MINUTES

MONTANA SENATE
51st LEGISLATURE - SECOND SPECIAL SESSION

COMMITTEE ON TAXATION

Call to Order: By Senator Bob Brown, Chairman, on Monday, May 21, 1990, at 10:00 a.m.

ROLL CALL

Members Present: Senator Brown, Senator Hager, Senator Norman, Senator Eck, Senator Bishop, Senator Halligan, Senator Walker, Senator Harp, Senator Gage, Senator Severson, Senator Mazurek, Senator Crippen

Members Excused: None

Members Absent: None

Staff Present: Jill Rohyans, Committee Secretary
Jeff Martin, Legislative Council Researcher

Announcements/Discussion: The Legislative Finance Committee joined the Taxation Committee for a presentation by Teresa Cohea comparing local government severance tax bills, definitions of "revenue neutral", and a discussion of flat taxes (attachments #1, #2, and #3). Dennis Adams, Director, Department of Revenue, presented a brief review of the local government severance tax (attachment #4). Following the presentations, the Finance Committee withdrew to continue their deliberations. The Taxation Committee continued their meeting with the formal hearing on Senate Bill 1.

HEARING ON SENATE BILL 1

Presentation and Opening Statement by Sponsor:

Senator Del Gage, District 5, sponsor of the bill, said concern has been expressed regarding manipulation of production in order to arrive at stripper rates rather than regular rates. He presented the committee members with a rationale detailing the reasons such action would not be feasible (attachment 1b, pages 1 and 2). Page 3 indicates the effect of a 1% percent change in the rates affecting regular, stripper and royalty oil rates as well as the corresponding rates for gas. Page 4 indicates the rates and tax neutral status based on 1987 revenues. The bottom half of page 4 indicates the tax neutrality of the rates in the bill. An explanation of the differennnce in the net proceeds tax is explained at the bottom of the page. Page 5 provides a "guesstimate" of 1989 production had it been calculated on a net proceeds tax base with 1987 deductions.

Senator Gage pointed out the reason for the bill is to correct the unintended exemption for the first 30MCF of stripper well gas production from the local government severance tax. The bill also addresses the concern that based on the 1987 net proceeds tax the rates in HB 28 would not produce the comparable amount of local government severance tax.

The rates in SB1 are adjusted to result in royalty owners paying the same local government severance tax as they paid in net proceeds tax in 1987. The working interests would also pay the same rates they would have paid in 1987. The rates on working interests for regular and stripper are different as the regular producer had to pick up the tax benefit that was given to the stripper. Overall, the oil and gas rates would be tax neutral on the working interests when you add both stripper and regular production.

Another problem with the bill is the one year time lag in calculation of the guaranteed tax base. HB 28 left the net proceeds or local government severance tax out of the guaranteed tax base calculation on a statewide basis, therefore, it was left out of each district calculation. This only happened during the first year and it has been resolved in the this bill.

Senator Gage noted there have been a number of language changes to ensure the clarity of definitions and functions of net proceeds tax, local government severance tax, and state severance tax.

Senator Gage reviewed the bill section by section. He noted the language clarifications in Section 1. He pointed out the stricken language on page 2, lines 9 and 10, was redundant because if the product is marketable it is taxable. If it is not of sufficient quantity to market, it would not be feasible to produce it in the first place.

He pointed out the rate changes in Section 1, subsections 1(a) -1(e). The state severance tax is set at 5%; the 8.4% rate on working interest (the rate used by the Department of Revenue under HB 28 and also used in determining the royalty percentage) is reduced to 8.11%. Local government severance tax on gas increases from 15.25% to 17.44%. There is no change in tertiary rates except the 4.2% of local government severance tax is changed to 4.06% which is stripper rate status. Page 5, subsection e, is a new subsection specifically drawn to delete the stripper well exemption which existed under the provisions of HB 28. Page 16, subsection (3) sets oil and gas royalty rates at 15% for oil and 17.9% for gas. Provisions of subsection (b), line 26 - page 7, line 4, indicate that royalty owners are exempt from the local government severance taxes imposed under 15-36-121 (3) and (4) and under subsections (1)(e) of Section 1. The royalty owners are not subject to the taxes imposed in the aforementioned sections but are subject instead to the tax imposed in subsection (3). Subsection (4), under HB 28 provisions, applied only to production of oil. The changes reflect the intention to apply the same provisions to drilling natural gas wells and production of natural gas. Page 8, subsection (6) deals with the definition of gross taxable values. Senator Gage said there may have to be language clarification amendments proposed for this section in order to avoid any possible misinterpretation.

Section 2 deals primarily with changes in language to identify all the various taxing entities as "taxing units". There is also a provision for exclusion of new and interim production with regard to calculation of unit values. It was never intended that new and interim production entered into those calculations.

The changes on page 10, subsection (b), reflect a concern by the counties that all the local government severance tax goes back to the county. Only the state severance tax is allocated to the state general fund. The balance of the section deals with the problems of the first year where there was no net proceeds tax or local government severance tax calculated into the guaranteed tax base. This section deals with the second part of the distribution so there will not be a negative distribution to any county. It is based on a percentage of the actual distribution rate of the second part of the distribution as opposed to previous methods which were based on the number of units of production in each of those taxing jurisdictions.

Section 3 deals with the tax on gas, specifying the first 30,000 cubic feet of average daily production per well is subject to a local government severance tax of 8.72%. It also clarifies that the first five barrels of average daily production from a stripper well are exempt from all of the state severance tax imposed by 15-36-101, but not from the local government severance tax.

Section 4 clarifies the guaranteed tax base provisions and the calculations resulting from the changes in the net proceeds tax and local government severance tax.

Section 5 contains the severability clause.

Section 6 indicates the effective date is set upon passage and approval.

Section 7 indicates Sections 1 and 3 apply retroactively to gas and oil produced after December 31, 1988.

Senator Gage reviewed the information contained in attachment 1b, pages 1 and 2, regarding the possibility of an incentive to convert from regular production to stripper production in both gas and oil. Senator Gage pointed out the figure he used is about $1.5 million higher than the actual revenue that net proceeds brought in and he was unable to adjust the rates on the lower half of the page as he did not know for sure what areas were affected (as noted in the postscript, page 4).

Senator Gage said the biggest problem in the bill affects four counties, that being the first 30,000 of stripper gas being exempt under the old bill. He said if no other problem is addressed in the whole special session, this one area needs to be corrected. He anticipated bills being introduced which would set a 138% rate, as compared to a 100% rate, based on 1987 production. He noted he had been working on this bill with the industry people from all across Montana since November. This bill is an attempt to put the bill in the shape it was intended to be in as a result of the first special session. The commitment was made at that time to rates that would raise the same local government severance tax based on 1987 production as the net proceeds tax raised. There was no commitment and neither was there any proposal to continue to bump the rates up as the production declined. Senator Gage said that he had indicated at the time that 1987 rates were being used as a base year because 1988 effective rates on net proceeds were going to be lower than 1987 because of declining prices and production. The industry agreed to that in order to maintain the revenue neutrality status.

List of Testifying Proponents and What Group They Represent:

William W. Ballard, Past President, Montana Petroleum Association, President, Rocky Mountain Oil and Gas Association, and President, Balcron Oil.

List of Testifying Opponents and What Group They Represent:

Senator Larry Tveit, District 11
Senator Tom Keating, District 44

List of Those Who Wished to Testify As Neither Opponents or Proponents and What Group They Represent:

Senator Dennis Nathe, District 10
Carl Knutson, Superintendent of Schools, Saco, Montana
Greg Groepper, Office of Public Instruction
Bruce Moerer, Montana School Boards Association
Pat Melby, Underfunded Schools
Tom Bilodeau, Montana Education Association
Gloria Palatichek, Richland County Commissioners
Terri Minnow, Montana Federation of Teachers

Testimony:

Mr. Ballard presented his testimony to the committee (written testimony attachment #2b).

Opponents:

Senator Larry Tveit, District 11, expressed concern with the tax on royalty owner interests. He felt the tax is excessive and it needs to be determined who is going to pay for the $2 million shortfall. He felt doubling the tax on operators is excessive and that many small royalty owners are being taxed unfairly under provisions of the bill.

Senator Tveit said he lives in the Williston Basin, right next to North Dakota, and he just attended the North Dakota Petroleum Association meeting. He noted the Bakken formation in eastern Montana has a great potential with 92 billion barrels of oil on the North Dakota side. There are 10 billion barrels on the Montana side. He noted this is just one of many formations in the Williston Basin. He noted that 32 wells have been drilled on the North Dakota side and 30 of those are producing. Movement is beginning to come into Montana at present. He said the potential is very great, even at 10% of 10 billion barrels. He felt the bill sends a clear signal about the instability of taxing policies in Montana. Companies are afraid to come to the state because of the shifting tax structure in the oil and gas area. Montana already taxes oil at 2.5% higher than North Dakota. Natural gas is taxed at 5%, in Montana at 17.5%. North Dakota also defined strippers separately and taxed them at 5%. He expressed concern that trying to maintain a revenue neutral position during the course of the next few years will drive taxes higher and higher, due to declining production.

Senator Keating, District 44, testifying as a citizen of Montana and a royalty owner, said he opposes the increase in the rate of tax on royalty production. He disagreed with the assumption that tax revenues must be revenue neutral for a specific period of time. He said the revenue neutral figure is based on the total production in the state. There are only 23 counties that are oil and gas or coal producers and there are probably 2 or 3 school districts within each county. This would mean 60 - 70 taxing units as defined in the bill all of which have different millages. The flat tax was figured on the average of all those taxing units. It is an impossibility to try to attain revenue neutral status for those taxing units because the average will only affect about 10% of those taxing units that are within the average range. All the rest will be outside that range and there is no way to make them tax neutral with a flat tax.

Senator Keating explained the ownership of royalties. When someone buys property in the state, he usually becomes the owner of the mineral rights. Oil companies drill an average of 15 dry holes before they hit production. Under normal oil and gas leases, the landowner (mineral owner) is promised 1/8th of the production as his royalty free of cost of the risk and expense of drilling and completing and producing the oil or gas. This is a private contract between the operator and the royalty owner. Yet, the legislature has seen fit to confiscate approximately 20% of the royalty owners private property in the form of taxes. The purpose of the tax is to provide services for the taxpayer that the taxpayer cannot provide for himself. Senator Keating asked what governmental service the royalty owner receives for the tax he pays. He pays surface tax as a landowner, property tax as a responsible member of the community, for which he receives roads, schools, law enforcement protection, etc. As a royalty owner, he receives nothing in return for the taxes paid.

He felt it is unfair for the royalty owners to have to pick up the $2 million shortfall, when all the taxpayers will benefit from that increase.

Those Wishing to Testify on a Neutral Basis:

Senator Dennis Nathe, District 10, expressed concern with the fairness issue as it relates to royalty owners. He noted he supports the bill except for the royalty tax issue. He said he is concerned about the signals that are being sent and the direction in which we are moving if we pass the bill with these provisions regarding royalty interests.

Carl Knutson, Superintendent of Schools, Saco, expressed appreciation for the support of the Governor and the Legislature in addressing the shortfall problem. His district would experience over a $200,000 loss under the previous legislation. He said using 1987 as a base leaves his district short $103,000, due to reduction in foundation program levels and increased costs and declining enrollment which causes costs to go up and state payments to go down. He said using the 1989 basis would only leave them $37,600 short. This does not sound too bad, except that HB 28 effectively took $13 million of their $16 million tax base away. So instead of raising $16,000 on one mill, they now raise $3,340 per mill. He noted in his district this year the gas companies were assessed 149 mills which is the major share of the district's tax income. The flat tax would only generate about 55 mills on the same property. He would like to stay as close to present level as possible. He understands production is declining and so would like to avoid starting from a deficit figure in the beginning. He urged the committee to try to adjust the rates so that his district can stay somewhat close to the current funding level.

Greg Groepper, Office of Public Instruction, pointed out that his concern is that the floor appears to be $35.9 million to get back to what the schools were expecting. The concern is not so much with the district that has oil and gas as it is with the district that does not have oil or gas and is looking for reimbursement under the guaranteed tax base. He pointed out that if the $35.9 million revenue neutral figure is not reached, the state's wealth is going to be less, the average payment per mill per child will be less statewide, and a district with no oil or gas will not receive what they would under the $35.9 million base. He said there are a couple of technical problems with the bill. He presented proposed amendments to the committee which corrected these problems (attachment #3b). The second half tax payment is due May 31st and it is impossible to get the information from the County Treasurers in time to make the payment this year.

Mr. Groepper said the committee might want to consider clarifying the royalty collection mechanism (if it is adopted) as to whether it is a withholding tax on the producer or a tax liability that is on the individual who receives the royalty interest. This is an area that is unclear in the bill and would cause some concern in the revenue and liability area.

Bruce Moerer, Montana School Boards Association, said his Association did not oppose the flat tax in HB 28 because it was intended to be revenue neutral for the local schools. They still have no problem with that concept and do not oppose the bill. He urges the committee to maintain the revenue neutrality and to aim for a $36 million base figure.

Pat Melby, Underfunded Schools, said he concurred with both Mr. Groepper and Mr. Moerer. He said their understanding of HB 28 was that in the first year of implementation there would be the same amount of revenue available from the flat tax on oil and gas and coal as there was under net proceeds taxes in 1987 - approximately $36 million. He urged the committee to strive to meet that level and to set the tax policy accordingly.

Tom Bilodeau, Montana Education Association, said he agreed with the previous testimony. He pointed out HB 28 was a compromise and revenue neutrality was a commitment by the oil and gas industry to the school districts. He urged the committee to continue to fund the base at $35.9 million.

Gloria Palatichek, Richland County Commissioner, said SB 1 does deal with the two major issues the special session has been called to address, the stripper exemptions and revenue neutrality. Fixed distribution is one issue that is not addressed but should be addressed more properly at the next regular session.

Terri Minnow, Montana Federation of Teachers, urged the committee to ensure revenue neutrality and to make sure schools and counties are not harmed in the process.

Questions From Committee Members:

Senator Crippen asked Mr. Ballard if it is correct that the royalty owner's tax liability increased substantially under the provisions of HB 28 as passed last summer as compared to the rates under net proceeds.

Mr. Ballard replied that royalty owners would be paying less tax under this proposal than under the old net proceeds tax. He pointed out some royalty owners were paying as much as 30% under the net proceeds tax.

Senator Walker asked Mr. Ballard if he had a bottom line figure that he preferred for the bill (referring to Mr. Ballard's attachment #2b).

Mr. Ballard said the changes would result in approximately a $40,000 surplus based on the 1987 revenues. The county governments would receive approximately $40,000 more than they would have under the old net proceeds provisions.

Senator Mazurek asked Mr. Groepper to clarify figures that have been presented as anticipated total revenue from the bill.

Mr. Groepper said the $36.4 million figure (attachment #1) is the total of both the local government severance tax plus the post-'85 tax.

Senator Mazurek asked Senator Nathe if it was his suggestion to raise the rates on the backs of the royalty owners.

Senator Nathe said it is important to look at a lot of options and especially to retain the revenue neutrality. He also feels there has to be a sense of fairness involved and he said he has no specific answer for achieving revenue neutrality.

Senator Halligan asked Senator Gage if he had looked at a floating average on a three or four year base when doing the calculations for the bill.

Senator Gage said if you feel the revenue has to be there regardless of the production, then you keep rolling the rate forward until you ultimately get a 100% tax. It does not make any difference if it raised on a rolling average or a base three average. If it is raised on decreasing production, it can only result in a 100% tax.

Senator Crippen said the crux of the matter is revenue neutrality. He asked just where the local governments and schools feel the revenue will come from in the future if we are to maintain the revenue neutrality provision indefinitely.

Mr. Groepper said it is his understanding the legislature is here to set a tax rate that will generate revenues for the first year implementation. He said schools have an expectation of the what that number should be for this year and that future funding will be decided in the next regular session when everything will again be open for debate.

Senator Mazurek asked Senator Gage to share his thoughts on changing the rates by eliminating the distinction between new and old oil.

Senator Gage said that at the time the rate was set in order to hold the new production at revenue neutral rates. Oil on a gross basis was paying about a 7% tax and gas was paying about 12%. The feeling was to hold that rate constant so that if companies were coming into the state there would be a set rate for their tax which would not escalate due to millages. He felt that changing those rates, or tying them to revenue neutrality sends the message that there is a whole new tax structure which has no set rates and no stability.

Senator Eck asked if different rates had been considered for stripper wells based on production and market.

Senator Gage replied there are a number of things that impact gas that do not impact oil. Weather has quite an impact on demand, for example. He said a level had to be set somewhere.

Senator Mazurek asked how Senator Gage felt about the rates recommended by the Petroleum Association as opposed to the rates proposed in the bill.

Senator Gage said he had no problem with the Petroleum Association rates. He pointed out the rates in the bill are practically tax neutral on all products and all payers on a statewide average.

Closing by Sponsor:

Senator Gage closed by pointing out once again that the rates in the bill are based on statewide averages. He said there were over 1000 leases and over $50 million in product sales that paid no net proceeds tax in 1987 which will now being paying local government severance tax under the provisions of this bill. He said Senator Nathe is correct to express concern about his area, other Senators should be supporting the bill as folks in their areas will see a decrease in taxes under the terms of the bill. Individuals will be affected differently across the state.

He reminded the committee members that this bill does not affect new and interim production - only wells that were drilled and producing prior to July 1, 1985 are affected.

He pointed out that areas where there is gas and oil production pay fewer mills on property that those areas where there is no oil and gas production. There is a vast difference in the tax rate on similar properties in the two different areas. The people in distribution areas have had significantly lower taxes than people in other areas of the state.

Senator Gage noted that up to as much as 50% of the royalty owners are from out of state. He also pointed out that there are as many as 80 - 90 royalty owners on a single lease in some cases. Some of them have as small a royalty as 1000th of a percent which might yield as much as 40 cents a year.

It will be almost impossible to hold schools and counties harmless year after year short of increasing the rates each year. Production will decline and only if there are price hikes comparable to the decline will the neutrality be preserved.

Approximately 60% of the wells in Montana are strippers. They do not produce anywhere near 60% of the total production in the state. If we were to lose 60% of the wells in the state, the service companies would shut down and leave the state at a rate which would make the past decline in services seem insignificant.

Senator Gage said he reviewed five other bills which have been introduced and four of the bills varied between 107% and 137% of the 1987 rates. One of the bills is 95% of the 1987 rates.

Senator Gage said rather than studying the oil and gas rates any further, we need a whole new tax structure in Montana. Not only do we need a new tax structure, we need a whole reorganization of the state. He said we have too much of everything in this state except tax revenue. At some point we are going to have to take a deep breath and do the hard things that need to be done for the betterment of the State.

DISPOSITION OF SENATE BILL 1

Amendments and Votes:

Senator Gage MOVED the adoption of the proposed amendments as presented by the Office of Public Instruction (attachment 3b).

The motion CARRIED with Senators Eck and Halligan absent.

Senator Norman asked for clarification of the year on which the rates are based.

Senator Gage replied the base year is 1987. Using the rates in the bill the same amount of revenue would be generated in 1989.

Senator Norman then asked if there had never been a flat tax at all, would the revenue generated in 1989 be less than that of 1987?

Senator Gage indicated that would be true if the mills stayed the same.

Senator Norman asked if revenue neutral means 1989 revenue must be equal to the 1987 revenue.

Senator Gage said revenue neutral means that under this bill the net proceeds will be converted to a percentage of the gross proceeds in such a way that the same revenue would have been generated in 1987 under a flat tax as was generated by millages throughout the state and that percentage will stay the same in the future. Otherwise there is no sense in finding rates for 1987 if they are not going to be used as a base. If the rates are going to be changed every year then an adjustment would have to be made on the amount of money, i.e., if we generate $40 million, then the rates will have to be adjusted each year to raise $40 million whether the rates have to go to 50% or 65% or

100%.

Senator Gage MOVED to amend the bill by adopting the rates as presented by the Montana Petroleum Association (attachment 2b).

Senator Brown asked if it was the intent of the Petroleum Association to raise the same amount of money with these rates as would be raised in the bill as written.

Mr. Ballard said that was his intent.

Senator Gage said the MPA rates would raise more than $33 million because most of the taxable production is in the regular oil area and those rates are being raised. Therefore, more of the 1989 production would be taxed at a higher rate.

Senator Mazurek asked if there was anyone from OPI or DOR who could interpret the proposed new rates.

Greg Groepper, OPI, said after a quick review it appears the calculation is correct. One problem is the uncertainty of how much of the royalty interest is on regular production since that has not been collected for some time.

Senator Mazurek asked if DOR would respond.

Judy Rippingale said the rates haven't been run at 12.5% and 15.25% on royalty but they would do that immediately. Regular oil does get an increase under Senator Gage's rates of approximately $3.2 million. The royalty owners will see and increase over current law, but they will not pay as much, in terms of a percentage rate, as they would have under net proceeds or in the introduced bill, SB 1. DOR will send a form to the companies which will record the royalty data which will then be integrated into the current system.

Senator Norman said he does not distrust the MPA figures, but this is such a critical juncture that he would like to have DOR, OPI, and the LFA agree on the rates and the revenues likely to be generated before any action is taken.

Senator Walker said the bottom line neutrality figure is $35.9 million and he wants to know how the proposed rates compare to that number.

Senator Mazurek said he realizes the need to get the bill moving quickly. He and the other committee members have received an enormous amount of material in the last 24 hours and he wanted to be sure that he understood the facts and figures clearly before acting on the bill. He felt that is the only way to avoid making another mistake such as was made last session.

Senator Brown said it appears that the controversial and complicated part of the bill is the part that deals with the rates. There is philosophy, politics, and some confusion involved in that aspect of the bill. He felt the 30MCF exemption is not particularly controversial and wondered if the committee would like to deal with that now and deal with the rates in another bill.

Senator Harp said he would support that since the exemption is the main reason the Legislature was called back. He felt the rates will be a real stumbling block.

Senator Mazurek expressed some nervousness about that approach. He felt the commitment to revenue neutrality is most important and an equal obligation for action.

Judy Rippingale said the numbers the DOR ran were almost exactly the same as Terri Cohea's figures (attachment #1).

Senator Brown asked Judy Rippingale to have the DOR staff to run the figures on the newly proposed rates.

Senator Gage WITHDREW THE MOTION regarding the adoption of the rates as proposed by the Montana Petroleum Association.

Senator Crippen asked if there is any objection to the language in the bill which relates to stripper gas rates.

Senator Norman said he can agree on parts of the bill, but he is not prepared to act on the bill or any part of it until he is sure of all the figures.

Senator Eck asked Doug Abelin to respond to the stripper rates as proposed by MPA.

Doug Abelin said he does agree with the rates and feels fairly certain that is the case industry wide.

William Tulick, Meridian Oil, said his company operates both regular and stripper wells. He said, to the best of his knowledge, Meridian is the largest royalty owner in the state. He said Meridian does support regular oil subsidizing the tax burden on the stripper. He said they are interested in economies of production as any business would be. He said that as an operator they would ask that there be no reduction in the present burden under LGST. In fact, they would be willing to take a slight increase. As a royalty owner, they want to get back to the revenue neutral position and hold the schools and counties neutral to the 1987 revenue in the face of declining production.

Jerome Anderson said Shell Western produces about 30% of the oil in Montana and they are willing to accept the burden of the increase in order to protect the stripper. He said they are most interested in avoiding the uncertainties they face under net proceeds computations.

Senator Mazurek said he is trying to compare the current rates to the MPA proposed rates.

Senator Gage pointed out that previously stripper royalty was being taxed at stripper rates. Under HB 28 royalty strippers rates went from 4.2% to 12.5%.

Senator Mazurek said that now the rate on both is 12.5% on oil.

Senator Gage confirmed that.

Senator Mazurek said on gas it is 15.25%.

Senator Gage replied that is the same they would have paid under HB 28 on regular gas, but it is an increase on stripper gas royalties.

Senator Mazurek expressed concern regarding a potential equal protection problem.

Valencia Lane, Legislative Council, responded that retroactive legislation is not prohibited. The question that arises is if the period of retroactivity is reasonable. The U.S. Supreme Court, in looking at federal income taxes, established two major considerations when dealing with equal protection and retroactivity in tax law. The first is whether the change in the tax law was foreseeable. The second was whether the change was merely a change in the tax rate or the imposition of a new tax. Generally, a new tax will not be upheld or retroactively applied, whereas a change in the tax rate will be upheld. A one year period is generally the norm - particularly retroactivity to the beginning of the year in which the tax was enacted. There are three caveats in respect to retroactivity, the first being whether it is a new tax. Her understanding of the royalty interest is that it is a new tax. Therefore, the retroactivity question becomes a problem with regard to the royalty interest. Another consideration is whether or not payments have been made. The final consideration is the question of applying new obligations to transactions that have already been completed. If you are looking at a mere change in the tax rate, you are more likely to have the retroactive application upheld as opposed to the imposition of a new tax.

Senator Mazurek said the question is, then, whether the taxing of royalty is a new tax.

Valencia Lane said her understanding was that they were previously taxed under the net proceeds law. But under HB 28, it is her understanding that they were not taxed. Therefore, if the courts look at this as the imposition of a new tax, there will be a problem applying the retroactivity.

Senator Gage noted a memo prepared for Norfolk Energy by Lou Moore (name unclear) of the Crowley law firm in Billings indicated that "retroactive tax legislation of the next succeeding legislative session can be valid even if it eliminates existing exemptions".

Senator Gage said in regard to equal protection the federal government did the same thing in regard to the windfall profit tax. The tax depended on who you were and what your volumes were and that determined what your rate was. This is the same ground the federal government plowed and they had no problem with windfall profit taxes as far as equal protection and no challenges.

Senator Crippen MOVED the committee recess for one half hour. The motion CARRIED unanimously.

The committee reconvened with Chairman Brown calling on Judy Rippingale to present the rate calculations from DOR.

Judy Rippingale reviewed the information on attachment 4b for the committee.

Senator Mazurek asked what the difference on net and gross proceeds would be based on 1989. He said the report indicated there would be $4 million more than current law if you were under net and gross proceeds.

Judy Rippingale said for 1989 production there is no net proceeds since the law was changed.

Senator Mazurek indicated he understood that but wondered what it would have been.

Judy Rippingale said the gross value of oil and gas for calendar 1989 was just slightly above the gross value for 1988. Production was down, but the price on both oil and gas rose between 1988 and 1989 making the gross value of the product in 1989 slightly more than 1988.

Senator Mazurek asked if that meant Ms. Rippingale was suggesting the number would be about the same.

Judy Rippingale said that indicated to her that unless expenses increased significantly that the number would be about the same. It was $36 million net proceeds in 1988.

Senator Mazurek asked how the calculations were done when there are no royalty production reports.

Judy Rippingale replied they were able to make a fairly accurate assumption based on the exempt royalty reports for 1987 and the exempt percentage or portion of royalties has not changed significantly in the totals.

Senator Brown asked the committee to compare the DOR information to the fiscal note. He noted there is a $1 million dollar difference in the last column and a $2 million difference in the column affected by the MPA amendments. He asked Ms. Rippingale to respond to his determination that there is $1 million less with the MPA amendments than there is in the fiscal note.

Judy Rippingale said Senator Gage's rates, as introduced, raised more money than revenue neutrality, therefore the fiscal note would be higher.

Senator Brown said the effect of the amendments, then, is to bring in less revenue than the fiscal note indicates.

Judy Rippingale agreed that was true.

Senator Gage said (verbatim) he would defy anyone to find (either on the tapes or in their memory) anyone who said these are to bring in the same revenue in 1989 as they brought in in 1987 or even the same revenue in 1988 as was brought in in 1987. But I would remind you that my statement to you then was that we're using 1987 rates because we think 1988 rates will be lower because the net proceeds tax will be lower because the price has gone down significantly since 1987. And we don't feel that it is fair to wait for 1988 lower rates. If you'll search your memory and if we had the tapes, you would hear that on the tapes.

Senator Mazurek returned the discussion to the subject of retroactivity. He said he had visited with Valencia Lane and Dave Woodyard, attorney for DOR, and he said there is some real concern about the royalties since the returns are already in. He asked Mr. Woodyard to address the issue.

Dave Woodyard, DOR attorney, said he has looked at the exemption and think that is cured through the legislation.

On the rate side it is somewhat different. There is a fiscal note indicating there is going to be a revenue deficit (not revenue neutral). That would raise a question in the Court's mind as to whether changing the royalty rates or the tax rates at all is, in fact, cured in legislation. If it is not cured in legislation, there is a real question about the constitutionality of going all the way back to December 31, 1988, and changing the rates. It would require new returns to be filed with the rate change which would be a hard pill to swallow. It is a concern, but he does not see there is any problem with going to the beginning of 1990 and starting there with the change in the royalty.

Senator Mazurek asked what the dollar impact would be if 1989 was dropped and 1990 was used.

Judy Rippingale responded that the loss would be approximately $2.1 million.

Senator Eck asked if Senator Gage could prepare a set of percentages (rates) that would apply to just the one year. She expressed concern that this could end up in court which would be most embarrassing.

Senator Gage said he would not trust the next legislature to leave the one year alone. He felt they would take the one year out.

Senator Gage indicated Mr. Moore, who prepared the retroactivity memorandum, will be in Helena tomorrow and it is possible he could address the committee regarding that issue.

Senator Mazurek said he did not know if Mr. Moore applied the opinion specifically to the royalty question.
He said there is the curative problem, i.e., going back and fixing an acknowledged mistake, versus just going back and making up dollars.

Senator Gage it doesn't make any difference if it is working interest or royalty owner, it is a retroactive change. It is intended to pick up revenue shortfall.

Senator Mazurek suggested the Council Staff, Jeff Martin, prepare an explanatory or purpose clause that justifies the proposal saying that even though there was a fiscal note that indicated it might not be revenue neutral that it was represented and there was testimony that indicated that it would be revenue neutral (foregoing is verbatim). Somehow we need to justify going back on the royalties if that is what is going to be done. He also asked for a severability clause that would segregate 1989 and 1990 so that "the whole thing is not lost".

Senator Crippen expressed a desire to have some time to review all the material that has been presented and to delay any further action until tomorrow.

Senator Gage MOVED that Section 1 be deleted from the bill. This is the section dealing with the rates. Further, that page 13, line 23 be changed to 7.625% and line 25 be changed to reflect 7.625%. On page 18, Section 7 should be changed to indicate Section 1 is no longer in the bill. This would in effect say there is no longer an exemption for stripper gas and that in calculation of the guaranteed tax base there must be the value of the net proceeds tax or the local government severance tax in the calculation for the interim year. It also leaves in the bill the second distribution of the formula change so there will not be a negative distribution in any county.

Senator Mazurek expressed disappointment with the motion as it seems the whole offer by the industry to make the bill revenue neutral is being thrown out at the first challenge.

The first time a question is raised, the revenue neutral provision is going to be left behind and the correction of the stripper problem sent on. The effect of that will be shorting the foundation program and the various taxing jurisdictions across the state. He felt that breaks the promise that has been stated clearly all day.

Senator Brown said the effect of the motion is to allow the committee to do that which is non-controversial and "do-able".

Senator Eck said it is more controversial than anything else. The neutrality is being eliminated.

Senator Mazurek said this segregates the rates and the exemption and he hates to see that happen at this point.

Senator Brown said he would hate to see the committee become bogged down in some meandering discussion over rates that might take the better part of a week.

Senator Crippen felt this was an opportunity to pass the non-controversial items and then allow time to digest the volume of material that has been presented and make an informed decision on the rates in another bill - either a House or Senate bill at a later date.

Senator Gage said the attempt at this point is to do what is possible ("do-able"). Nobody has objection to correcting the stripper problem, the negative distribution problem, and the guaranteed tax base problem. This bill will end up in a conference committee and the sooner it gets to it the better. It will also not be recognizable when it comes out of the House Taxation Committee and goes to the conference committee. Senator Gage urged the committee to get the bill on its way as quickly as possible so that the conference committee can get to work.

Senator Halligan and Senator Mazurek expressed concern about letting the House deal with the rates and not addressing that issue in the Senate.

The motion CARRIED on a roll call vote (attachment 6b).

Recommendation and Vote:

Senator Gage MOVED SB 1 as amended DO PASS.

Senator Mazurek asked if it is the intention of the Chair to not meet tomorrow and consider rates.

The Chairman indicated the committee could meet tomorrow and propose a committee bill if a 3/4ths majority would agree to drafting a bill with Senate rates in it. Senator Brown said it is his intention to have a bill on the floor tomorrow.

Senator Eck said she would hope the committee would meet to consider a committee bill dealing with rates as she would feel much better about a bill coming from Senate Taxation than from House Taxation.

Senator Mazurek asked if it is Senator Gage's intention to continue to push for inclusion of revenue neutrality in addition to the stripper well correction in whatever bill finally is passed.

Senator Gage said it is his intention to do exactly what was intended to be done in the special session of 1989 - to make the bill revenue neutral to 1987 production and the revenue that those rates would have raised be equal to the revenue that was raised on 1987 production net proceeds tax. He said he has no intention of working toward rates that would raise that same revenue based on 1989 production. It was never discussed and was never the intent of the legislature and he defied anyone to show him that it was ever intended.

The motion CARRIED on a roll call vote (attachment 7b).

ADJOURNMENT

Adjournment At: 5:45 p.m.

Bob Brown

Senator Bob Brown, Chairman

jdr

ROLL CALL

TAXATION COMMITTEE

51st LEGISLATIVE SESSION -- 1990 Date 5/21/90

Special Session II

NAME	PRESENT	ABSENT	EXCUSED
SENATOR BROWN	X		
SENATOR BISHOP	X		
SENATOR CRIPPEN	X		
SENATOR ECK	X		
SENATOR GAGE	X		
SENATOR HAGER	X		
SENATOR HALLIGAN	X		
SENATOR HARP	X		
SENATOR MAZUREK	X		
SENATOR NORMAN	X		
SENATOR SEVERSON	X		
SENATOR WALKER	X		

Each day attach to minutes.

SENATE STANDING COMMITTEE REPORT

May 21, 1990

MR. PRESIDENT:

We, your committee on Taxation, having had under consideration Senate Bill 1 (first reading copy -- white), respectfully report that Senate Bill 1 be amended and as so amended do pass:

1. Title, lines 4 through 8.
Following: "ACT"
Strike: remainder of line 4 through "PRODUCTION;" on line 8

2. Title, lines 14 and 15.
Following: "WELLS"
Strike: remainder of line 14 through "WELLS" on line 15

3. Title, line 19.
Strike: "15-36-101,"

4. Page 1, line 24 through page 9, line 7.
Strike: section 1 in its entirety
Renumber: subsequent sections

5. Page 13, line 23.
Strike: "8.72%"
Insert: "7.625%"

6. Page 13, line 25.
Strike: "8.72%"
Insert: "7.625%"

7. Page 14, line 25.
Strike: "and"
Insert: "for production occurring after March 31, 1990, plus"

8. Page 15, line 24.
Strike: "and"
Insert: "for production occurring after March 31, 1990, plus"

9. Page 17, line 3.
Strike: "and"
Insert: "for production occurring after March 31, 1990, plus"

10. Page 18, line 8.
Strike: "Sections 1 and 3"
Insert: "Section 2"
Strike: "apply"

sb01522.lh

Insert: "applies"

11. Page 18, lines 9 and 10.
Strike: "oil" on line 9 through "and" on line 10

AS AMENDED DO PASS

Signed: Bob Brown
Bob Brown, Chairman

#1

STATE OF MONTANA

Office of the Legislative Fiscal Analyst

STATE CAPITOL
HELENA, MONTANA 59620
406/444-2986

SENATE TAXATION
EXHIBIT NO. 1
DATE 5/21/90
BILL NO. SB 1

TERESA OLCOTT COHEA
LEGISLATIVE FISCAL ANALYST

May 18, 1990

Comparison of Local Government Severance Tax Bills and Definitions of "Revenue Neutral"

A. TAX RATES

Category	1987 Net Proceeds Average Effective Tax Rate	Current LGST	Gage - LC 3 (first version)	SB1 Gage - SB1 (revised)	O'Keefe LC 8	O'Keefe LC 14	O'Keefe LC 15	Eudaily LC 13
OIL								
Operator								
Regular	7.32%	8.4%	8.4%	8.11%	9.0%	9.72%	11.9%	8.4%
Stripper	8.22	4.2	4.2	4.06	9.0	4.86	5.95	4.2
Incremental	N/A	4.2	4.2	4.06	9.0	4.86	5.95	4.2
Royalty								
Regular	14.72	8.4	13	15	9.0	9.72	11.9	8.4
Stripper	14.72	4.2	13	15	9.0	4.86	5.95	4.2
NATURAL GAS								
Operator								
Regular	15.95	15.25	15.25	17.44	15.25	20.6	24.5	15.25
Stripper (exempt)	11.25	0.00	7.625	8.72	15.25	10.3	12.25	7.625
Stripper (taxable)	11.25	7.625	7.625	8.72	15.25	10.3	12.25	7.625
Royalty								
Regular	17.87	15.25	13	17.9	15.25	20.6	24.5	15.25
Stripper (exempt)	17.87	0.00	13	17.9	15.25	10.3	12.25	7.625
Stripper (taxable)	17.87	7.625	13	17.9	15.25	10.3	12.25	7.625
NEW & INTERIM PRODUCTION								
Oil	7.0	7.0	7.0	7.0	9.0	7.0	7.0	7.0
Gas	12.0	12.0	12.0	12.0	15.25	12.0	12.0	12.0

SENATE TAXATION
EXHIBIT NO. 16
DATE 5/21/90
BILL NO. SB 1
page 1

Montana State Senate

SENATOR DELWYN GAGE
SENATE DISTRICT 5
HELENA ADDRESS:
CAPITOL STATION
HELENA, MT 59620
HOME ADDRESS:
BOX 787
CUT BANK, MT 59427
PHONE: (406) 873-4662

The Big Sky Country

MAJORITY FLOOR LEADER
COMMITTEES:
TAXATION
RULES COMMITTEE CHAIRMAN

May 18, 1990

IS THERE AN INCENTIVE TO CONVERT FROM REGULAR PRODUCTION TO STRIPPER?

OIL -,	11 barrels @ $ 17.50 per bbl		$ 192.50
	5% severance tax	$ 9.62	
	8.11% local government severance tax	15.62	25.24
	Net		$ 167.26
	10 barrels @ 17.50		$ 175.00
	3% X 5 barrels X 17.50	$ 2.62	
	4.06% local government severance tax	7.10	9.72
	Net		$ 165.28

By dropping one barrel of production to qualify for stripper status the operator reduces his tax by $ 15.52 but he loses $ 17.50 in oil sales so he has a net loss of $ 1.98. If he has to drop two barrels of oil to get to stripper status he has a net loss of $ 17.19 and the more oil he does not produce to get to stripper status the larger his loss is. There is a point between 10.9 barrels and 10.8 barrels at which a person ends up with the same net by reducing his average to 10 barrels. At an average of 10.9 barrels the producer loses 46¢ by reducing his production to an average of 10 barrels per day. At 10.8 barrels the producer gains $ 1.06 by reducing his daily average to 10 barrels. At 10.1 barrels the producer gains $ 11.70 by reducing his production to a 10 barrel average. Thus this says when your average daily production is just over 10 barrels per day but under 10.9 barrels per day a producer will end up with a larger net income after state severance and local government severance tax if he can limit his production to ten barrels per day average per well.

On the other end of this calculation, assuming that a producer could be producing 10.1 barrels per day but decides that if he limits his production to qualify for stripper status and ends up with production of only 9.2 barrels per day he then finds that again he would have been better off to produce the 10.1 barrels, pay the higher taxes and end up with a larger net. There is a point between 9.2 and 9.3 barrels that again is a break-even compared to 10.1 barrels per day. There are many differing effects between 9.2 barrels and 10.9 barrels. It appears to me that a producer has a very slight margin of error when he is manipulating his production to qualify for stripper status.

Montana State Senate

The Big Sky Country

SENATOR DELWYN GAGE
SENATE DISTRICT 5
HELENA ADDRESS:
CAPITOL STATION
HELENA, MT 59620
HOME ADDRESS:
BOX 787
CUT BANK, MT 59427
PHONE: (406) 873-4662

MAJORITY FLOOR LEADER
COMMITTEES:
TAXATION
RULES COMMITTEE CHAIRMAN

GAS - There is a little different situation with gas, but not much.

70,000 mcf @ $ 1.75		$ 122.50
2.65% state severance tax	$ 3.25	
17.44% local gov't severance tax	21.36	24.61
Net		$ 97.89
60,000 mcf @ $ 1.75		$ 105.00
1.59% state severance tax	$ .83	
8.72% local gov't severance tax	9.16	9.99
Net		$ 95.01

The above says that by producing 70,000 and paying a higher tax rate the producer is still better off than if he limits his production to 60,000 to qualify for stripper rates. Again there is a point between these two production figures at which there is an incentive to limit production to qualify as strippers and again as in oil if a person does not regulate his production within a very narrow range he could produce under the 60,000 level to the point that again he would be at a lesser revenue figure than he would have received if he had produced and paid the higher tax rates.

There is no question that some unusual situations can be concockted to illustrate the point of incentive for production limitation to qualify for stripper status but in my judgement they would be very rare and unusual.

SENATE TAXATION
EXHIBIT NO. 16
DATE 5/21/90
BILL NO. SB 1

Montana State Senate

SENATOR DELWYN GAGE
SENATE DISTRICT 5
HELENA ADDRESS:
CAPITOL STATION
HELENA, MT 59620
HOME ADDRESS:
BOX 787
CUT BANK, MT 59427
PHONE: (406) 873-4662

The Big Sky Country

MAJORITY FLOOR LEADER
COMMITTEES:
TAXATION
RULES COMMITTEE CHAIRMAN

May 19, 1990

According to the latest figures that I have from the Dept. of Rev. a 1% change in the following will result in the respective dollar changes:

Regular oil rates - assuming in 1987 that 7.5% of oil production was stripper, hence 92.5% is regular - 327,112,522 X 92.5% = 302,579,083	3,025,791
Stripper oil rates - per assumptions above 327,112,522 - 302,579,083 = 24,533,439	245,334
Oil royalty rates - 43,514,296	435,143
Regular gas rates - assuming that in 1987 36% of gas production was stripper, hence 64% is regular - 57,620,826 X 64% = 36,877,329	368,773
Stripper gas rates - 57,620,826 - 36,877,329 = 20,743,497	207,435
Gas royalty rates - 8,812,001	88,120

SENATE TAXATION
EXHIBIT NO. 16
DATE 5/31/90
BILL NO. SB1

Montana State Senate

The Big Sky Country

SENATOR DELWYN GAGE
SENATE DISTRICT 5
HELENA ADDRESS:
CAPITOL STATION
HELENA, MT 59620
HOME ADDRESS:
BOX 787
CUT BANK, MT 59427
PHONE: (406) 873-4662

MAJORITY FLOOR LEADER
COMMITTEES:
TAXATION
RULES COMMITTEE CHAIRMAN

May 19, 1990

MPA proposal that had concensus support from those who met May 10, 1990:

Regular Oil - 302,579,083 X 8.4%	$ 25,416,643
Stripper oil - 24,533,439 X 4.2%	1,030,404
Royalty oil - 43,514,296 X 12.5%	5,439,287
Regular gas - 36,877,329 X 15.25%	5,623,793
Stripper gas - 20,743,497 X 7.625%	1,581,692
Royalty gas - 8,812,001 X 15,25%	1,343,830
Total local government severance tax on 1987	$ 40,435,649
Net proceeds tax paid on 1987	40,384,717 *
Excess over tax neutral	$ 50,932

Tax distribution per percentages in the bill:

Regular oil - 302,579,083 X 8.11%	$ 24,539,164
Stripper oil - 24,533,439 X 4.06%	996,058
Royalty oil - 43,514,296 X 15%	6,527,144
Regular gas - 36,877,329 X 17.44%	6,431,406
Stripper gas - 20,743,497 X 8.72%	1,808,833
Royalty gas - 8,812,001 X 17.9%	1,577,348
Total local government severance tax on 1987	$ 41,879,953
Net proceeds tax paid on 1987	41,874,436 *
Excess over tax neutral	$ 5,517

* There is a difference of $ 1,489,719 in these two figures both of which came from the Dept. of Revenue. My calculations were based on the higher figure and after they gave me that figure they found that a producer had included new production in his net proceeds calculation and thus the net proceeds tax had been over-stated by that much.

Montana State Senate

SENATE TAXATION
EXHIBIT NO. 16
DATE 5/21/90
BILL NO. SB1

SENATOR DELWYN GAGE
SENATE DISTRICT 5
HELENA ADDRESS:
CAPITOL STATION
HELENA, MT 59620
HOME ADDRESS:
BOX 787
CUT BANK, MT 59427
PHONE: (406) 873-4662

The Big Sky Country

MAJORITY FLOOR LEADER
COMMITTEES:
TAXATION
RULES COMMITTEE CHAIRMAN

May 19, 1990

Oil - Working interest gross	$ 327,112,522	
Deductions allowed.	157,152,194	
Working interest subject to net proceeds tax	$ 169,960,328	(1)

Gas - Working interest gross	$ 57,620,826	
Deductions allowed	12,586,150	
Working interest subject to net proceeds tax	$ 45,034,676	(2)

Based on figures received from Dept. of Rev. average oil royalty percentage on 1987 production was 14.875% and on gas 20.1%. If we assume these same percentages and just use the same deductions that were used in 1987 applied to 1989 production we would arrive at a working interest subject to net proceeds tax (if we still had a net proceeds tax as follows:

Oil - 1989 gross production 17,725,727 X 17.019 =	$ 301,674,146	
Less: Royalty of 14.875%	44,874,029	
Working interest gross	$ 256,800,117	
1987 deductions allowed	157,152,194	
Working interest subject to net proceeds tax	$ 99,647,923	(1)
Gas - 1989 gross production 33,810,499 X 1.696	$ 57,342,606	
Less: Royalty of 20.1%	11,525,864	
Working interest gross	$ 45,816,742	
1987 deductions allowed	12,586,150	
Working interest subject to net proceeds tax	$ 33,230,592	(2)

Oil - 1987 working interest taxable	$ 168,960,328	(1)
1989 " " "	99,647,923	(1)
Decrease in taxable	$ 69,312,405	(3)
Gas - 1987 working interest taxable	$ 45,034,676	(2)
1989 " " "	33,230,592	(2)
Decrease in taxable	$ 11,804,084	(3)
Total decrease in taxable	$ 81,116,489	(3)

EXHIBIT NO. 16
DATE 5/21/90
BILL NO. SB 1

Montana State Senate

The Big Sky Country

SENATOR DELWYN GAGE
SENATE DISTRICT 5
HELENA ADDRESS:
CAPITOL STATION
HELENA, MT 59620
HOME ADDRESS:
BOX 787
CUT BANK, MT 59427
PHONE: (406) 873-4662

MAJORITY FLOOR LEADER
COMMITTEES:
TAXATION
RULES COMMITTEE CHAIRMAN

The decrease in gross dollars from production from 1987 to 1989 were:

Oil -	1987	$ 384,276,967
	1989	301,674,146
	Decrease	$ 82,602,821
Gas -	1987	$ 72,124,426
	1989	57,342,606
	Decrease	$ 14,781,820
Total decrease of		$ 97,384,641

The point of this report is that there are those who are saying that to be tax neutral the oil and gas industry should pay the same tax on the 1989 production that they paid on the 1987 production, otherwise there will be a revenue loss of 8.8 million. I ask you where the fairness is in saying to an industry "We know that your total sales are down over 97 million dollars and if you were still under the old net proceeds tax law you would have about 81 million less taxable revenue, but that is too bad, we are going to raise your rates from an overall 1987 rate of 9.25% to a new overall rate of 11.55%". Anyone for talking about a regressive tax policy?????

SENATE TAXATION
EXHIBIT NO. 2
DATE 5/21/90
BILL NO. SB1

Local Government Severance Tax

Issues and Options

Prepared for the
Legislative Finance Committee
by

Teresa Olcott Cohea
Legislative Fiscal Analyst
May 21, 1990

MONTANA PETROLEUM ASSOCIATION
A Division of the
Rocky Mountain Oil and Gas Association

EXHIBIT NO. 2b
DATE 5/21/90
BILL NO. SB1

Helena Office
2030 11th Avenue, Suite 23
~~Helena, Montana~~ 59601
Phone (406) 442-7582
Fax (406) 443-7291

Janelle K. Fallan
Executive Director

Billings Office
The Grand Building, Suite 510
P.O. Box 1398
Billings, Montana 59103
Phone (406) 252-3871
Fax (406) 252-3871

Jill Rohyans

May 21, 1990

The Montana Petroleum Association supports the following rates on the local government severance tax:

Regular oil -- 8.4% P 2, line 24
Stripper oil -- 4.2% P5, line 19
Nonworking interest oil -- 12.5% P6, line 18
Regular gas -- 15.25% P3 line 12
Stripper gas -- 7.625% P 13, lines 23 & 25
Nonworking interest gas -- 15.25% P6, line 22

SENATE TAXATION
EXHIBIT NO. 26
DATE 5/21/90
BILL NO. SB1

L C 0003/01

A BILL CORRECTING AND AMENDING CERTAIN PROVISIONS OF THE LOCAL GOVERNMENT SEVERANCE TAX

TESTIMONY BY: W. W. BALLARD
(Past President MPA, President RMOGA, President Balcron Oil)

On behalf of the Montana Petroleum Association and as a Montana independent since 1963, I am testifying in support of Senator Gage's bill. Exemption of gas strippers producing less than 30 MCFPD was an error and the industry recognizes it as such. We believe that this exemption should be eliminated and this bill does that. We also support revenue neutral tax rates for the LGST using 1987 as the base year, and Senator Gage's bill adjusts rates so that this is accomplished.

Please remember that this bill affects only production established before 1985. The 1985 legislature established uniform net proceeds rates state-wide for production established after July of that year. Pre-1985 production is a declining asset that will continue to decline, but until enough new production is found, cash flow from this production is a major revenue source for drilling new wells in the State.

I have testified many times before various bodies of this legislature concerning geologic potential in this state. I made a statement that Balcron would double their drilling activity if the legislature would pass certain incentive bills. During the time period 1985-86, Balcron drilled (or caused to be drilled) 14 wildcat wells in Montana. During the 1987-1989 period, we drilled 29 wildcats. On the development side, we drilled 20 wells in 1985-86 and increased this to 30 during 1987-89. We plan to continue to operate in Montana as long as cash flow and our ability to bring in joint venture partners will permit. This year we will be drilling the most venturesome test in our 27 year history: A well in the overthrust belt near Townsend. This well will be 13,500 feet deep and cost almost 4 million dollars just to get to our objective. Without the incentive bills we could not have brought in the partners necessary to accomplish such an undertaking.

I have supplied you with several graphs to demonstrate the plight of the industry in Montana. I will discuss three here: (1) Severance and Net Proceeds Taxes Paid by Industry; (2) Gross Value of Oil and Gas Produced in Montana By Year; and (3) Number of Exploratory Wells Drilled.

The Severance and Net Proceeds Graph shows income to

SENATE TAXATION
EXHIBIT NO. 26
DATE 5/21/90
BILL NO. SB1

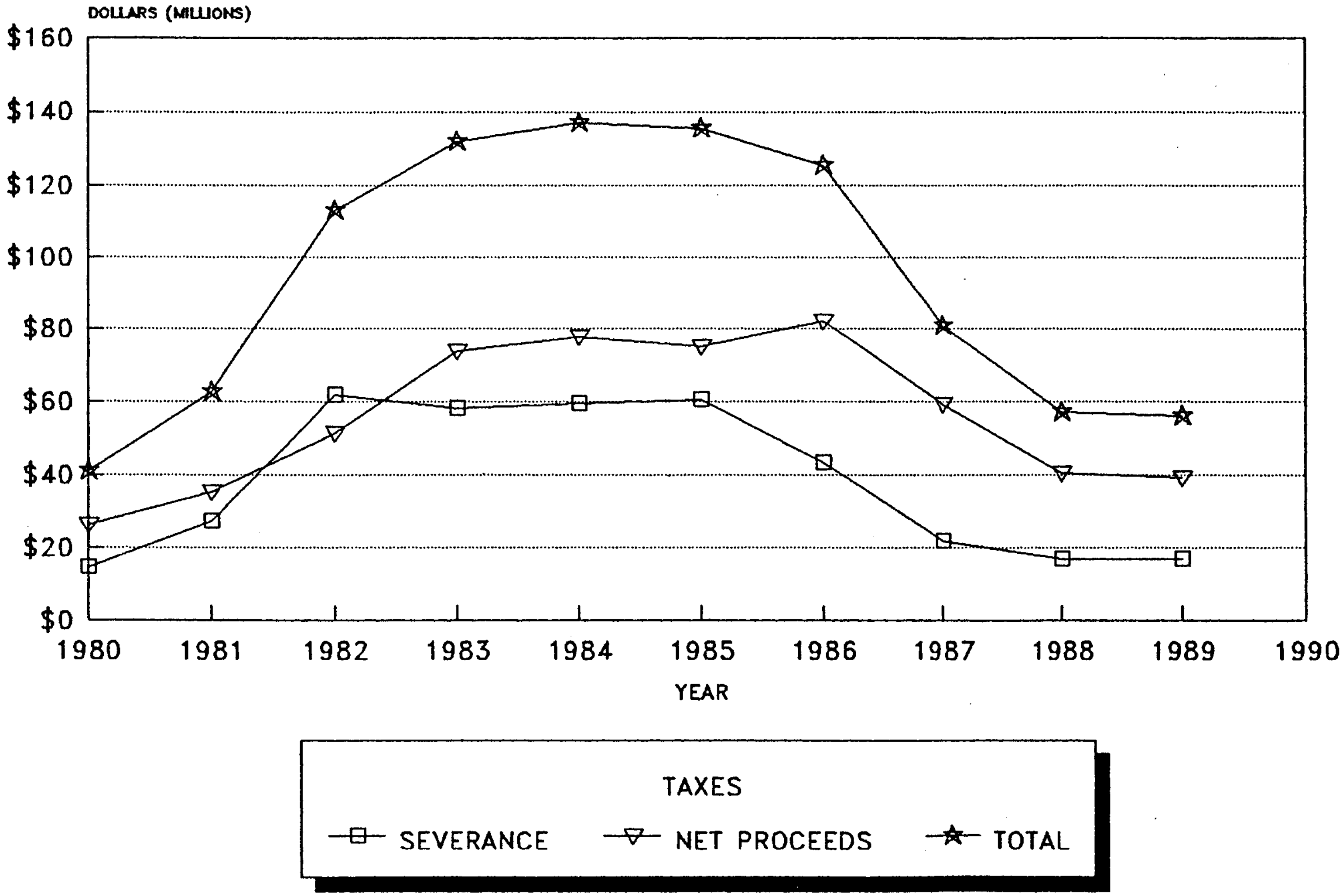
state and local governments during the 1980's. Note that the peak year for this income was 1984 and comparing 1984 on the Gross Value Graph, it is apparent that the time of greatest taxes was well past the time of greatest value. Note also that 1986 was the year of greatest income from the Net Proceeds Tax and this was the year that oil prices hit rock bottom! (See Price Charts.)

The answer to all our dilemma is found on the graph showing numbers of exploratory wells drilled by year. I chose to plot only exploratory wells because these are the ones seeking new fields. (Development wells are offsets drilled to develop a discovery found by a wildcat [exploratory well]). In order to solve the cash flow problem in which both industry and government find themselves, we simply have to drill more exploratory wells and find more reserves. Government and industry must work together to accomplish this. To raise the LGST above rates that would be revenue neutral on 1987 production, or to return to the old net proceeds method of taxing would be devastating. Montana has a tremendously negative image among the industry as a poor place to do business. This was never more apparent to me than when I travelled from one end of this country to another looking for partners in our overthrust venture.

The Governor, the Director of the DOR and members of the Montana Oil and Gas Industry are planning a public relations effort to convince industry outside of Montana that Montana is a fine place to do business. Please pass Senator Gage's bill and give us the credibility that we must have in order to be successful in this effort.

EXHIBIT NO. 26
DATE 5/21/90
BILL NO. SB1

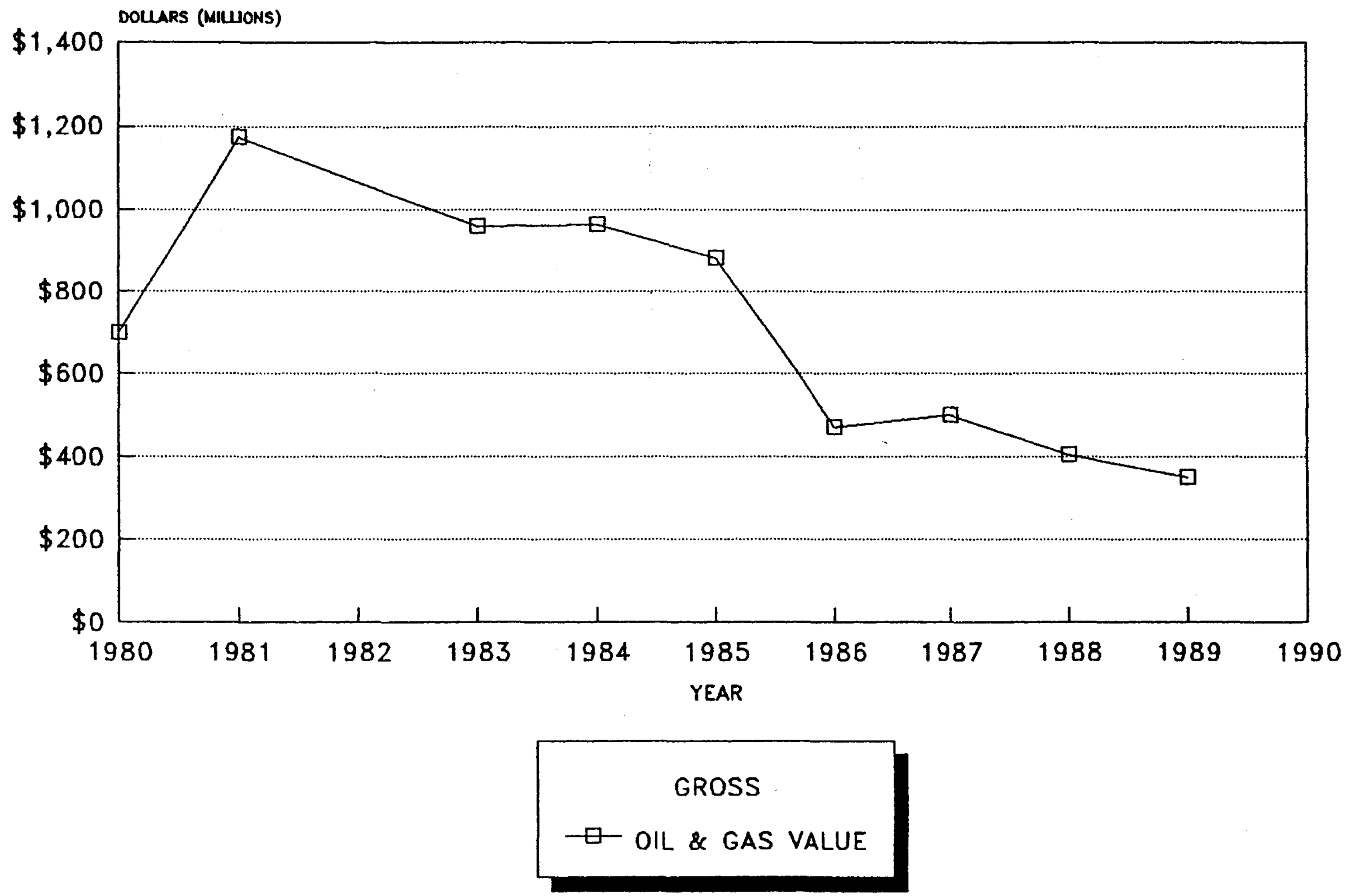
SEVERANCE AND NET PROCEEDS TAXES PAID BY INDUSTRY



(Source Montana Department of Revenue)

SENATE TAXATION
EXHIBIT NO. 26
DATE 5/21/90
BILL NO. SB1

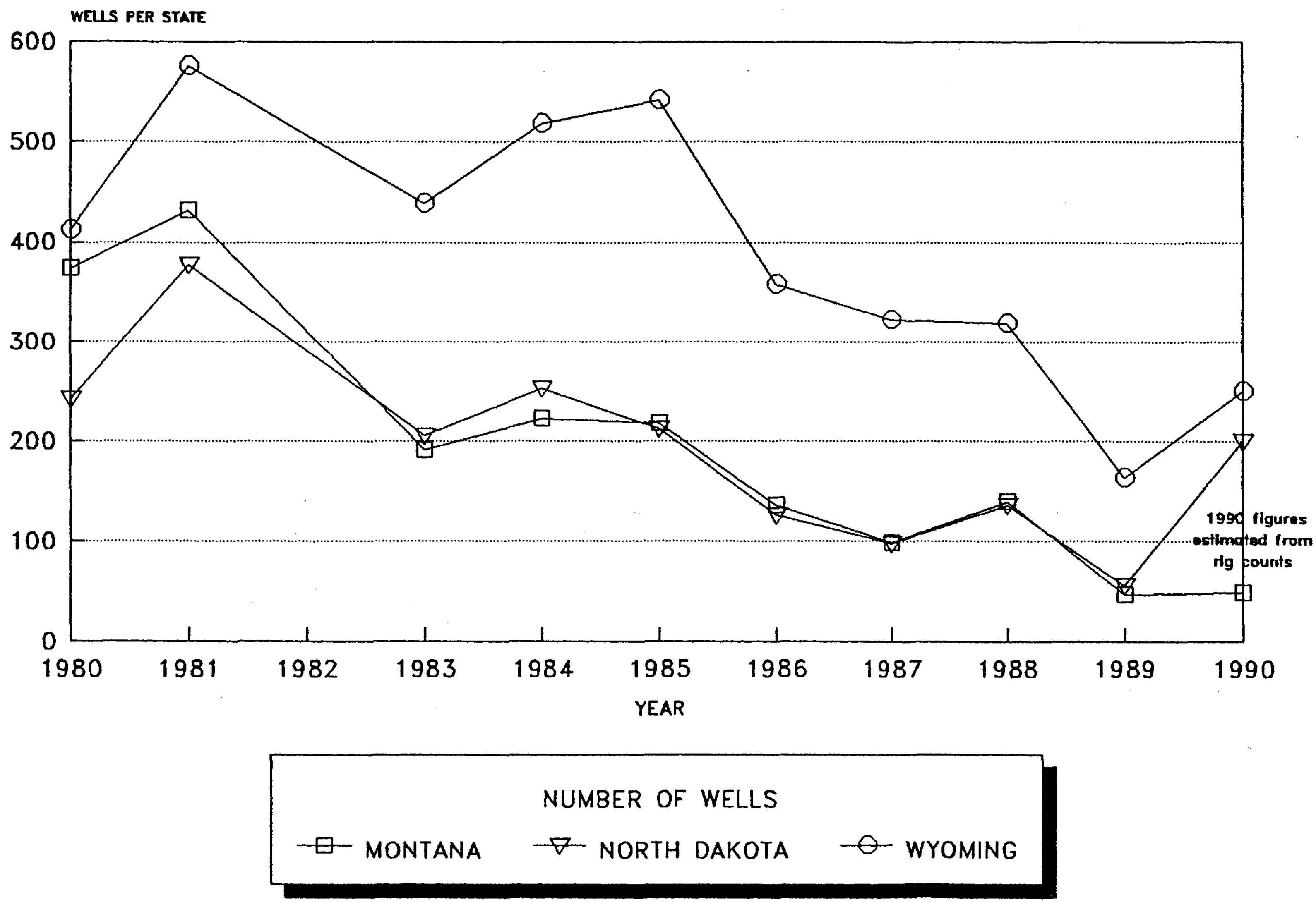
GROSS VALUE OF OIL & GAS PRODUCED IN MONTANA BY YEAR



(Source IPAA Annual Review)

SENATE TAXATION
EXHIBIT NO. 26
DATE 5/21/90
BILL NO. SB1

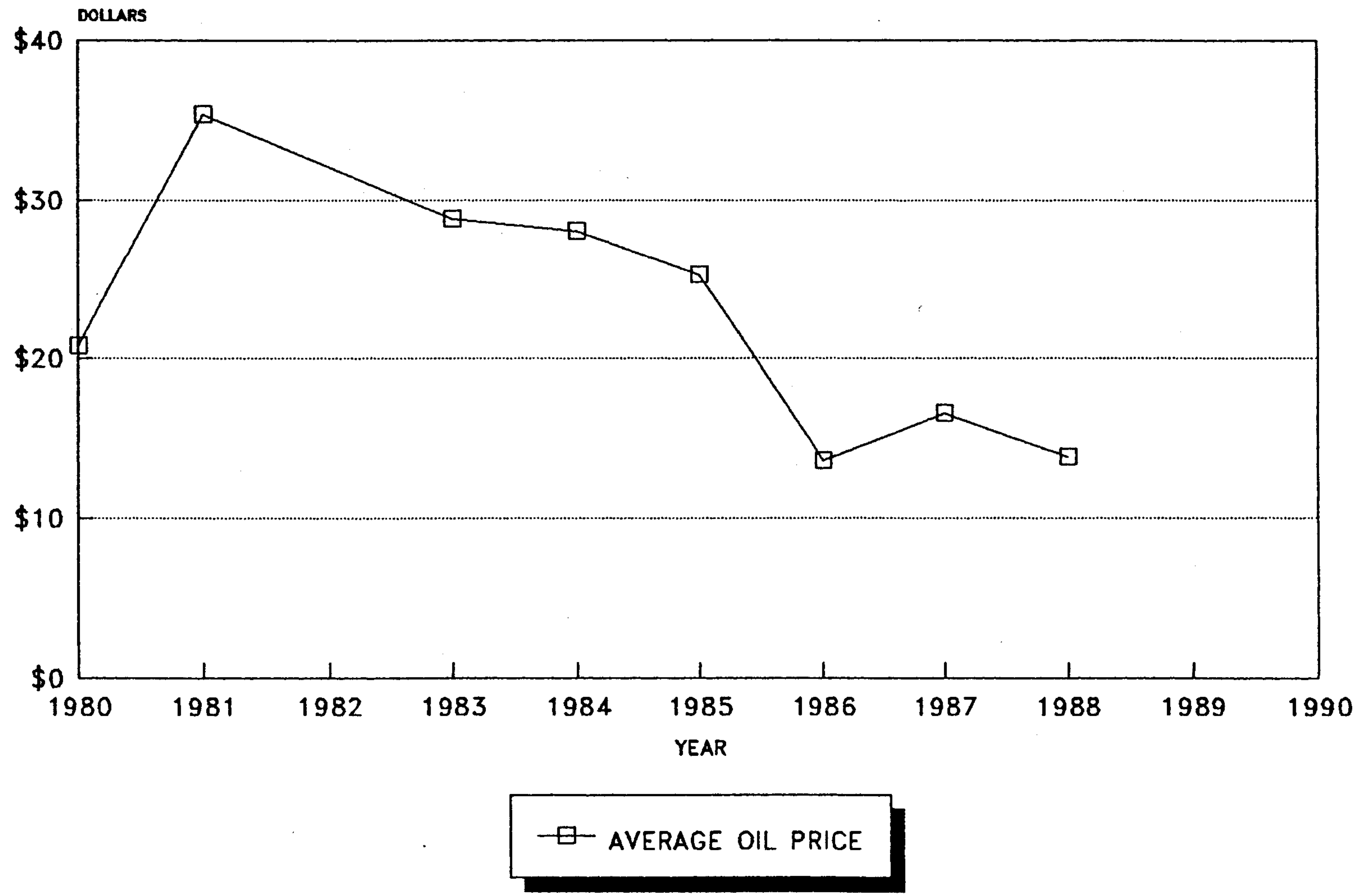
NUMBER OF EXPLORATORY WELLS DRILLED



(Source IPAA Annual Review)

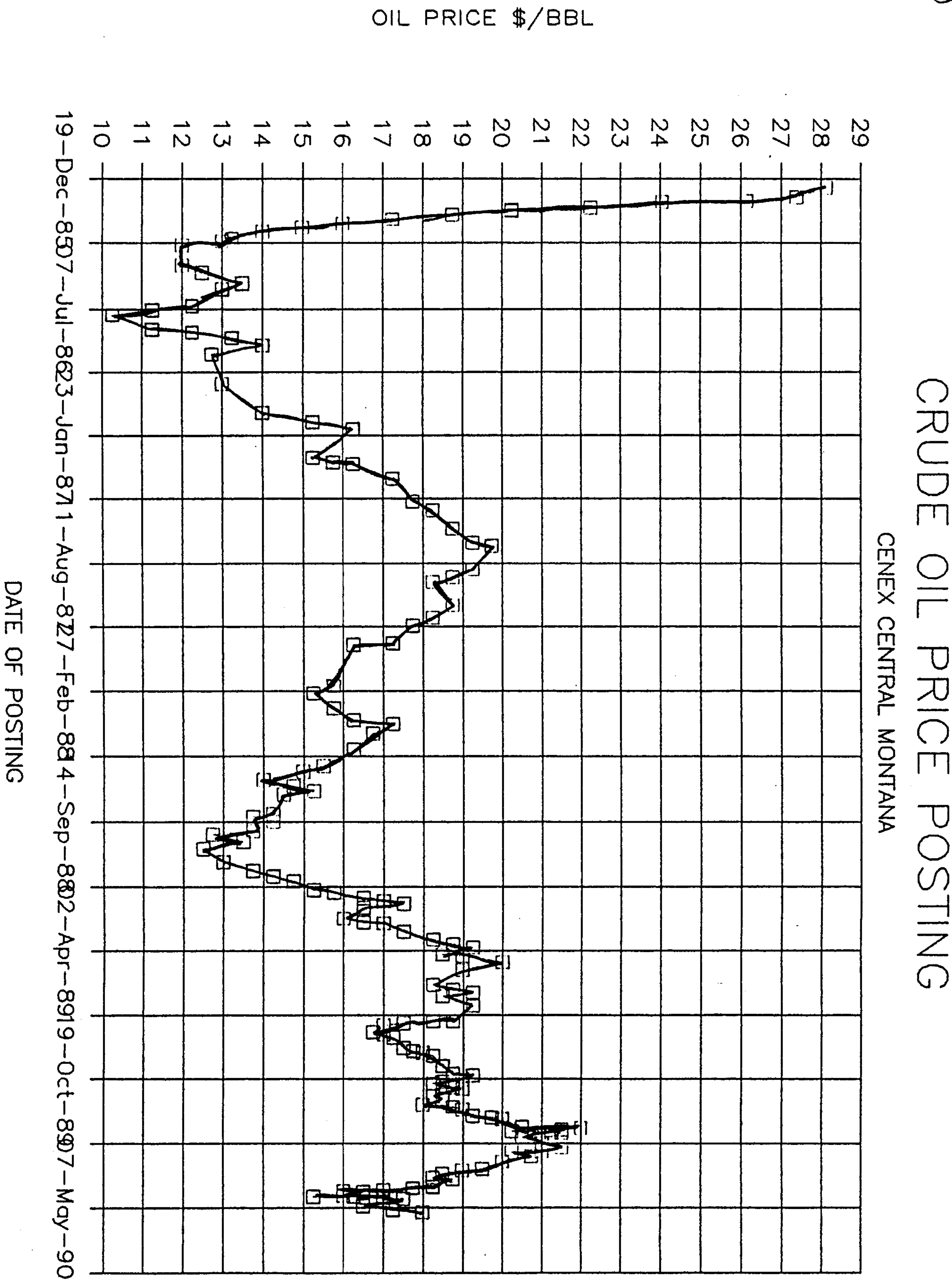
SENATE TAXATION
EXHIBIT NO. 26
DATE 5/21/93
BILL NO. SB1

AVERAGE OIL PRICE IN MONTANA BY YEAR



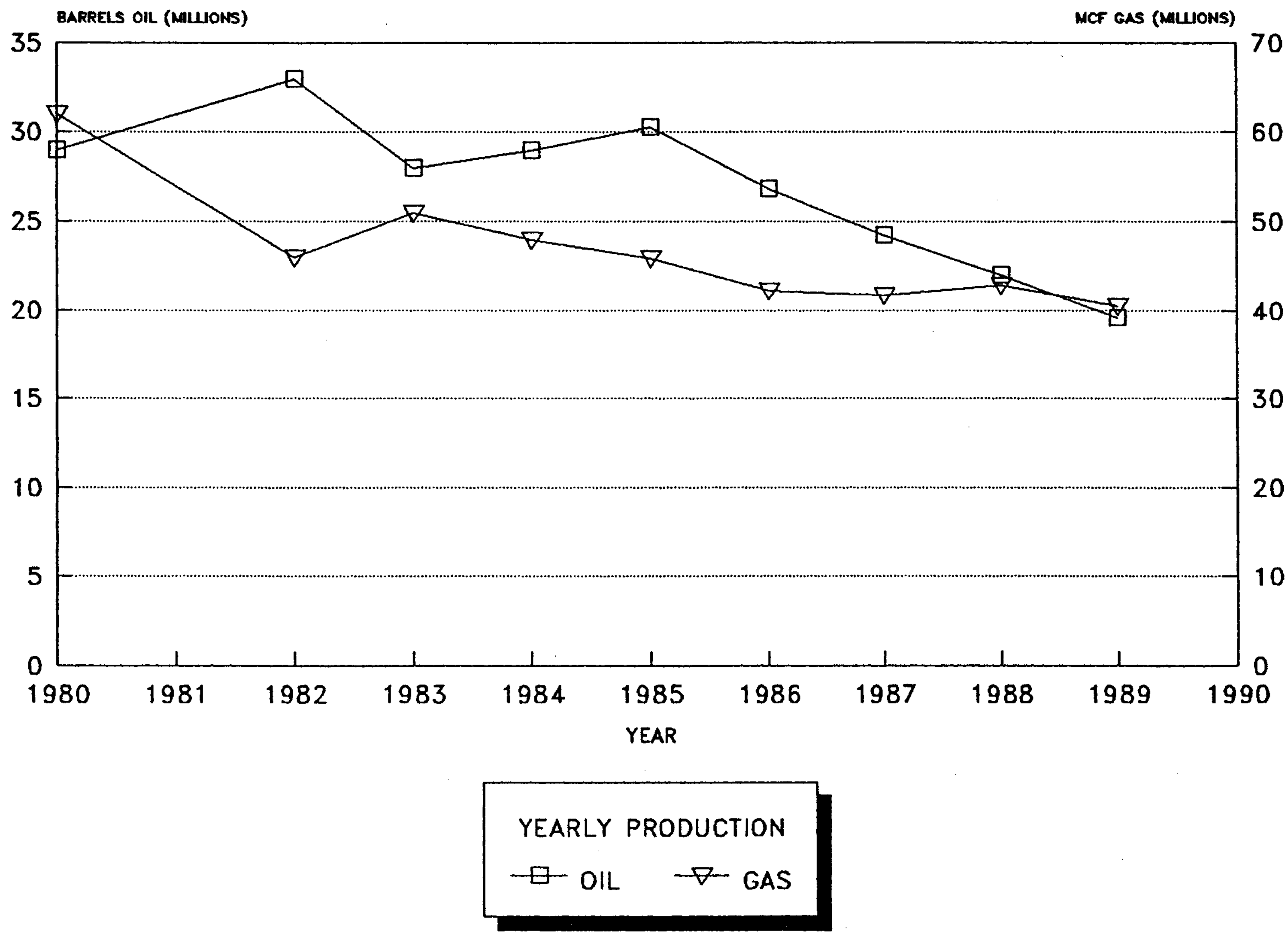
(Source IPAA Annual Review)

SENATE TAXATION
EXHIBIT NO. 26
DATE 5/31/90
BILL NO. SB1



SENATE TAXATION
EXHIBIT NO. 2b
DATE 5/21/90
BILL NO. SB1

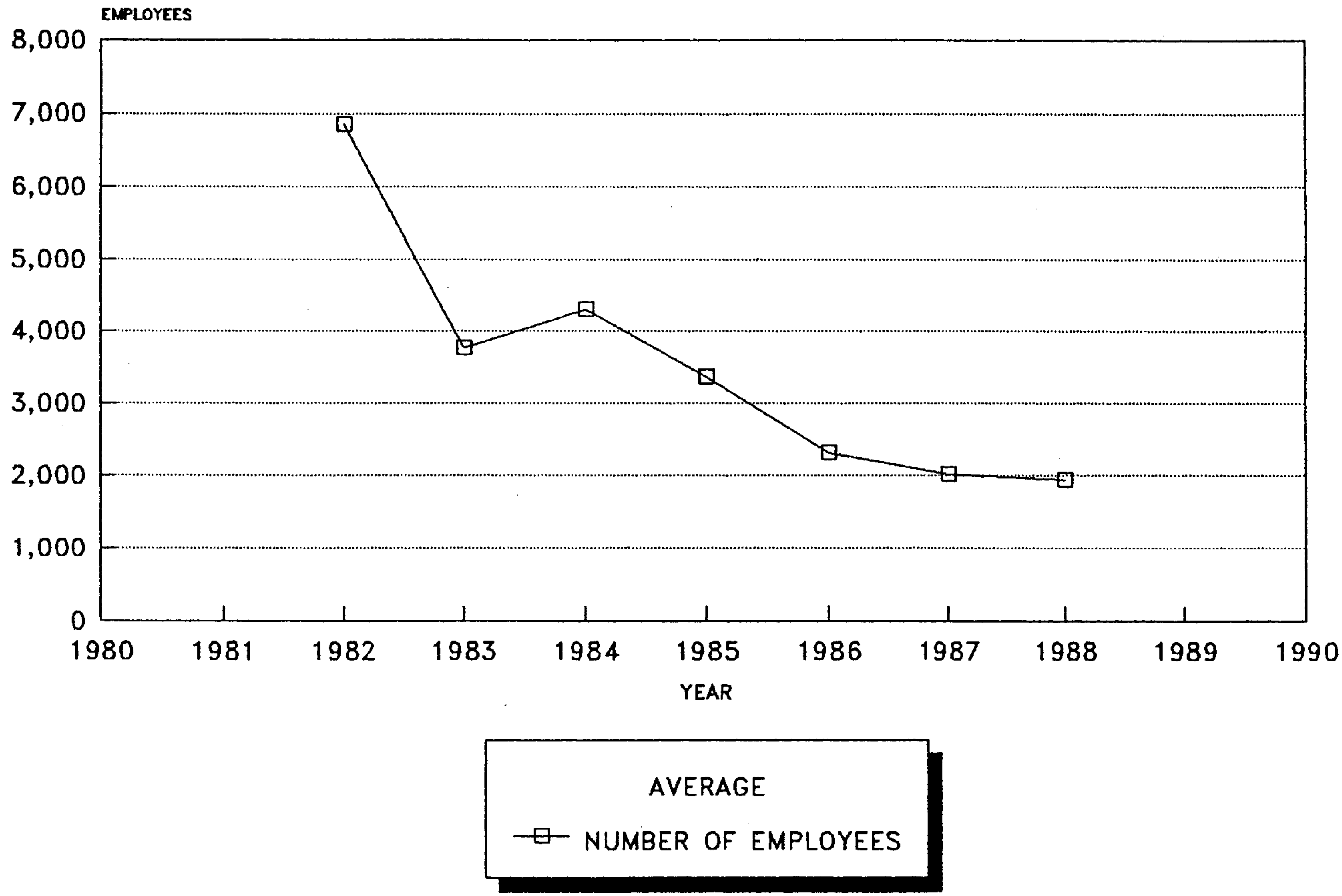
PRODUCTION BY YEAR



(Source IPAA Annual Review)

SENATE TAXATION
EXHIBIT NO. 2b
DATE 5/21/90
BILL NO. SB1

NUMBER OF EXPLORATION AND PRODUCTION EMPLOYEES IN MONTANA



(Source IPAA Annual Review)

SENATE TAXATION
EXHIBIT NO. 3
DATE 5/21/90
BILL NO. SB 1

"FLAT TAXES"

Local Government Severance Taxes
and Coal Gross Proceeds Tax

A Report Prepared for the

Legislative Finance Committee

by

Teresa Olcott Cohea,
Legislative Fiscal Analyst

April 7, 1990

SENATE TAXATION
EXHIBIT NO. 4
DATE 5/21/90
BILL NO. SB1

Local Government Severance Tax

Presentation to

Legislative Finance Committee

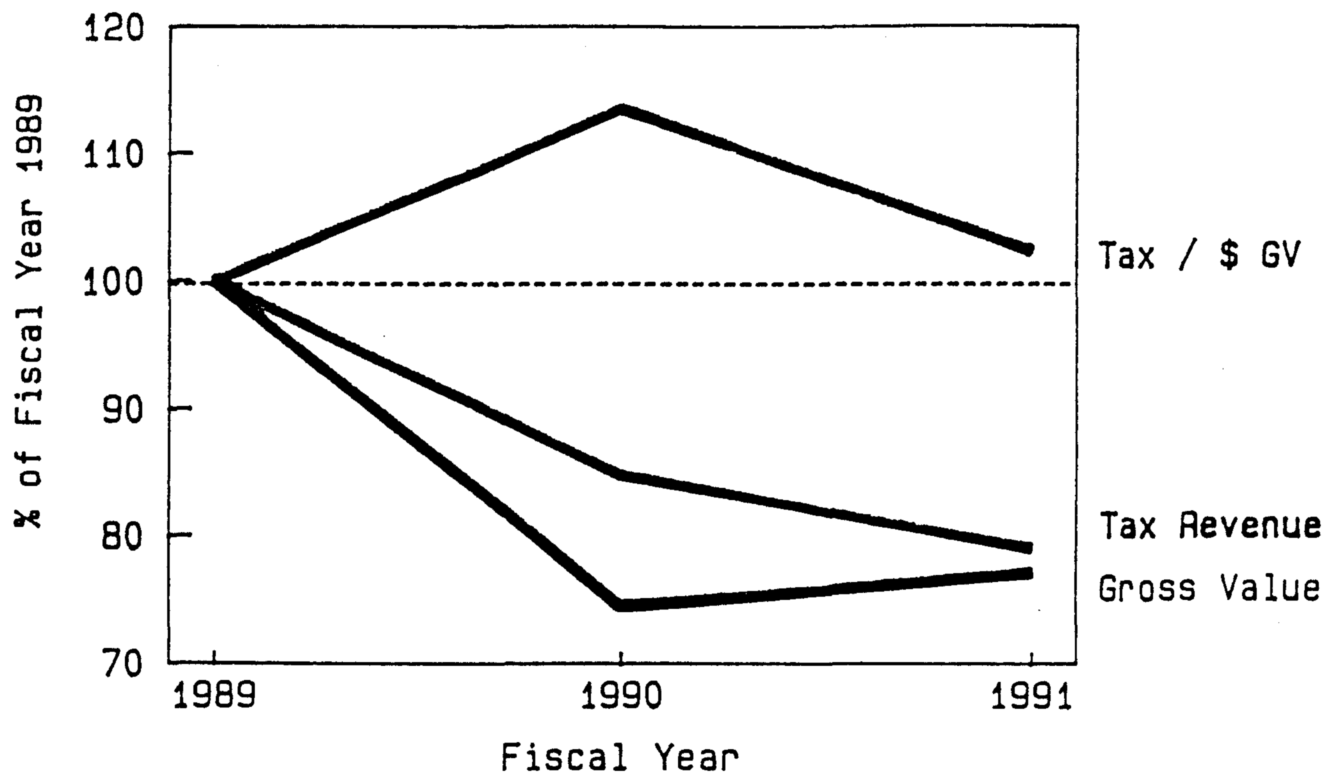
Senate Taxation Committee

May 21, 1990

Montana Department of Revenue

Oil

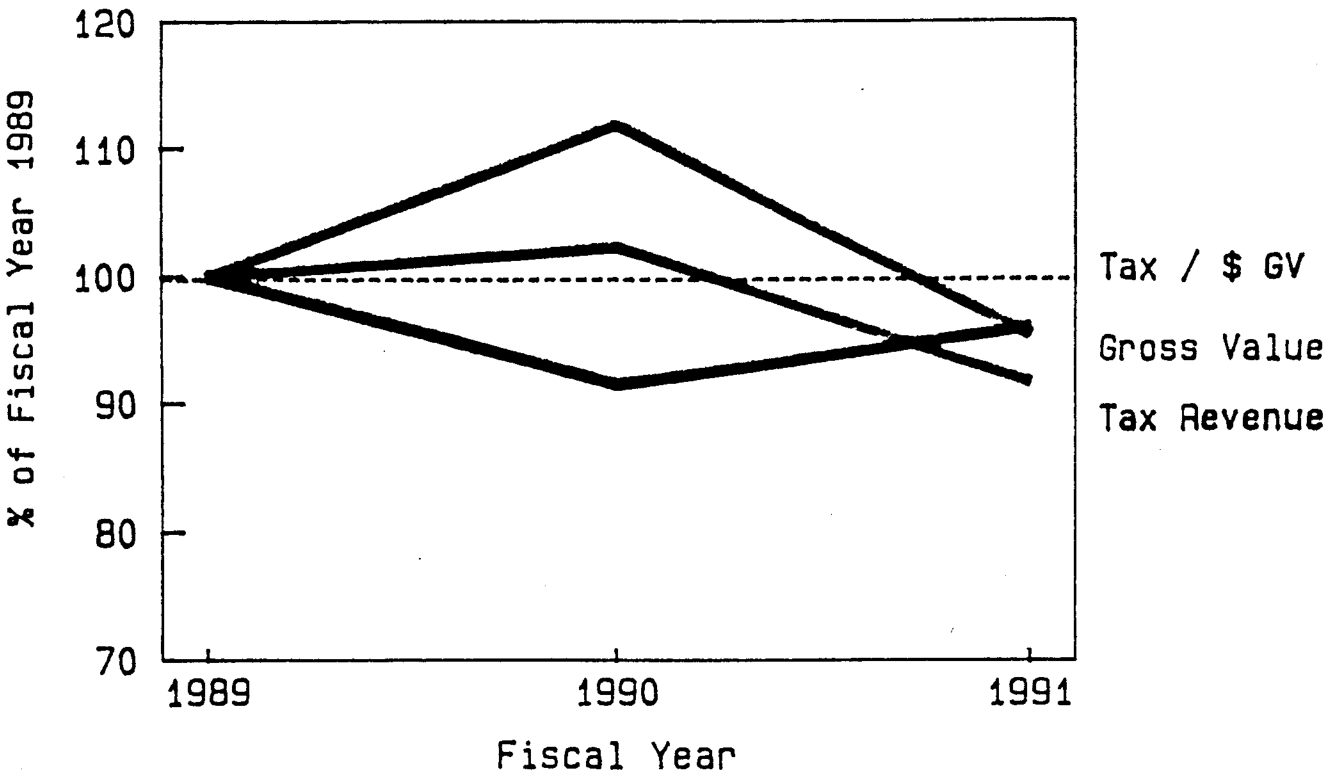
Comparison of Gross Value and Tax Revenue



			Pre-1985				
Tax Method	Prod. Year	Price	Production	G.V.	Tax Revenue	Tax % G.V.	Post-85 Tax %
Net Proceeds	87	$16.55	22,400,000	$370.8	$30.6	8.25	7.00
Net Proceeds	88	$13.89	19,900,000	$276.5	$25.9	9.38	7.00
LGST-Gage	89	$16.93	16,900,000	$286.2	$24.2	8.44	7.00

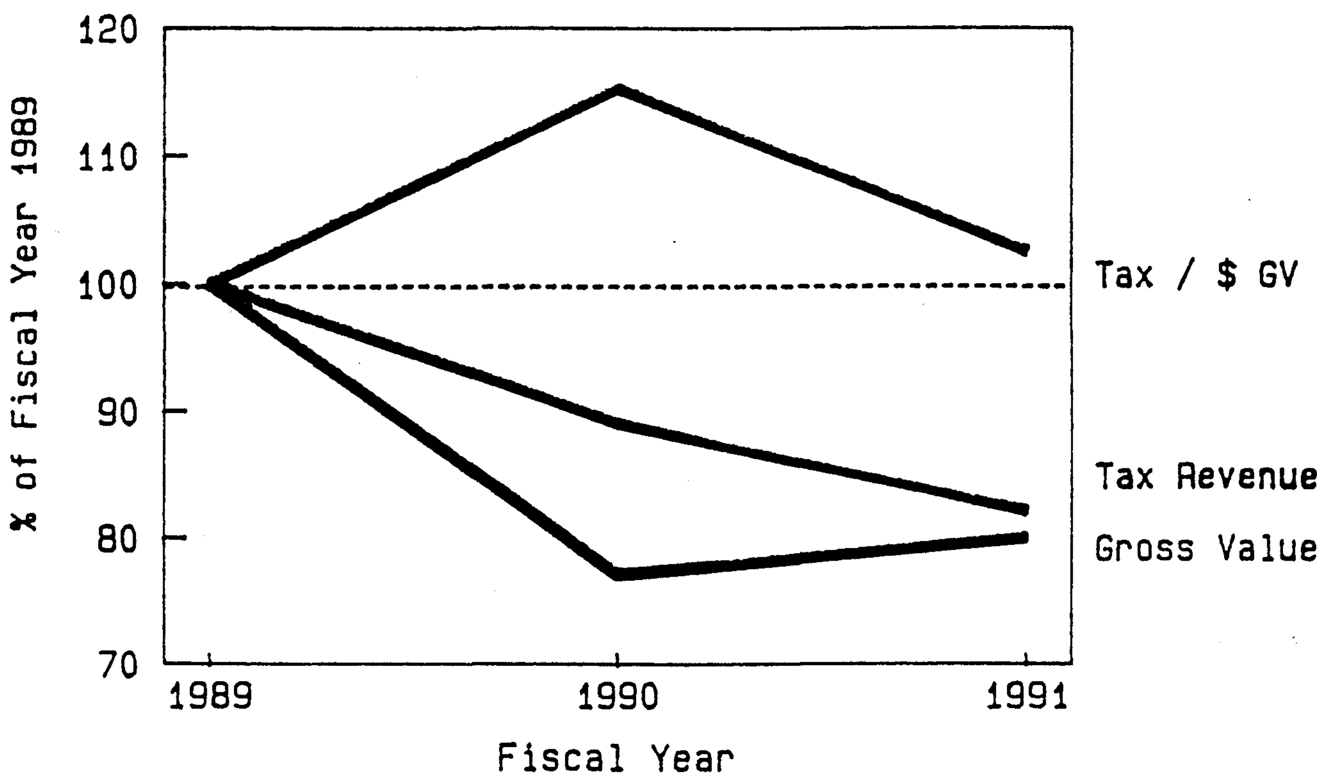
Gas

Comparison of Gross Value and Tax Revenue



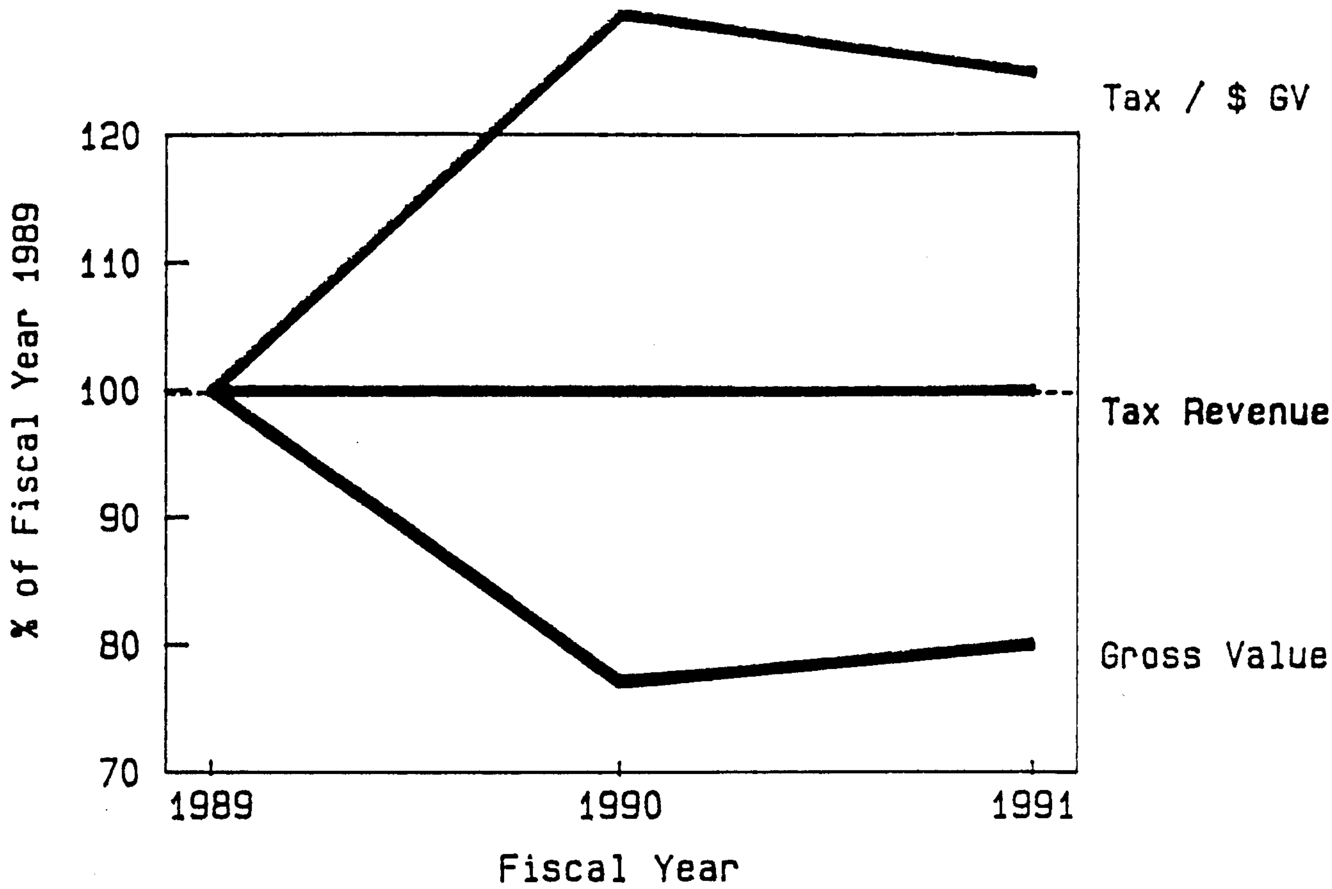
			Pre-1985				
Tax Method	Prod. Year	Price	Production	G.V.	Tax Revenue	Tax % G.V.	Post-85 Tax %
Net Proceeds	87	$1.72	38,700,000	$66.5	$9.8	14.73	12.00
Net Proceeds	88	$1.64	37,100,000	$60.8	$10.0	16.48	12.00
LGST-Gage	89	$1.96	32,600,000	$63.9	$9.0	14.06	12.00

Combined Oil and Gas
Comparison of Gross Value and Tax Revenue



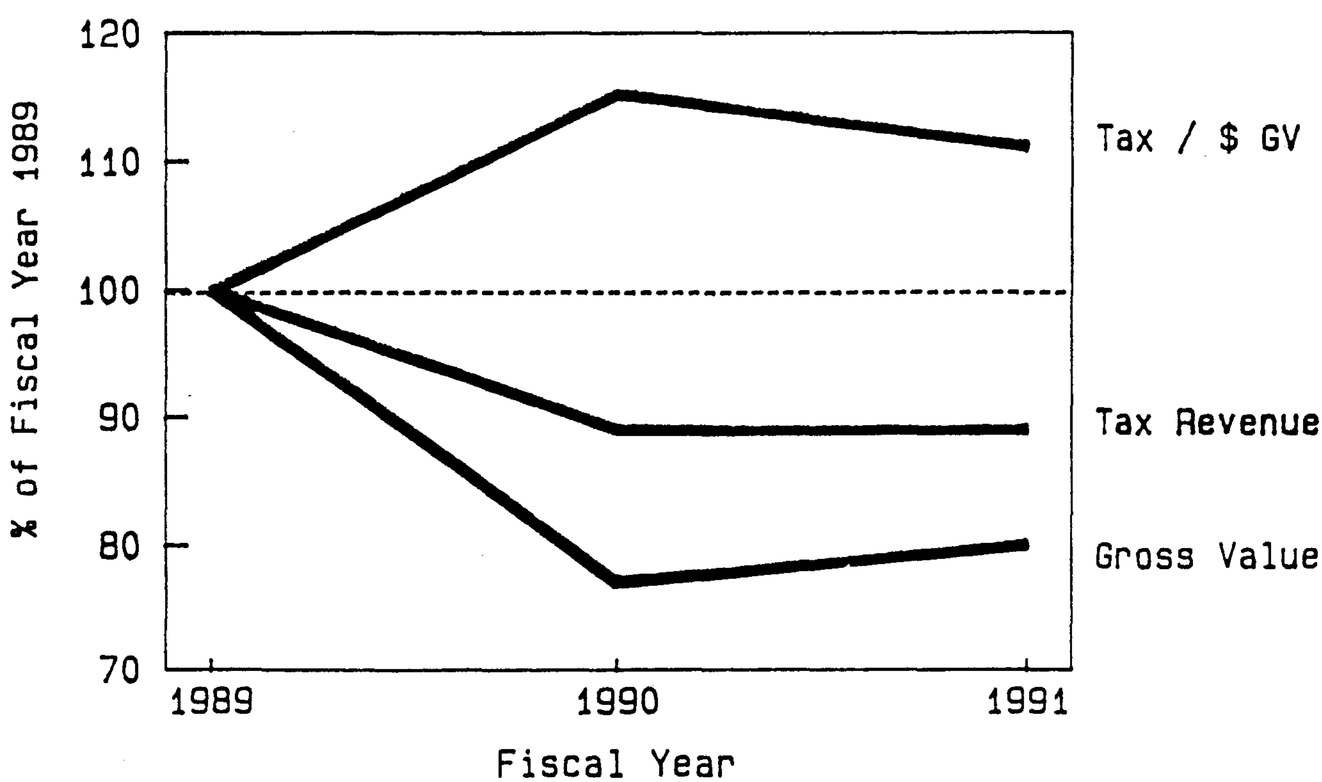
Tax Method	Prod. Year	G.V.	Tax Revenue	Tax % G.V.	Post-85 Tax %
	--- Pre-1985 ---				
Net Proceeds	87	$437.3	$40.4	9.24	7.75
Net Proceeds	88	$337.3	$36.0	10.66	7.78
LGST-Gage	89	$350.0	$33.1	9.47	7.78

Combined Oil and Gas
Comparison of Gross Value and Tax Revenue
(Fiscal Year 1989 Revenue Held Constant)



Tax Method	Prod. Year	G.V.	Tax Revenue	Tax % G.V.	Post-85 Tax %
		------------- Pre-1985 -------------			
Net Proceeds	87	$437.3	$40.4	9.24	7.75
Net Proceeds	88	$337.3	$40.4	11.97	7.78
LGST-Gage	89	$350.0	$40.4	11.54	7.78

Combined Oil and Gas
Comparison of Gross Value and Tax Revenue
(Fiscal Year 1990 Revenue Held Constant)



Tax Method	Prod. Year	G.V.	Tax Revenue	Tax % G.V.	Post-85 Tax %
		Pre-1985			
Net Proceeds	87	$437.3	$40.4	9.24	7.75
Net Proceeds	88	$337.3	$36.0	10.66	7.78
LGST-Gage	89	$350.0	$36.0	10.27	7.78

OIL AND GAS LGST AND NEW AND INTERIM TAX REVENUE
Production Related to Fiscal 1989 and 1991 Revenue

OIL

Production	Pre-1985	Post-1985	Total
Tax Due FY 89	22,400,616(1)	1,598,724	23,999,340
Tax Due FY 91	16,954,373	2,344,205	19,298,578
Difference	(5,446,243)	745,481	(4,700,762)
Revenue			
FY 89	$30,588,593	$1,608,008	$32,196,601
Gage - FY 91	24,165,759	2,634,453	26,800,212
Difference	$(6,422,834)	1,026,445	$(5,396,389)

GAS

Production	Pre-1985	Post-1985	Total
Tax Due FY 89	38,698,149	7,047,071	45,745,220
Tax Due FY 91	32,623,665	10,782,835	43,406,500
Difference	(6,074,484)	3,735,764	(2,338,720)
Revenue			
FY 89	$9,796,131	$1,193,493	$10,989,624
FY 91	8,978,466	1,829,546	10,808,012
Difference	$(817,665)	$ 636,053	$(181,612)

COMBINED OIL AND GAS REVENUE

	Pre-1985	Post-1985	Total
FY 89	$40,384,724	$2,801,501	$43,186,225
FY 91	33,144,225	4,463,999	37,608,224
Difference	$(7,240,499)	$1,662,498	$(5,578,001)

(1) Excludes exempt production estimated at 800,000 Bbls.

EXHIBIT NO. 36
DATE 5/21/90
BILL NO. SB1

Proposed Amendments to Senate Bill 1
Office of Public Instruction
May 21, 1990

PURPOSE: To eliminate, for fiscal 1991 only, the requirement that new and interim production taxes be used in the calculation of county, state and district mill values.

Amend Senate Bill 1 as follows:

1. Page 14, line 25.
   Following: "15-23-607(4)"
   Strike: "and"
   Insert: "for production after March 31, 1990 plus"

2. Page 15, line 24.
   Following: "15-23-607(4)"
   Strike: "and"
   Insert: "for production after March 31, 1990 plus"

3. Page 17, line 3.
   Following: "15-23-607(4)"
   Strike: "and"
   Insert: "for production after March 31, 1990 plus"

EXHIBIT NO. 46
DATE 5/21/90
BILL NO. SB1

COMPARISON OF NET PROCEEDS TAXES TO SENATE BILL 1 - MPA RATES
1987 PRODUCTION
May 21, 1990

TAX REVENUE		
Fiscal 1989 Oil and Gas Net Proceeds Tax		$40,384,725
Fiscal 1989 Local Government Severance Tax - SB1		40,462,425
Total Revenue Difference		$ 77,700
TAXPAYER		
Royalty Owners -	Stripper Gas Rate	($ 32,329)
	Stripper Oil Rate	(255,132)
	Regular Gas Rate	(199,172)
	Regular Oil Rate	($ 711,550)
	Total Royalty Owners	($1,198,183)
Operators -	Stripper Gas Rate	($ 757,598)
	Stripper Oil Rate	(975,406)
	Regular Gas Rate	(256,736)
	Regular Oil Rate	3,265,624
	Total Operators	$ 1,275,884
Total Taxpayer Difference		$ 77,701

EXHIBIT NO. 46
DATE 5/21/90
BILL NO. SB1

1989 PRODUCTION-ESTIMATED LGST COUNTY IMPACT
NO 30 MCF EXEMPTION

MAY 21, 1990

	OIL RATE	GAS RATES
	********	***********
REGULAR NON-ROYALTY	8.40%	15.25%
STRIPPER NON-ROYALTY	4.20%	7.625%
REGULAR ROYALTY	12.50%	15.25%
STRIPPER ROYALTY	12.50%	15.25%

COUNTY	1989 BARRELLS	PROPOSED LGST OIL DISTRIBUTION	GAS MCF	PROPOSED LGST GAS DISTRIBUTION	PROPOSED LGST TOTAL DISTRIBUTION	TOTAL FINAL DISTRIBUTION	PROPOSED LGST MINUS CURRENT LAW
***********	***********	***********	***********	***********	***********	***********	***********
BIG HORN	60,732	$28,225	0	$0	$28,225	$29,568	($1,343)
BLAINE	159,324	$145,646	6,985,406	$1,797,573	$1,943,218	$1,880,158	$63,060
CARBON	581,151	$1,069,120	903,376	$228,311	$1,297,431	$1,200,669	$96,762
CARTER	5,946	$0	0	$0	$0	$0	$0
CHOUTEAU	0	$0	963,658	$193,517	$193,517	$158,278	$35,239
CUSTER	0	$0	68,765	$44,303	$44,303	$26,384	$17,919
DANIELS	2,756	$0	0	$0	$0	$0	$0
DAWSON	242,300	$508,869	17,944	$518	$509,387	$465,660	$43,727
FALLON	4,489,599	$6,536,231	1,010,626	$225,984	$6,762,215	$6,100,626	$661,589
FERGUS	0	$0	39,730	$9,284	$9,284	$10,644	($1,360)
GARFIELD	40,650	$56,794	0	$0	$56,794	$53,019	$3,775
GLACIER	947,925	$1,603,027	2,878,041	$727,418	$2,330,444	$1,908,307	$422,137
GOLDEN VALLEY	3,704	$544	47,500	$9,142	$9,686	$9,359	$327
HILL	1,241	$991	4,234,994	$1,553,523	$1,554,513	$1,582,344	($27,830)
LIBERTY	183,249	$344,159	1,755,061	$304,903	$649,062	$467,218	$181,843
MCCONE	44,011	$98,880	0	$0	$98,880	$90,214	$8,666
MUSSELSHELL	600,253	$946,573	0	$0	$946,573	$877,669	$68,904
PETROLEUM	61,593	$101,290	0	$0	$101,290	$93,706	$7,584
PHILLIPS	0	$0	5,371,046	$1,481,644	$1,481,644	$410,600	$1,071,043
PONDERA	251,557	$477,622	361,064	$53,052	$530,674	$448,451	$82,223
POWDER RIVER	661,445	$1,114,815	0	$0	$1,114,815	$1,030,012	$84,804
PRAIRIE	53,540	$48,598	190	$48	$48,646	$46,857	$1,788
RICHLAND	2,694,375	$3,417,162	1,151,357	$88,790	$3,505,952	$3,254,948	$251,004
ROOSEVELT	1,419,430	$2,354,220	383,856	$19,273	$2,373,493	$2,184,629	$188,864
ROSEBUD	533,156	$311,658	0	$0	$311,658	$315,391	($3,733)
SHERIDAN	1,984,285	$2,829,943	669,273	$46,938	$2,876,881	$2,662,781	$214,100
STILLWATER	0	$0	295,575	$90,875	$90,875	$45,827	$45,048
TETON	111,675	$130,494	55,408	$1,072	$131,566	$123,325	$8,241
TOOLE	584,052	$649,833	5,022,346	$799,251	$1,449,084	$1,010,020	$439,064
VALLEY	294,874	$129,090	366,388	$132,391	$261,481	$141,273	$120,20[illegible]
WIBAUX	899,469	$1,024,786	42,061	$7,880	$1,032,666	$969,989	$62,67[illegible]
YELLOWSTONE	42,081	$70,106	0	$0	$70,106	$64,564	$5,542
	***********	***********	***********	***********	***********	***********	***********
	16,954,373	$23,998,677	32,623,665	$7,815,687	$31,814,364	$27,662,491	$4,151,87[illegible]

EXHIBIT NO. 56
DATE 5/21/90
BILL NO. SB 1

MAY 21, 1990

NATURAL RESOURCES & CORPORATION TAX DIVISION
* * * * * * * ** * * * * * * *
COMPARISON OF TAX LIABILITY BY COUNTY
FOR PRE-1985 PRODUCTION
* * * * * * * ** * * * * * * *

COUNTY	1987 PROD FY89 NET P. TAXES	1988 PROD FY90 NET P. TAXES	PROPOSED LGST TOTAL DISTRIBUTION
	***********	***********	***********
BIG HORN	61,082	32,072	$28,225
BLAINE	2,783,618	2,602,948	$1,943,218
CARBON	1,691,785	1,581,564	$1,297,431
CARTER	18,148	9,702	$0
CHOUTEAU	229,811	220,140	$193,517
CUSTER	21,356	79,534	$44,303
DANIELS	3,278	0	$0
DAWSON	877,399	848,536	$509,387
FALLON	5,849,371	6,712,422	$6,762,215
FERGUS	78,452	22,910	$9,284
GARFIELD	208,871	97,167	$56,794
GLACIER	3,366,557	2,680,728	$2,330,444
GOLDEN VALLEY	5,668	13,679	$9,686
HILL	1,841,595	2,020,744	$1,554,513
LIBERTY	785,547	677,954	$649,062
MCCONE	135,285	122,448	$98,880
MUSSELSHELL	1,054,196	973,775	$946,573
PETROLEUM	248,195	137,848	$101,290
PHILLIPS	1,703,499	1,772,308	$1,481,644
PONDERA	850,752	540,569	$530,674
POWDER RIVER	1,368,344	1,305,405	$1,114,815
PRAIRIE	119,887	49,271	$48,646
RICHLAND	5,268,040	4,150,789	$3,505,952
ROOSEVELT	3,235,742	2,532,629	$2,373,493
ROSEBUD	434,694	356,643	$311,658
SHERIDAN	3,605,844	3,070,923	$2,876,881
STILLWATER	178,147	123,021	$90,875
TETON	235,023	139,298	$131,566
TOOLE	1,874,669	1,623,526	$1,449,084
VALLEY	434,513	293,247	$261,481
WIBAUX	1,538,165	1,078,502	$1,032,666
YELLOWSTONE	277,183	80,793	$70,106
	***********	***********	***********
	40,384,718	35,951,094	$31,814,364

SENATE TAXATION
EXHIBIT NO 66
DATE 5/21/90
BILL NO. SB1

ROLL CALL VOTE

SENATE COMMITTEE TAXATION

Date 5/21/90 SB Bill No. 1 Time 5:05 pm

NAME	YES	NO
SENATOR BROWN	X	
SENATOR BISHOP	X	
SENATOR CRIPPEN	X	
SENATOR ECK		X
SENATOR GAGE	X	
SENATOR HAGER	X	
SENATOR HALLIGAN		X
SENATOR HARP	X	
SENATOR MAZUREK		X
SENATOR NORMAN		
SENATOR SEVERSON	X	
SENATOR WALKER		X

Jill Rohyans
Secretary

SENATOR BOB BROWN
Chairman

Motion: by Senator Gage to delete Section 1, page 13, line 23 changed to 7.625%, line 25 changed to 7.625%, page 18 - Section 7 to reflect Section 1 no longer in the bill

1989

SENATE TAXATION
EXHIBIT NO. 76
DATE 5/21/90
BILL NO. SB1

ROLL CALL VOTE

SENATE COMMITTEE TAXATION

Date 5/21/90 Senate Bill No. 1 Time

NAME	YES	NO
SENATOR BROWN	X	
SENATOR BISHOP	X	
SENATOR CRIPPEN	X	
SENATOR ECK		X
SENATOR GAGE	X	
SENATOR HAGER	X	
SENATOR HALLIGAN		X
SENATOR HARP	X	
SENATOR MAZUREK		X
SENATOR NORMAN		
SENATOR SEVERSON	X	
SENATOR WALKER		X

Jill Rohyans
Secretary

SENATOR BOB BROWN
Chairman

Motion: by Senator Gage SB1 Do Pass
As Amended

DATE May 21, 1990

COMMITTEE ON Taxation

VISITORS' REGISTER

NAME	REPRESENTING	BILL #	Check One: Support	Check One: Oppose
Judy Rippingale	Dept of Revenue			
Dave Woodgerd	" " "			
Denis Adams	" " "			
Tom Keating	Senate Dist 44			
TOM BILODEAU	MEA			
Janelle Fallan	MPA	SB 1	✓	
Bill Ballard	Balcron Oil Co.	SB 1	✓	
Terry Minow	MT Fed Teachers			
Carl Knudsen	SACO PUBLIC SCHOOL			
Doug Abelin	MONTANA OIL & GAS ASSC.	SB 1	✓	
William Duffield	MO Counties Assc. Fallon co	SB-1	✓	
Bruce W. Moerer	MSBA	SB-1	so long as revenue neutral	
Pat Melby	Underfunded Schools -	SB-1 Revenue	neutral	
Mark O'Keefe	HD 45	SB 1		✓
TOM BILODEAU	MEA			
Gordon Morris	MACo.	SB 1	✓	
Gloria Paladichuk	Richland Co-Commissioner	SB 1	✓	
William H Tulloch	Meridian Oil Inc.	SB 1	✓	

(Please leave prepared statement with Secretary)

SENATE STANDING COMMITTEE REPORT

May 21, 1990

MR. PRESIDENT:

We, your committee on Taxation, having had under consideration Senate Bill 1 (first reading copy -- white), respectfully report that Senate Bill 1 be amended and as so amended do pass:

1. Title, lines 4 through 8.
Following: "ACT"
Strike: remainder of line 4 through "PRODUCTION;" on line 8

2. Title, lines 14 and 15.
Following: "WELLS"
Strike: remainder of line 14 through "WELLS" on line 15

3. Title, line 19.
Strike: "15-36-101,"

4. Page 1, line 24 through page 9, line 7.
Strike: section 1 in its entirety
Renumber: subsequent sections

5. Page 13, line 23.
Strike: "8.72%"
Insert: "7.625%"

6. Page 13, line 25.
Strike: "8.72%"
Insert: "7.625%"

7. Page 14, line 25.
Strike: "and"
Insert: "for production occurring after March 31, 1990, plus"

8. Page 15, line 24.
Strike: "and"
Insert: "for production occurring after March 31, 1990, plus"

9. Page 17, line 3.
Strike: "and"
Insert: "for production occurring after March 31, 1990, plus"

10. Page 18, line 8.
Strike: "Sections 1 and 3"
Insert: "Section 2"
Strike: "apply"

Insert: "applies"

11. Page 13, lines 9 and 10.
Strike: "oil" on line 9 through "and" on line 10

AS AMENDED DO PASS

Signed: Bob Brown
Bob Brown, Chairman

H.C. 5/12/90 1:25 [illegible]

sb01522.1h