8,906,000,000	$578,890,000	$400,770,000	($178,120,000)


Effective Tax Rate
12.0000%
11.0000%
10.0000%
9.0000%
8.0000%
7.0000%
6.0000%
5.0000%
Bakken New
Well Incentive
Horizontal New
Well Incentive
South Cedar Hills Unit
EOR Exemption Expires
Trigger
Effective
Stripper Definition
Changed
Effective Tax Rate
200008
200012
200104
200108
200112
200204
200208
200212
200304
200308
200312
200404
200408
200412
200504
200508
200512
200604
200608
200612
200704
200708
200712
200804
200808
200812
200904
200908
200912
201004
201008
201012
201104
201108
201112
201204
201208

2-20-13

To: Sen. Cook and Rep. Onstad

From : Ladd Erickson

Date: February 11th, 2013

Re: SB2336

Thank you both for visiting with me today about oil taxes. My thoughts on this issue are driven by the past promises that have been made to the legislature to get exempted oil, and my deep concerns about what I believe will be a very unmanageable problem with stripper wells in future years as many Bakken wells ripen to that status.

Adjusting triggers and stripper well "properties" makes sense to do. I am concerned about a 2% extraction tax reduction in 2017. First, our oil tax rates are not out of line presently when true comparisons are made with other states. In addition to our current rates and exemptions, our very low (and possibly getting lower this session) corporate tax rates coupled with the fact that we don't levy property taxes on wells - and other factors - lead to the conclusion that we treat oil companies very fairly and always have with our taxing policies. Second, for the same reason that weather forecasts more than a few days out are not accurate, fiscal impacts 4 years out have too many assumptions that won't be right and any projected revenue gain or loss is really just guessing. This is even more so if projections extend out further than 4 years. We know from even two year revenue forecasts that margins of error are great. Third, I think it is bad civics to start a new major tax rate four years from now, but right before a legislative session when we have no idea what our economic realities are in agriculture, federal payments to the state, and oil prices.

For these reasons I think a 1% extraction tax reduction this session is the preferable policy to a future 2% reduction. A 1% reduction would put our effective rate between 9.5 and 10%, again with low corporate taxes and no property taxes on wells - that is a very fair rate. This is particularly the case when considering the many costs the booming oil industry externalizes on North Dakotans – from elevated housing expenses, increased employee costs across both the private and public sectors, to roads, etc. When factoring all these things in our oil tax rates are darn cheap.

A 2% reduction is excessive and unwarranted in my review of the evidence, economics, and financial statements of the oil companies. I also believe that whatever our rates are they are expenses on federal taxes for the industry, so lowering our taxes doesn't necessarily equate to an equal advance in an oil company's net income.

I believe a 2013 1 % extraction tax reduction only makes sense for the state if stripper wells are recertified every year. And, I don't understand the reason to go to 45 bopd when we already have a very expansive 30 bopd? If anything, that 30 bopd should be reduced closer to the industry norm of 10 bopd. (Aren't the expenses of drilling deep into the Bakken or Three Forks already recovered on the front end of well production? If there are higher costs incurred to market ND oil it might justify more than 10 bopd, but 30?)

Stripper wells are a problem that will snowball into a larger and larger problem each session unless addressed. By 2019 or 2021 this issue might be completely out of control just based on the timing of when a glut of Bakken wells hit stripper status.

The whole purpose of special tax treatment on stripper wells is to keep low output wells in production. We defeat that purpose by allowing non-low producing wells to be extraction tax exempt. Currently we are allowing the "gaming" or exploiting of the tax code by our stripper well policies. To our detriment, our current stripper well policies incentivize lowering the outputs on a well until it qualifies for a stripper tax exemption, and then increasing that output which will be forever free of extraction taxes no matter what that increased output is. Frankly, this is terrible tax policy - especially in a shale play where new technology, additional laterals, or refracking can boost production after the extraction tax come off.

In addition, having a bopd trigger for when extraction taxes go back on, such as 100 or 150 bopd, incentivizes oil companies to mechanically rig the per day outputs to stay just below that trigger. Again, that is counterproductive tax policy. Since all other states recertify their stripper wells every year I would suggest just doing what they normally do when a well exceeds stripper triggers. That makes the tax code simple, and doesn't create a negative tax incentive to keeping a productive well at lower outputs just to avoid taxation.

I realize the fiscal note for lowering the extraction tax 1% coupled with fixing stripper wells is important. But, no matter where those immediate numbers come out, the long-term must be considered. True, high producing wells will see an immediate tax reduction under this proposal and that will amount to a lot of revenue. However, it will not take too many biennium's before the immediate loss in revenue reverses itself into revenue gains for the state as the volume of wells in the Bakken hit stripper status. I can't tell you whether it will be this biennium, 2017, 2019, 2021,...2025 when the short term losses from a 1% extraction tax reduction bisect with closing the stripper well loophole? But it is a mathematical certainty those lines will bisect at some point. The problem is, the more stripper wells we have the harder they will be to deal with, so if extraction taxes are going to be reduced this issue had best be dealt with at the same time. (You could tame the fiscal note down a bit, if it is a problem, by adjusting the drilling dates of the wells. For example, if we have 15 year old wells in stripper status, but they have been reworked and are producing far more than 30 bopd there is no reason not to require those wells to be recertified.)

If the public is made to understand the untenable future with current stripper well policies I believe it would be politically acceptable, if both parties on are board with this, to lower the extraction tax 1% now in exchange for fixing the stripper well problems down the road. On the issue of oil taxes, public acceptance is important because I do honestly believe that SB2336 in its current form is subject to be referred. Oil taxes are a touchy subject as you all know. Once again, thank you for considering my concerns....

#1
p. 1

Moser, Patricia M.

From: Molander, Shane A.
Sent: Thursday, March 14, 2013 2:30 PM
To: Moser, Patricia M.
Subject: Week 10 - 30 years ago
Attachments: 2299_001.pdf

Hi Patty....Here's a week 10. Also thought you and the Lt. Governor might get a kick out of the article in the attachment. Have a great weekend!

Shane

Week 10 – March 11-15

30 years ago this week legislators were reeling from information that revenue forecasts may be decreased by $40 million, forcing lawmakers to begin looking for ways to make up the projected shortfall. Some lawmakers and state officials at the time blamed the Initiated Measure 6 for the state's current financial woes while others continued to defend it. The controversial initiated measure, approved by voters in the November 1980 election and modified in the 1981 Legislature, increased the oil production tax from 5% to 11.5%. The increased revenue was going to be used to increase education funding and to provide property and income tax relief. Much of the projected oil money simply didn't materialize as oil prices declined, leading to "the shortfall" in the state's budget.

SB 2336-Explanation of what it would do

Two Taxes:

Oil and Gas Production Tax:	5.0%
Extraction Tax:	+ 6.5%
Total Oil & Gas Tax:	11.5%

Effective date: June 30, 2013: I-IV

I. **Require oil companies to withhold income taxes from royalty payments to out of state mineral rights holders. This is a 4.1M benefit to the state.**

   a. Effective date: June 30, 2013

II. **Eliminates stripper well properties exemptions in The Bakken and Three Forks Formation.**

Certified Stripper Well properties - **Current Law**

	Average Daily Production
6,000 or less	10 barrels per day
6,000 ↔ 10,000	15 barrels per day
10,000 or more	30 barrels per day

The 6.5% oil extraction tax is exempt on stripper well properties and only the 5% production tax is collected. The whole spacing is exempt from the 6.5% extraction tax.

Example: If there is a single certified stripper well on a spacing and second well is drilled, then if the new well produces 1,000 barrels per day, it will be taxed at the 5% production tax and the 6.5% extraction tax will be exempt for the life of the well.

   a. Stripper well status is granted to an individual well, NOT the whole spacing for a Bakken or Three Forks Well.

   b. Represents a $83 Million increase to the state.

   c. Current Stripper Well: Qualified Properties Exposed
      1500 Wells

   d. Effective date: June 30, 2013

III. **Changes the definition of a Certified Stripper Well for Bakken and Three Forks Wells of 10,000 ft. or more from 30 barrels to 40 barrels per day.**

   a. Effective date: June 30, 2013

IV. **Annual Recertification of stripper wells in The Bakken and Three Forks Formations.**

a. If annual recertification shows output of 150 barrels/day or more stripper well status is lost

b. Also has a claw back - we will look at wells drilled after June 30, 2011 into a stripper well property in The Bakken and Three Forks Formations and if they are producing more than 30 barrels per day they will lose stripper status and be required to pay 6.5% extraction tax.

c. Effective date: June 30, 2013

V. Creates an incentive to explore for oil outside The Bakken and Three Forks Formations.

a. This incentive reduces the extraction tax from 6.5% to 2.5% for wells outside these formations for the first 18 months of production or the first 75,000 barrels of oil.

b. Only 2 of the current 182 rigs are operating outside The Bakken and Three Forks Formations.

c. Effective date: June 30, 2013

Effective date: December 31, 2016: V-VI

VI. Eliminates 10 production incentives which trigger "on" and "off" on oil prices.

a. If the prices of a barrel of oil drops below the trigger price ($52.40) for five consecutive months, then a 24 month exemption on the 6.5% extraction tax would go into effect on all new wells. Also, as long as the exemption is in place, when the well finishes the 24 month holiday the extraction tax rate would be 4% not 6.5% until the price would trigger the rate back to 6.5%

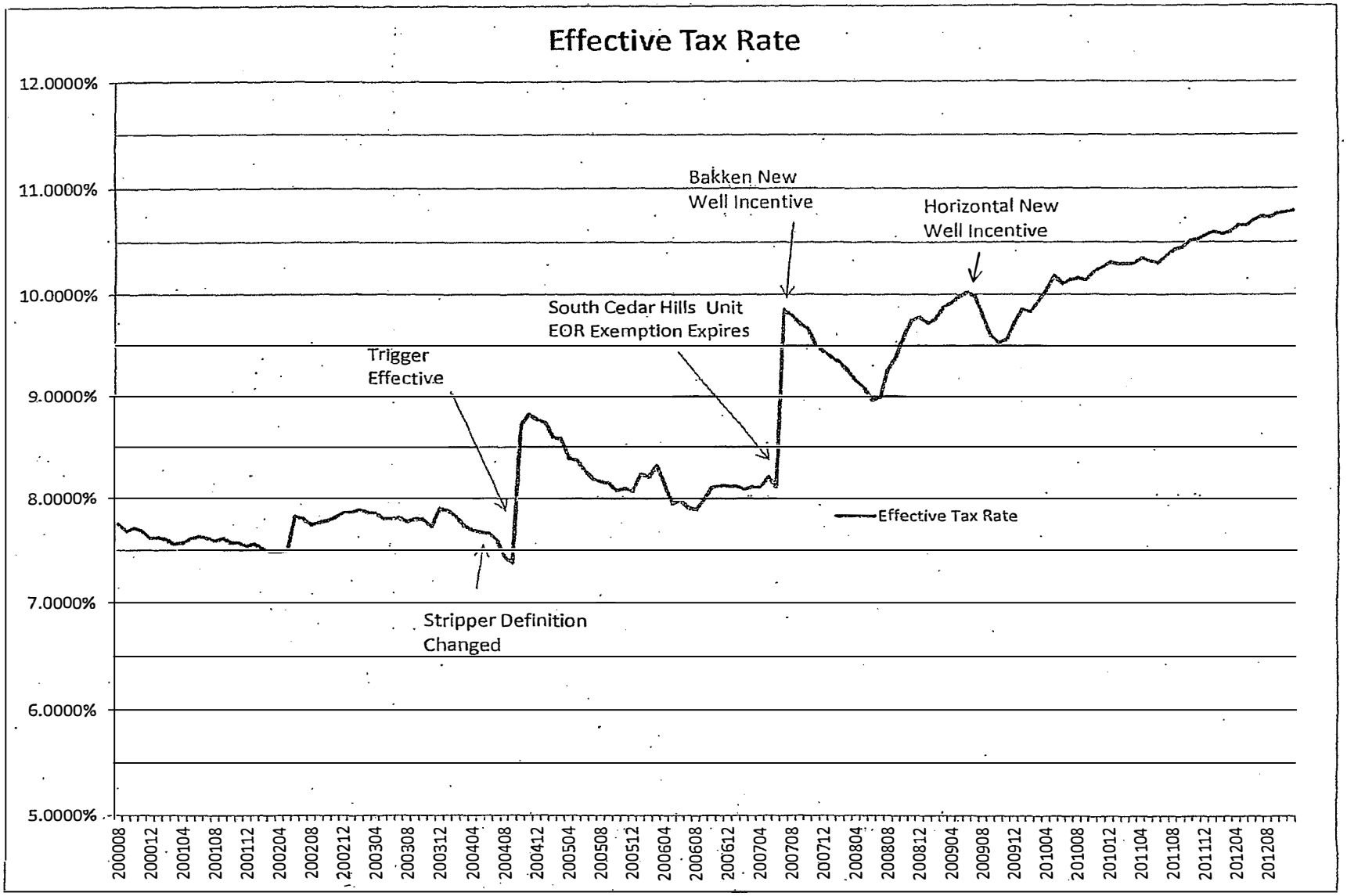
b. Effective date: December 31, 2016

VII. Changes the extraction tax rate from 6.5% to 4.5% on new wells only.

a. The new total oil tax would be:
5% production + 4.5% extraction = 9.5% total

b. Protects the state from a potential $2 billion revenue decrease if the world price drops dramatically like it did in 2009.

c. Effective date: December 31, 2016 (Unless oil production hits 1 million barrels per day for three consecutive months.)


Effective Tax Rate
12.0000%
11.0000%
10.0000%
9.0000%
8.0000%
7.0000%
6.0000%
5.0000%
Bakken New Well Incentive
Horizontal New Well Incentive
South Cedar Hills Unit EOR Exemption Expires
Trigger Effective
Stripper Definition Changed
Effective Tax Rate
200008
200012
200104
200108
200112
200204
200208
200212
200304
200308
200312
200404
200408
200412
200504
200508
200512
200604
200608
200612
200704
200708
200712
200804
200808
200812
200904
200908
200912
201004
201008
201012
201104
201108
201112
201204
201208

Barrels of Oil Expected to be Produced from Bakken Wells in Stripper Properties and Estimation of the Additional Oil Extraction Tax Associated with a "Stripper Fix" as Contained in SB 2336 (Color Coded to Reflect Different Tax Rates Contained in SB 2336)

Production from Wells Drilled in Stripper Properties	Production In 2013-15 Biennium	Production in 2015-17 Biennium	Production in 2017-19 Biennium	Production in 2019-21 Biennium
Drilled in 2013-15	16,154,000	8,077,000	4,038,500	2,019,250
Drilled in 2015-17		17,769,400	8,884,700	4,442,350
Drilled in 2017-19			19,546,340	9,773,170
Drilled in 2019-21				21,500,974
OET Due on Barrels Formerly Exempt as Stripper Wells (Assume Average Price of $80):				
OET on Barrels Taxed at 6.5%	$ 84,000,800	$ 42,000,400	$ 21,000,200	$ 10,500,100
OET on Barrels Taxed at 6.0% /1		85,293,120	42,646,560	21,323,280
OET on Barrels Taxed at 4.5%			70,366,824	35,183,412
				77,403,506
Total Gain from Stripper "Fix"	**$ 84,000,800**	**$ 127,293,520**	**$ 134,013,584**	**$ 144,410,298**

/1 Oil extraction tax rate is 6.5% until 1/1/2017 when rate becomes 4.5% on new production. The rate is blended to 6% for the 2015-17 biennium

Assumptions

Production from Bakken wells in "stripper" properties will grow at least 10% per biennium
Production from wells decline 50% per biennium, reaching the augmented stripper status in fifth biennium
Average oil price is $80 for entire timeframe
Only new production (after 1/1/2017) is subject to the rate relief in SB 2336

Conclusion

Over the 8 years estimated, the Bakken stripper property "fix" will increase OET revenues an **estimated $490 million**

hide

#2 p.5

Very Rough Estimate of Oil Tax Revenues for the Next Two Biennia
Under Current Price & Production Assumption (Current Law)
And Assuming a Significant Price Drop Resulting in Triggering-On of Incentives and an Associated Production Decrease
Occurs at the Beginning of 2015-17 Biennium

Estimated Revenues:	Estimate - Current Law Assumes Growth 10%/yr	Estimate - Price Drop To $55 Per Barrel	Price Drop & Trigger Eff Tx Rt falls to 7%	Price Drop/Trigger & Production Decrease	Percent Decrease Combined
2013-15 Biennium	5,128,000,000	Existing Forecast; Does not anticipate a price or production drop, or the triggering "on" of incentives			
2015-17 Biennium	6,153,600,000	4,184,448,000	2,678,046,720	2,008,535,040	-67%
2017-19 Biennium	7,384,320,000	5,021,337,600	3,213,656,064	2,410,242,048	-67%

Estimated CHANGE in Revenues (Fiscal Impact):	Fiscal impact of Price Decrease	Fiscal impact of Triggered Incentives	Fiscal Impact of Production Decrease	Total Biennial Estimated Fiscal Impact
2015-17 Biennium	(1,969,152,000)	(1,506,401,280)	(669,511,680)	(4,145,064,960)
2017-19 Biennium	(2,362,982,400)	(1,807,681,536)	(803,414,016)	(4,974,077,952)
Total Estimated Impact - 2 Biennia	(4,332,134,400)	(3,314,082,816)	(1,472,925,696)	(9,119,142,912)

Conclusion: If, at the close of the 2013-15 biennium, the oil price drops to $55 per barrel, and incentives "trigger on", and production falls by 25%, the combined revenue impact would be a reduction in expected oil tax revenues of 67%.
A rough estimate of total oil revenues for the 2017-19 biennium is less than half of the revenue expected for the 2013-15 biennium under current price/production/tax rate assumptions, assuming a price, production, and revenue drop has occurred.

#3

Cook, Dwight C.

From: Helms, Lynn D.
Sent: Monday, March 18, 2013 2:32 PM
To: Cook, Dwight C.; Campbell, Tom S.; Burckhard, Randall A.; Miller, Joe T.; Oehlke, H. Dave; Dotzenrod, Jim A.; Triplett, Constance T.
Subject: Stripper Well Property Maximum Efficient Rate Analysis

Chairman Cook and members of Senate Finance and Taxation Committee,

Your committee requested information regarding the technology and processes used to determine the maximum efficient rate (MER) of a Stripper Well Property.

Following are the methods utilized to determine if the Stripper Well Property produced at its MER during the proposed qualifying period:

1) Upon receipt of a Stripper Well Property Application, the scanned well file for the qualifying well is reviewed for any indication of work performed during the proposed qualifying period. If work was performed during the qualifying period, this is noted.

2) Once the well file review is complete, a Stripper Well Qualifying Data report is created for the proposed qualifying period. This report is created using the Ground Water Protection Council's Risk Based Data Management System (RBDMS) which is licensed for use by the Oil and Gas Division. The Stripper Well Qualifying Data report is reviewed as follows:

    a. Days per month the well produced and the oil volume per month produced during the qualifying period. If the report shows significant downtime, the well file review notes from earlier are reviewed for work performed during the qualifying period. If no workover report has been submitted, the applicant is contacted via phone or email to discuss why the well was down and/or documentation of work performed during the downtime.

    b. All field inspector notes for the qualifying period.

    c. Oil and gas sales, production, and transportation reports.

3) After analyzing the Stripper Well Qualifying Data report, the production curve for the Stripper Well Property is reviewed using the Oil and Gas division's DeclineCurveND software. This analysis is performed to review the historical production in graphical form.

The technologies utilized during a maximum efficient rate review are Adobe software, RBDMS, email correspondence in Microsoft Outlook, phone conversations, and the DeclineCurveND program.

These reviews can take from 1 hour (if no problems are found) to several weeks (if significant documentation gaps are found).

We maintain records of the 4-5% of applications denied for not producing at MER and we estimate that there are approximately 5% more that are withdrawn by the applicant when we question MER. We also provide a tool on our website that allows applicants to screen the well for MER before making application.

Sincerely,
Lynn D. Helms
Director, DMR