MINUTES OF THE MEETING
TAXATION COMMITTEE
MONTANA STATE SENATE

March 16, 1985

The fifty-first meeting of the Senate Taxation Committee was called to order at 7:37 am, Saturday, in Room 413-415 of the Capitol Building by Chairman Thomas E. Towe.

ROLL CALL: Senators Mazurek and Goodover were excused. All other members of the committee were present.

CONSIDERATION OF SB 431: Exhibit 1 contains the amendments that were discussed by Mr. Lear, committee staff. The committee discussed the wisdom of grandfathering in currently platted subdivisions and decided that in certain situations, such as the apple orchards in the Bitterroot, it was necessary.

Mr. Gregg Groepper of the Department of Revenue was recognized and told the committee that an educated guess, based on the amendments was that $30 to 42 million taxable valuation would be added by the bill. He said the bill would give the Department a good definition of agriculture and as the exemptions were given that definition had to be tight. He said the reduced tax treatment would be not taking in ground outside city limits that currently gets the agricultural mill levy.

MOTION: Senator Eck moved that SB 431 be amended per Exhibit 1.

Senator Halligan suggested that January 1, 1986 be the effective date to allow some time for those projects in progress to be completed under current law.

MOTION: Senator Halligan moved that January 1, 1986 be the effective date of the bill. With only Senator Lybeck voting no, the motion carried.

Question was called on Senator Eck's motion. Senators Lybeck and McCallum voted no; other committee members present voted yes; Senator Mazurek asked to be recorded as yes on these amendments; Senator Goodover was excused. The motion carried.

MOTION: Senator Eck moved that SB 431 carry the Statement of Intent found in Exhibit 2. The motion carried unanimously.

MOTION: Senator Eck moved that SB 431 do pass as amended. Senators Brown and McCallum voted no; Senator Mazurek had asked to be recorded as yes; other present members voted yes; the motion carried.

CONSIDERATION OF SB 443: Senator Pat Regan, Senate District 47 of Billings, was recognized as chief sponsor of the bill. She said the bill would delay for two years a drop in the oil and gas severance tax from 6 to 5 percent. She said Montana cannot afford at this time to be dropping revenue. She said that exploration and development will not be affected because they are a function of market and geology and not of tax policy. She demonstrated this with information from Exhibit 3. She noted that Montana compares favorably with other states in its taxation of oil and gas. She quoted Ralph E. Bailey, Chairman and Chief Executive of Conoco as saying "Montana is a good place to do business." She discussed how these taxes are computed in North Dakota and Wyoming and concluded that Montana's tax structure is too generous for these times.

She provided the committee with a copy of Exhibit 4 which was a part of her discussion showing that exploration is a function of the world price of oil.

PROPONENTS

Mr. Don Judge, representing the AFL-CIO, said that they would oppose any potential break in oil and gas severance taxes. He discussed the short fall in revenue. He said the fiscal note is the best argument for the bill and suggested the break be delayed permanently and not just until 1987.

OPPONENTS

Mr. Darwin Vandergraff of the Montana Petroleum Association said that the effective rate in Montana is higher even than the industry had thought it was. He said in 1983 the Legislature thought it appropriate to lower the rate. He said they had agreed to live with it higher for one more biennium. He said that consistency and long-term commitment are necessary for natural resource and taxation policy. He said the balance in other states is shifted by the fact that they pay no property or income taxes there. He said the issue is whether the oil industry is paying a fair share and that they should be dealt with fairly per the agreements of last session.

Mr. Tucker Hill, Director of Project 85, an organization of 80 oil and gas operators, said they were promised two years ago that if they would wait they would receive the lower rate.

Mr. Pat Melby, representing the Montana Oil and Gas Producers, said it concerns him that oil companies are seen as out-of-state and large. Many, he said, are small Montana companies, some with wells that are averaging as little as 2 barrels a day. He said this kind of legislation will lead to more wells being plugged and abandon.

Mr. Welden Summers, the tax manager for Shell Oil said that they are considering major investments here and that consideration competes with investments that have a more attractive tax package elsewhere.

Ms. Janelle Fallan, Montana Chamber of Commerce, said Montana made a commitment and should keep it. She said they oppose the bill.

Mr. Mike Micone, Western Environmental Trade Association, said they support consistent tax policies as necessary and oppose the bill.

Mr. John Shontz, Richland County, said they have lost 2000 jobs in the oil industry. He said that Dawson County has lost $10 million in retail sales because of declining production. He said $36 million has come from the tax base in Richland County. He said that in 1983 they paid $2.4 million into the school foundation program; in 1984 they paid $1,263,000; and in 1985 would pay about $590,000. In contrast he said North Dakota set an all time produciton record in 1983 with the same geological considerations. He said they want to compete to stabalize production. He said they supported SB 390 because it would broaden the tax base and provide more jobs and they oppose this bill for the same reasons.

Mr. Dave Goss, Billings Area Chamber of Commerce, said that Billings houses companies related to and servicing the oil industry. He said they are impacted by industry decline. He said that anything that affects the oil industry adversely has a host of secondary effects as well.

Senator Larry Tviet said that he has worked closely with the oil companies and that oil and gas revenues are down. He talked about North Dakota's tax structure as more favorable. He said that oil companies talk more about pulling out of Montana and going to a healthier tax rate and a more stable business climate. He appealed for consistency in the tax structure. He said some big investors will not drill here at all and Montana will continue its production decline.

Senator Tviet said Montana has the highest property tax, corporation income tax and severance tax around. He quoted an investor as saying "I will not spend another dime in Montana." He said that oil exploration helps the agricultural economy as well, that the leases keep farmers on the farms in hard years. He urged the committee to look beyond the 90th day and to the long term economic health of the state.

Mr. Harold Ude, Cenex, said they oppose SB 443 as a tax increase on the industry that will reduce available exploration dollars.

Mr. Gordon Morris, Montana Association of Counties, said that a resolution like this introduced at their meeting was defeated by a two to one margin.

Questions from the committee were called for.

Senator Towe said that the oil and gas industry said that SB 390 was very important to them and that it actually increased the effective rate of taxation. He said this would give them even more tax breaks.

Mr. Hill responded that SB 390 dealt only with new production. Mr. Vandergaff said that SB 390 provided stability and that SB 443 was destabalizing. He agreed that taxation, however, is not the only consideration in response to questioning by Senator Towe. He said new planning is a comparative and competitive choice based on several factors.

The committee discussed with the industry whether a measuring stick could be used to see if tax policy actually was an incentive to production.

Senator Regan's position was that "This bill will not materially affect production in the state one single bit."

In response to the effect of this bill on local government funding, Senator Tviet said that a severance tax of only 4 percent would replace the money that had been promised to local government. He said we cannot wait for the world market to help Montana production. He said that Montana needs a sustained yield right now.

Mr. Shontz cited an example where the Blackfeet assessed a severance tax on reservation wells and 67 wells were abandoned.

Chairman Towe said the committee had already passed two bills that reduced tax on the industry

Senator Regan closed saying that the price of oil and geology are the important production considerations. She said the Governor would sign the bill if it passed. She said the property taxpayer must be able to afford to live here. She said if the bill doesn't pass then every person back home would pay higher taxes.

Chairman Towe adjourned the meeting at 9 am, saying that the committee would meet again at 7:30 am, Monday.

Thomas E. Towe

Chairman

ROLL CALL

SENATE TAXATION COMMITTEE

49th Legislative Session -- 1985

Date March 16, 1985 7:31 am

Location -- Room 413-415

Name	Present	Absent	Excused
Senator Brown	✓		
Senator Eck	✓		
Senator Goodover			✓
Senator Hager	✓		
Senator Halligan	✓		
Senator Hirsch	✓		
Senator Lybeck	✓		
Senator Mazurek			✓
Senator McCallum	✓		
Senator Neuman	✓		
Senator Severson	✓		
Senator Towe	✓		

DATE March 16, 1985

COMMITTEE ON Taxation BILL NO. SB443

VISITOR'S REGISTER

NAME	REPRESENTING	Check One Support	Check One Oppose
Tucker Hill	Project 85		X
Jerome Anderson	Shell Western E+P		X
D. Van De Graaff	Mont Petroleum Assn		X
Weldon Summers	Shell Western E+P		X
Harold Uda	CENEX		X
G. Morris	MACo.		
Pat Melby	Mont Oil and Gas Association		✓
Mike Micone	WETA		X
Janelle Fallan	MT Ch of C		SB445
Rick Lewis + Kay	Harkin Ins		
Dave Goss	Billings Chamber of Commerce		✓
Don Judge	MT STATE AFL-CIO	X	

(Please leave prepared statement with Secretary)

Amend SB 431, introduced copy, as follows:

1. Title, line 7.
Following: "PURPOSES;"
STrike: "CLASSIFYING SEPARATELY RESIDENCES SITUATED ON AGRICULTURAL LAND:
Insert: "ALLOWING FOR THE REDUCED VALUE OF AGRICULTURAL IMPROVEMENTS SITUATED ON AGRICULTURAL LAND BY CLASSIFYING THEM SEPARATELY"

2. Page 1, line 16.
Following: "(1)"
Strike: "Land which is"
Insert: "Contiguous parcels of land under one ownership that are actively devoted to agricultural use or noncontiguous parcels of land under one ownership that are"

3. Page 2, line 5.
Following: "produces"
Insert: "and the owner or the owner's agent, employee, or lessee markets"

4. Page 2, line 6.
Following: line 5
Strike: "income"
Insert: "sales"

5. Page 2, line 17.
Following: "produces"
INsert: "and the owner or the owner's agent, employee, or lessee markets"

6. Page 2, lines 22 through 24.
Strike: lines 22 through 24 in their entirety
Renumber: subsequent subsection

7. Page 3, line 2.
Following: "through"
Strike: "(1)(e)"
Insert: "(1)(d)"

Exhibit 1 -- SB 431
March 16, 1985

8. Page 3, line 4.
Following: "producer"
Insert: "or marketing delay for economic advantage"

9. Page 3.
Following: line 5
Insert: "(2) Land shall not be classified or valued as agricultural if it is part of a platted subdivision that is filed with the county clerk and recorder after ~~[the effective date of this act]~~ Jan 1, 1986 in compliance with the Montana Subdivision and Platting Act."
Renumber: subsequent subsections

10. Page 3.
Following: line 8
Insert: "(4) Land shall not be classified or valued as agricultural if it is a commercial or industrial site."
Renumber: subsequent subsections

Exhibit 1 - SB431

STATMENT OF INTENT

SENATE BILL NO. 431

A statement of intent is attached to Senate Bill 431 to provide guidelines to the department of revenue in adopting rules under the extension of rulemaking authority granted by section 3 of the bill in order to implement certain provisions.

Section 1 amends 15-7-202 to restrict eligibility of land for valuation as agricultural because of wide-spread abuse of and difficulty in administering existing law. For those reasons subsections (a) and (c) require that the land produce and that the owner, or the owner's agent, employee, or lessee, market stated threshold measurements of agricultural products or gross sales of products. It is the intent of the legislature that the department adopt rules that would provide for methods of determining whether these thresholds are met in instances where the land is primarily used to grow crops that are not marketed, but consumed by livestock, poultry, or other animals in an agricultural operation.

Exhibit 2 -- SB 431
March 16, 1985

COMPARISON OF DRILLING ACTIVITY

MONTHLY AVERAGE

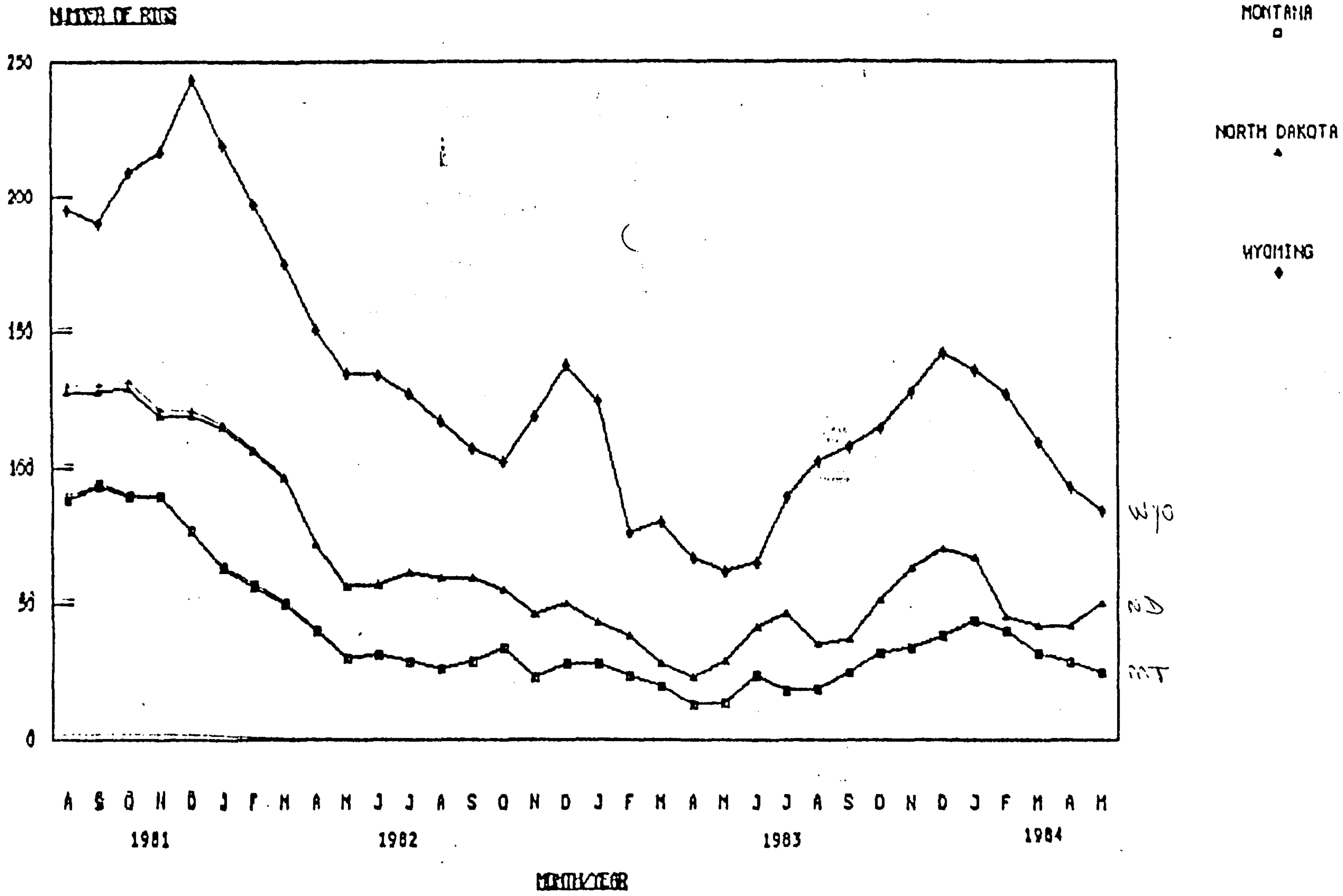


Exhibit 3 -- SB 443
March 16, 1985

FACT SHEET ON MONTANA OIL

I. PRODUCTION

Montana is the 13th largest oil-producing state in the U.S. In recent years, the amount of oil produced in the state has been:

Calendar Year	Bbls.	Gross Value
1978	30,934,923	$ 277,737,502
1979	30,285,631	362,239,259
1980	29,927,468	626,154,711
1981	30,517,947	1,052,333,907
1982	30,917,514	963,428,800
1983	28,614,597	826,517,213

Currently, there are over 4,600 oil wells operating in the state and the number is growing. In the first half of 1983, 100 successful new oil wells were completed.

II. TAXES

Montana imposes four taxes on oil:

A. Severance Tax: The severance tax is currently 6% of the gross value of oil. It will be reduced to 5% on April 1, 1985. This tax has yielded the following revenue:

FY80	$10,544,555	
FY81	19,578,172	
FY82	51,073,425	
FY83	45,228,535	
FY84	51,202,200	(Est.)

The revenue is allocated as follows:

1) One-third to the Local Government Block Grant account for distribution to all Montana's cities and counties;
2) A portion of the collections is returned to cities and counties in the oil-producing areas to help them in dealing with impacts. The portion returned varies according to the new production in each county: FY81-$992,488; FY82-$1,644,112; and FY83-$4,353,485.
3) The remainder to the state general fund.

B. Net Proceeds Tax: The largest tax on oil is the net proceeds tax imposed for local governments. The tax is calculated on the gross value of oil, minus all allowable deductions, multiplied by the local mill levy. The collections in recent years have been:

FY80	$21,011,951
FY81	28,663,376
FY82	40,868,506
FY83	66,160,884
FY84	N/A

On the average, local governments spend 60% of these funds for education, 8% for city operations, 23% for county operations, and 6% for five and other special districts. About 3% is returned to the state to support the university system.

C. Resource Indemnity: This tax (0.5% of gross value of all minerals produced) has yielded the following amounts from oil production:

FY80	$1,828,947
FY81	3,328,426
FY82	5,308,525
FY83	4,783,438
FY84	4,266,850

These taxes are placed in a trust fund to indemnify the state against damage to the environment from the extraction of non-renewable natural resources. Interest from the trust is appropriated for projects "to improve the total environment and rectify damages thereto."

D. Conservation Tax: The Board of Oil and Gas Conservation levies a small tax to support its own operations. The tax is .0008 of gross value and yields about $600,000 per year.

III. COMPARISON WITH OTHER STATES

A. Montana's tax rates compare favorably with other states

As the attached Table I shows, Montana's severance tax is lower than in nine other states.

When our total tax burden is compared with other states, Montana ranks lower than major producers Alaska and Louisiana and is comparable to neighboring states Wyoming and North Dakota.

The total tax rate in a particular county may be higher or lower than the statewide average, because the net proceeds tax rate varies from county to county depending on the local mill levy. In Glacier county, for example, the effective total tax rate for the current year is 16.35% because the local mill levy is 204. For Powder River county, the effective tax rate is 10.35% because the mill levy is 80. Thus, the total tax burden on oil produced in a high mill levy county may be higher than the taxes imposed in other states, but the statewide average mill levy imposed on oil makes our current total tax burden 12.93%.

Tax	Tax Rate
Net Tax Proceeds Tax	6.35%
Severance	6.00
Resource Indemnity	0.50
Conservation Tax	0.08
	12.93%

B. Montana's tax rate is declining, while other states' taxes are increasing

Since 1981, 7 of the 30 states producing oil have raised their oil severance taxes, and increases have been debated (and, in some cases, narrowly defeated) in at least five other states.

Three states have raised their oil severance taxes this year alone. Alabama's combined severance and conservation tax rate is now 10% of the gross value of non-stripper wells. Kansas enacted an 8% severance tax. And Ohio raised its small severance tax by over 300%. Other states have changed from quarterly to monthly severance tax reporting to speed collections and help balance strained state budgets.

Montana is unique in actually lowering its oil severance tax, effective in FY86.

C. Montana's tax structure has several advantages producers don't enjoy in other states:

1. Deductibility of operating costs and windfall profit tax. Montana allows oil producers to deduct certain operating costs, amortized drilling and capital expenditure costs, and all windfall profit taxes* paid in calculating the net proceeds tax due. Wyoming's gross proceeds tax, which is imposed in addition to its 4%-6% severance tax, does not allow deduction of these costs. North Dakota's 6.5% excise tax and 5% production tax also are imposed on gross value.

* Effective in 1984, the deduction for windfall profit tax will be reduced to 70%, retroactive to 1980.

In FY82, oil producers deducted $240.96 million in operating costs and $265.34 million in windfall profit tax. This reduced their net proceeds tax by $62.3 million.

2. No sales tax. In many states, all oil drilling and pumping equipment purchased or brought into the state is subject to a sales or use tax. In Wyoming, the sales tax is 3% (4% in some cities); in North Dakota, 3%; in Texas, 4%; and in California, 6%. Montana has no sales tax. Since sales taxes must be paid before production begins, this cost may deter exploration. Montana's severance taxes and net proceeds tax are not due until after production has begun.

3. Deductibility of windfall profit tax in computing corporate tax due. Like North Dakota, Oregon, California, and several other states, Montana allows oil producers to deduct the windfall profit tax paid during the year when computing the corporation tax due. Some states, like Minnesota, do not allow this deduction.

IV. RECENT OIL ACTIVITY

Montana's oil exploration activity has followed national trends closely, as Tables II and III show. When oil prices neared $40/bbl. (early 1981), 90 rotary rigs were exploring in Montana and nearly 4500 in the U.S. Now that world oil prices are at $29/bbl., Montana's rig count is 33 and the U.S. count is 2,401.

In these states and the U.S. as a whole, exploration activity has returned to the average of the late 1970's after the unusual activity of 1981. In Montana, the number of rigs active throughout that decade averaged between 18 and 32. Last month, there were 34 rigs active. Similarly, the U.S. rig count averaged between 1,200 and 2,200 in the 1970's; last month's rig count was 2,401.

TABLE I

COMPARISON OF STATE TAXES ON OIL PRODUCTION*

Severance and Excise Taxes on Oil Production

1.	Alaska	-	15.0% of value x economic limit factor**
2.	Louisiana	-	12.5% of value
3.	North Dakota	-	11.5% of gross value (5% for stripper wells)
4.	Kansas	-	8% of gross value
5.	Oklahoma	-	7.085% of gross value
6.	Alabama	-	6-10% of gross value
7.	Mississippi	-	6% of value
8.	Florida	-	5-8% of gross value (escaped oil - 17.5-20.5%)
9.	Michigan	-	5-7.6% of gross value
10.	Oregon	-	6% on production over $3,000 each quarter
11.	Montana	-	6% of gross value (5% effective April 1, 1985)
12.	Wyoming	-	4-6% of gross value
13.	Texas	-	4.6% of market value
14.	Kentucky	-	4.5% of market value
15.	South Dakota	-	4.5% of sales price less royalty paid to federal or state government
16.	Arkansas	-	4-5% of market value plus 25 mills and 2c per barrel
17.	New Mexico	-	3.75% of value less certain royalties and transportation costs to first purchaser
18.	Colorado	-	2-5% of market value
19.	Nebraska	-	2-3% of value
20.	Utah	-	2% of value on production over $50,000
21.	Idaho	-	2% of value
22.	Tennessee	-	1.5% of sales price
23.	Indiana	-	1% of value

Total Taxes*** on Oil Production in Various States

1.	Alaska	-	12.25%-15% of gross value x economic limit factor plus 5.125c per barrel
2.	Louisiana	-	13.45% of value
3.	Wyoming	-	11.07-13.07% of value
4.	Montana	-	12.93% of gross value
5.	North Dakota	-	12.07% of gross value
6.	Oklahoma	-	8.035% of gross value

* Source: Commerce Clearinghouse, <u>State Tax Guide</u> and information from Department of Revenue in each state.

** 12.25% on oil coming into commercial production after June 30, 1981; increased to 15% after five years production.

*** Includes severance, excise, resource indemnity, property, conservation, and sales or use taxes. Texas and California could not be included in this comparison since local production taxes vary so markedly.

Revised October 20, 1983

COHEA3:C/1

OIL AND GAS EXPLORATION ACTIVITY, STATEWIDE

WELLS DRILLED AND PERMITS ISSUED

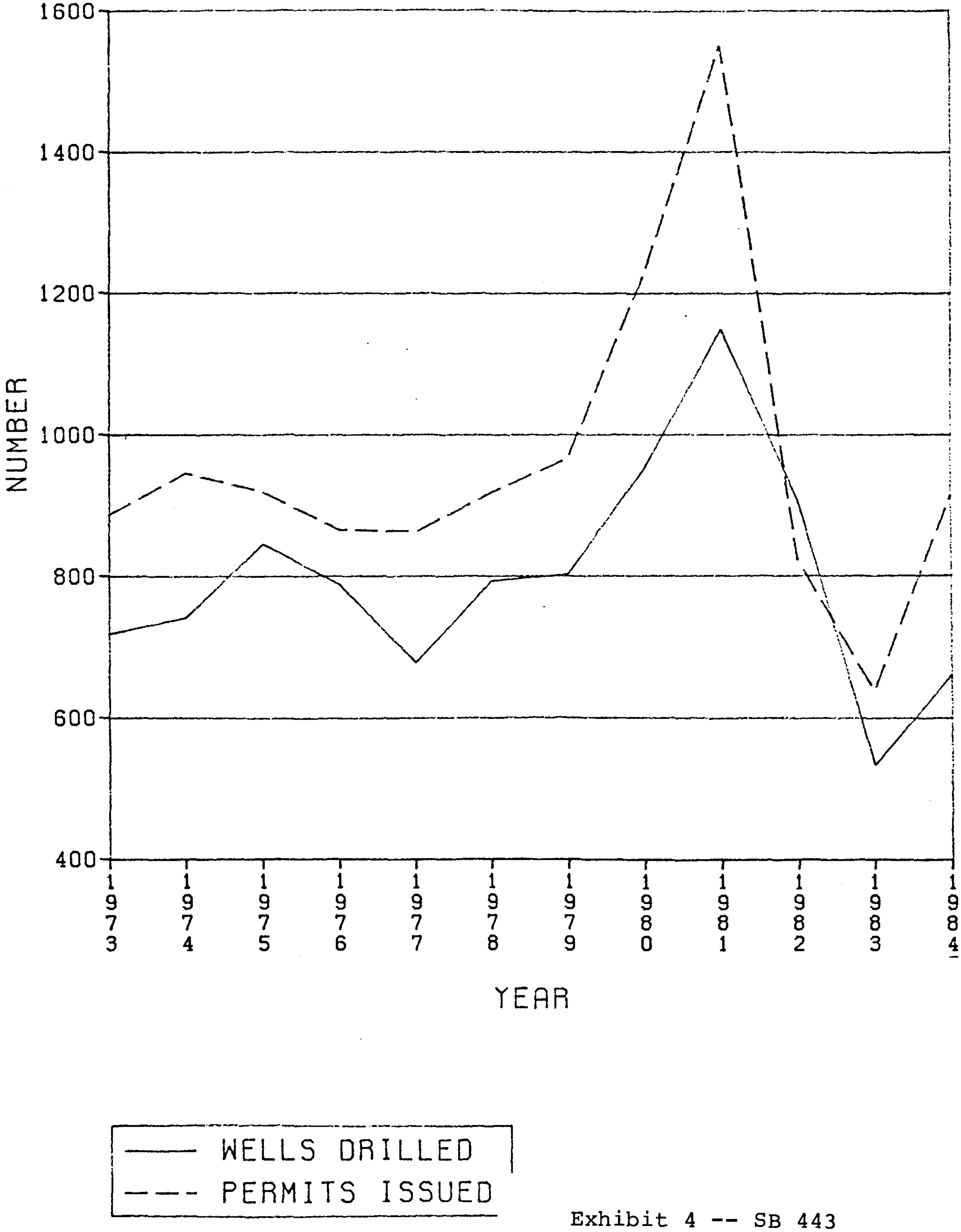
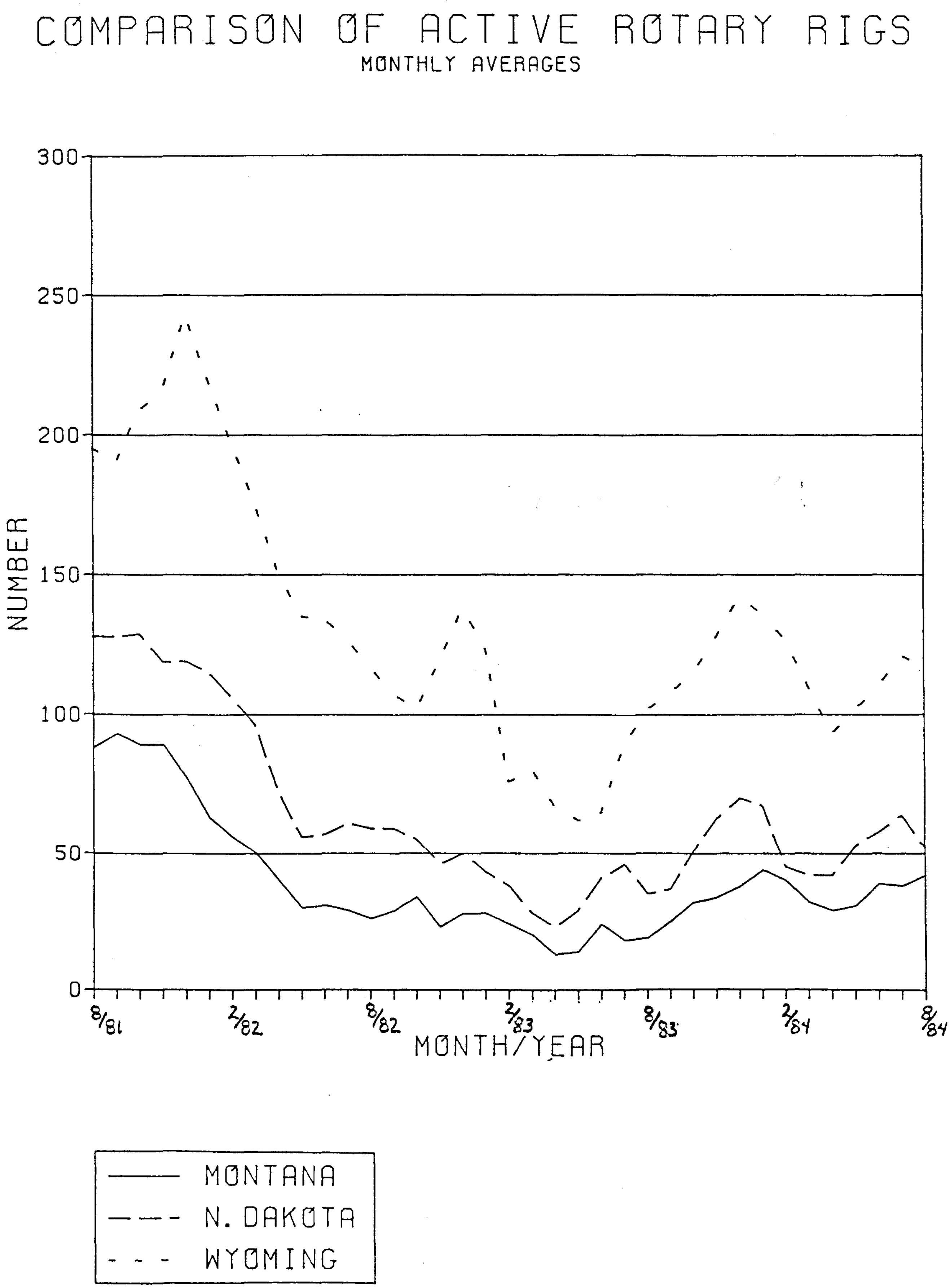
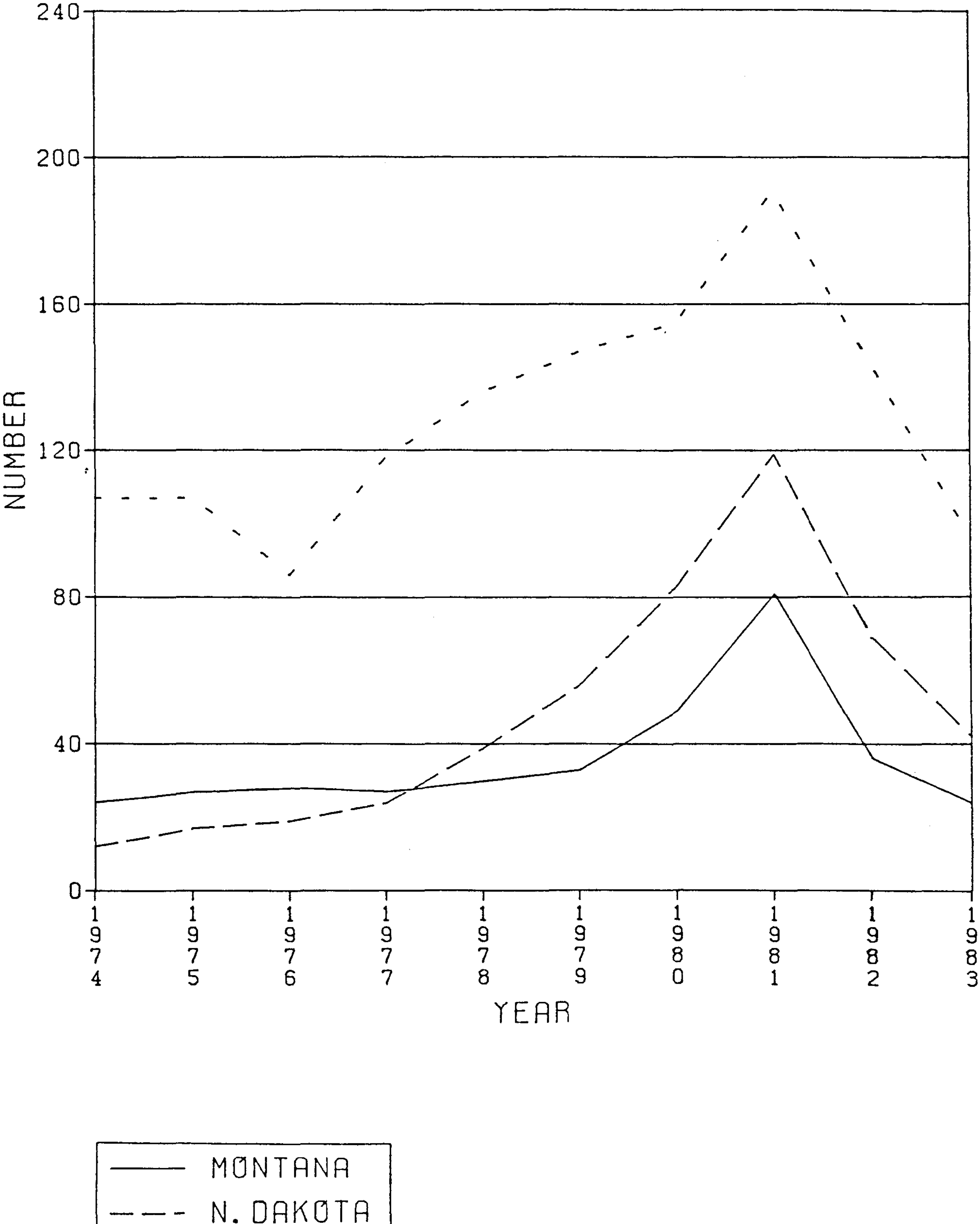


Exhibit 4 -- SB 443
March 16, 1985


COMPARISON OF ACTIVE ROTARY RIGS
MONTHLY AVERAGES
300
250
200
150
100
50
0
NUMBER
8/81
2/82
8/82
2/83
8/83
2/84
8/84
MONTH/YEAR
MONTANA
N. DAKOTA
WYOMING

COMPARISON OF ACTIVE ROTARY RIGS

ANNUAL AVERAGES



It also takes time to obtain drilling permits because the French government wants to protect scenic areas just outside of Paris.

Other operations. Crusader Oil,

Tax relief efforts stalled in two states

Oil and gas tax relief efforts have stalled in North Dakota and Wyoming.

Five bills providing various forms of tax relief failed to get out of the North Dakota legislature.

In addition, Wyoming Gov. Ed Herschler vetoed a bill that would have lightened the tax burden on operators of wildcats in his state (OGJ, Jan. 21, p. 42).

In North Dakota, the House turned down an industry supported bill that would have provided a 5 year reduction in the oil extraction tax to 3.5% from 6.5%. The bill also would have provided a 1 year moratorium from the tax for all new wells. Like the other tax change proposals, the bill required a two-thirds majority.

The House defeated a similar relief effort during 1983.

Producers pay the extraction tax, imposed via initiative during 1980, in addition to a 5% production tax on oil and gas.

Four other bills attempting to ease the tax burden on oil and gas firms also have died in this legislative session.

Gov. George Skinner proposed a 2 year exemption from the production and oil extraction taxes for wildcat discovery wells and a similar exemption from the oil extraction tax for extension wells. The bill died in the Senate.

Two other Senate tax relief bills failed. One would have provided a 2 year exemption from the oil extraction tax for all new wells drilled in the next year. It was defeated on the Senate floor.

The other would have provided a refund of sales and use taxes paid for materials used in wildcat drilling and an exemption from a special fuel tax on fuels used in wildcat drilling. It was withdrawn by sponsors.

Defeated in the House was a bill that would have provided exemptions from the oil extraction tax for drilling involving fluids made from North Dakota agricultural products.

The Wyoming bill vetoed by Herschler would have reduced the severance tax on production from wildcat discovery wells for 2 years.

"I fail to see that oil exploration is hurting," the governor said.

Veto of that measure may signal a similar fate for a bill passed by both Wyoming houses calling for a 5 year severance tax reduction for tertiary production from projects certified during July 1, 1985-July 1, 1990. ▪