TAXATION OF COAL, OIL, AND GAS AND HIGHWAY FUNDING

At the November 28, 2005, meeting of the Transportation Committee, information on energy industry taxation and highway funding was requested by the committee. This memorandum will focus on the severance and extraction taxes and generation taxes and not on taxes related to transmission or the distribution of energy. In particular, this memorandum will highlight the state general fund which may be used for highways and the oil and gas impact grant fund which is used to fund the repair of roads.

The first table summarizes the present taxation law as it relates to coal, oil, and gas. For coal, there is a coal severance tax that is imposed on the act of removing coal from the earth. The tax is in lieu of both sales and use taxes on coal and the property tax on minerals in the earth. The coal conversion tax is in lieu of property tax on a coal conversion facility and is a privilege tax imposed on the operator of a coal conversion facility for the privilege of producing electricity from coal conversion plants.

For oil and gas there is a gross production tax. This tax is in lieu of property taxes on oil and gas producing properties. In addition, for oil there is an oil extraction tax which is levied on the extraction of oil from the earth.

The table below lists the taxes, the rate of taxation, the allocation of funds collected under the tax, and the amount transferred to the state general fund in 2005.

<table>
<thead>
<tr>
<th>Taxes</th>
<th>Rate</th>
<th>Allocation</th>
<th>2005 Tax Revenue to General Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coal severance</td>
<td>37.5 cents/ton</td>
<td>30% coal development trust fund with remaining interest income to state general fund</td>
<td>$1,378,987.00</td>
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<td></td>
<td>2 cents/ton</td>
<td>70% coal-producing counties 70% to cities 30% to school districts 40% to counties</td>
<td></td>
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<tr>
<td>Coal conversion in lieu of property tax on facility</td>
<td>2 cents/ton For electricity generating with 10,000 kilowatt capacity .65 mill x 60% installed capacity x hours taxable period + .25 mill/kilowatt-hour of electricity produced For coal gasification - Higher of 4.1% of gross receipts or 13.5 cents/1,000 ft³ of gas produced</td>
<td>Lignite research fund 15% to producing county 85% state general fund 100% to state general fund Through 2009, first $41,666.67 each month from .25 mill/kilowatt-hour from sale in state general fund with remainder: 85% state general fund 15% county of plant 40% county 30% cities 30% school districts</td>
<td>$22,764,014.83</td>
</tr>
<tr>
<td>Oil and gas production in lieu of property tax</td>
<td>For oil, 5% of gross value For gas, adjusted flat rate/1,000 ft³ of nonexempt gas</td>
<td>1/5 State Treasurer 1/3 oil and gas impact grant fund with $5 million cap ($6 million on July 2007) with the remainder to the state general fund</td>
<td>$49,629,401.41</td>
</tr>
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<td>Taxes</td>
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</tr>
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<tr>
<td>Oil extraction tax</td>
<td>For oil, 6.5% of gross value, unless special well or project, then 4%</td>
<td>4/5 state general fund and producing county, including school districts and cities Less than $1 million 75% county 25% state $1 million to $2 million 50% county 50% state Greater than $2 million 25% county with cap based on population Less than 3,000 - $3.9 million 3,000 to 6,000 - $4.1 million Greater than or equal to 6,000 - $4.6 million 75% state</td>
<td>$27,301,469.20</td>
</tr>
</tbody>
</table>

1State general fund deposits from production tax and extraction tax are capped at $71 million per biennium. The excess is deposited in the permanent oil tax trust fund.

The following flow chart traces the distribution of funds collected under the oil and gas gross production tax and the oil extraction tax.
Oil and Gas Tax Revenues Distribution of Funds

Oil and gas gross production tax¹
(North Dakota Century Code Chapter 57-51)

Distributed per formula contained in Section 57-51-15

Oil and gas impact grant fund
(Up to $5 million per biennium until July 2007, then up to $6 million)

Political subdivisions within producing counties³

State’s share³

Oil extraction tax²
(North Dakota Century Code Chapter 57-51.1)

Distributed per allocation contained in Section 57-51.1-07

Oil and gas research fund
(Chapter 57-51.1-07.3)
(Up to $1.3 million per biennium)

Resources trust fund
(Section 57-51.1-07.1)

Common schools trust fund
(Article X, Section 24)

Foundation aid stabilization fund
(Article X, Section 24)

State general fund
(Up to $71 million per biennium)

Over $71 million per biennium

Permanent oil tax trust fund
(Section 57-51.1-07.2)

Interest

Principal

Transferred to state general fund at the end of each fiscal year

May only be spent upon two-thirds vote of members elected to each house of the Legislative Assembly

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

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

³The oil and gas gross production tax is distributed to the political subdivisions and to the state general fund based on each county’s production and population.
Some of the oil extraction tax proceeds are deposited in the state general fund and the permanent oil tax trust fund. These funds may be used for highway funding. The Legislative Assembly in Senate Bill No. 2366 (1997) established North Dakota Century Code Section 57-51.1-07.2, creating a permanent oil tax trust fund. This section provides that revenue deposited in the general fund during a biennium from oil and gas taxes which exceeds $71 million is to be transferred to a permanent oil tax trust fund. The interest earnings on the permanent oil tax trust fund are transferred to the general fund at the end of each fiscal year. Before the 1999-2001 biennium, there were no transfers to the trust fund. The section provides that the principal of the permanent oil tax trust fund may not be expended except upon a two-thirds vote of the members elected to each house of the Legislative Assembly. The section also provides that if there are adjustments to the oil tax distribution formulas contained in Chapter 57-51 or 57-51.1, the director of the budget is to adjust the $71 million amount by the same percentage as the amount of the increase or decrease in the amount of general fund revenue resulting from the change in the allocation formula.

Some oil and gas gross production tax proceeds are used for highway funding. The oil and gas impact grant fund is administered by the Energy Development Impact Office, a division within the Office of the Commissioner of the Board of University and School Lands. The Energy Development Impact Office provides financial assistance for basic governmental services to local units of government affected by energy activity. Since 1991 the Energy Development Impact Office has made grants for oil impact only. Attached as an appendix are the oil impact grant awards for 2005. Many of the awards went for road repair and maintenance.

ATTACH:1