

2009 HOUSE FINANCE AND TAXATION

HB 1281

2009 HOUSE STANDING COMMITTEE MINUTES

Bill/Resolution No. HB 1281

House Finance and Taxation Committee

Check here for Conference Committee

Hearing Date: 02/04/09

Recorder Job Number: 8621

Committee Clerk Signature *Lou Engelson*

Minutes:

Vice Chairman Drovdol: We'll open the hearing on HB 1281.

Rep. Thorpe: For the record my name is Woody Thorpe, Representative from District 5,

Minot. District 5 comprises most of the south half of the city of Minot. HB 1281 is an attempt to address cluttering and lingering problems with how North Dakota, as a state, handles

mineral interest that has been separated from the surface mineral interest. Let me start by taking you back in time to the decades of the 30s and 40s and the dust bowl years of the 30s when the federal land bank and a number of the lending agencies made loans to landowners who were mortgaging their land. Most landowners ended up losing their land because of the inability to repay those loans. Then beginning in the 40s when farmers were faring better and they began buying this land from the federal land bank and other lenders, here's where thousands and thousands of mineral interests were separated from surface attached mineral interests. When mortgagee-held surface acreage was resold, the mortgagee retained 50% of those mineral interests. Thus the start of separating mineral interest from surface acres. It is our contention that today there exists a large inequity in how we tax mineral interests. Since the beginning of taxing our land acreage and the minerals under it, the surface owner has

carried the burden of paying the full tax loan. For whatever reason we have failed to pass on

the tax percentage based on the percentage of mineral interest separated from the surface owner of record. Over the years, those surface owners have been paying their tax bills while the separated mineral interest owner has not paid any tax. However, we haven't asked them to. Our counties assess taxes to pay for all the needs of the county commission including our roads and bridges which undergo huge infrastructure costs related to exploration and production costs. Why do we leave the entire tax bill to the surface rights and surface connected mineral interests owners of record? Speaking of records, I remind you that all of the recordkeeping of all mineral interests under the surface property of the owner of record is at the owner's expense. I've been told that possibly as much as 70% of mineral interest in North Dakota is held separate from surface connected mineral owners. This tax of separated mineral interest will have a two-fold benefit. Not only will they be sharing costs of maintaining county infrastructures, this will promote a much needed data base on these mineral interests if they get the taxes in the counties who created those records. I recommend a do pass on HB 1281.

Vice Chairman Drovdol: Are there questions for Representative Thorpe? Others who wish to testify in favor of HB 1281? Other testimony in favor of HB 1281.

Brian Argabright offered testimony in support of HB 1281. See Testimony 1, attached.

Vice Chairman Drovdol: Any questions from the committee?

Rep. Headland: You mentioned it would not be double taxation but then I think later in your testimony you mentioned it would be \$1,000,000 more revenue to the county. Somebody needs to explain to me how that works.

Brian Argabright: That revenue would come from the severed mineral owners. Currently they pay zero. When I buy my farm, my acres are severed. Somebody else owns it. The leasing companies, they pay no tax on that.

Rep. Headland: So that would be new revenue.

Brian Argabright: New revenue.

Rep. Headland: So essentially a surface owner is getting no tax relief. This bill just provides for the county to have the ability to more money.

Brian Argabright: The surface owner will get tax relief because the county will have more money and technically they would be stewards of the funds and maybe reduce their mill levies. That would be the relief.

Vice Chairman Drovdol: Any other questions? Thank you for your testimony. Others who choose to testify on HB 1281.

Arden Haner: I'm Arden Haner. I come from Douglas, North Dakota. I rise in support of this proposal. I've had many experiences through the years. I'm going to tell you that a parcel of land is like a bundle of sticks. I bought my first parcel in 1970. The ink was not dry on the paperwork, and I got a letter from U.S. Fish & Wildlife Service telling me that I was not the sole owner and telling me how I was going to operate my farm. I was a little disappointed but they have enforced that. I'm going to pose a question because of this last man's testimony, and I'm going to change mine a little bit. Would this committee give everyone in this room 100 free raffle tickets forever? To pass on from generation to generation? I don't think so. On my farm there are minerals that are owned by insurance companies, by individuals who are 100 years old and the grandkids come and now they own it. And I own the parcel, and I didn't get any mineral rights. But I have to pay for the roads. And every time that they do something with these mineral acres that are severed, I have to put it on my abstract when I go to the banker. I have to pay for that. They can pay \$10 and cover multi-parcels for 20 years. They call that activity. There is a law today, 57-02-24, that allows for taxation of minerals. But somehow the Supreme Court got into it and said you can't have two setups on taxation. I was here in the

legislature back in 79 or 81 when Dick Backus got the law passed that stated if there was no activity for 20 years, it would automatically revert back. But this \$10 fee that they pay covers that. They call it activity. I got a call from a leasing agent from an oil company last winter, and he'd been checking my records. I'm not following them that close. He said, you bought the mineral acres on nine parcels of land in 1978 and he said the owner that sold them to you one week later made out a will and distributed them among the siblings. Six years later passed away and they divided them up. As Mr. Thorpe said, some of the mineral acres that are owned on some of my property were taken over in the early 40s. An insurance company supposedly loaned money to this land owner to make a payment. That company still exists. It's in Burleigh County. They paid the \$20 and they have several parcels throughout the state. I don't believe it's right that I pay taxes and maintain roads and do all the other things we need to do as taxpayers, and they get a free ride. Thank you for the opportunity to give testimony.

Rep. Froseth: What happens like now the city of Parshall, I have a friend there that has a house on a lot, and all of the sudden she got a lease check for oil because they drilled a well on the city of Parshall property and everyone is sharing in the royalty from that one well. You have a 75 foot lot. Are you going to tax it t \$2.00 an acre? Isn't this going to be a nightmare in some places? So if this passed people would have to pay a prorated portion of \$2.00 an acre. This could be an accounting nightmare for someone.

Arden Haner: I'm not a lawyer so I can't tell you how that part is going to work.

Rep. Weiler: You mentioned the Supreme Court came out years ago and said you can't have two taxes on the same, so is this bill even constitutional because you're taxing twice? You're taxing the landowner and you're taxing the mineral owner.

Vice Chairman Drovdol: I think that's a question we'll have to ask the lawyers.

Arden Haner: I don't know who presented it, and I don't know why the court did what they did because in my area there are several relatives, and those people are fighting tooth and nail on who has rights to the ground on these severed minerals. I'll go one step farther. I've met people that want hunting rights on my land.

Vice Chairman Drovdol: Thank you for your testimony. Others who wish to testify in favor of HB 1281.

Julie Ellingson: My name is Julie Ellingson, and I represent the North Dakota Stockman's Association. Members of the North Dakota Stockman's Association discussed this issue at their recent annual convention and supports the basic concepts behind the idea. At our meeting the stockman's member asked our board of directors to study the concept of shifting a percentage of property taxes to the mineral rights owners and giving surface rights owners the first option to redeem the mineral rights. We recognize the limitations of the bill today. We support the concept.

Vice Chairman Drovdol: Any questions? Seeing none, we thank you for your testimony. Others who wish to testify in favor of HB 1281. Seeing none, those who wish to testify in opposition to HB 1281

Ruth Stevens offered testimony in opposition to HB 1281. See Testimony 2, attached.

Dewey Oster offered testimony in opposition to HB 1281. See Testimony 3, attached.

Rep. Brandenburg: How does it work now when the people that have the minerals, they come in and keep up the activity. What is meant by that?

Dewey Oster: There is a mineral claim law I think you're getting at. That came into being in the mid 80s where if you have severed minerals, then you can come forth and file a claim if you haven't used them. You file that claim and basically you state that you have a mineral interest under that particular tract. You do that every 20 years to preserve that mineral

interest. If you don't, then supposedly the surface owner goes through the process of trying to get the severed minerals back to the surface and you have to print it in paper. I don't think this has ever been tested in court.

Rep. Brandenburg: If 20 years goes by, how do these people know that they need to come back and refile their mineral rights? Does somebody notify them?

Dewey Oster: They should keep track on their own.

Rep. Brandenburg: So I purchased land, and I've located abstract, and I know I've paid for those mineral rights to be updated. I don't ever remember a lawyer's office sending me a notice that these mineral rights are older than 20 years and no one's updating them. It seems like something is getting left out here.

Dewey Oster: There is nothing in the law that requires you to file that claim and if you leased oil and gas within that 20 years or if you passed away and transferred the minerals to your heirs, I believe that constitutes usage so you don't have to file this claim. It's been severed from the surface for years and it's getting worse. How do you take something away and put it back to the surface owner.

Vice Chairman Drovdol: What you're saying is that the recorder's job is to record the documents, not to keep track of them.

Dewey Oster: Exactly.

Rep. Brandenburg: That's what bothers me, when you buy land and you have to pay for that fee, pay for that abstract. Sometimes those abstracts have a number of transactions in there. You're talking thousands of dollars to update an abstract. I don't see mineral people paying for that. Yet, you're updating those abstracts for those people that own those mineral rights.

Dewey Oster: It's just the way it is.

Rep. Schmidt: Are you responsible for finding out if they're producing in your area?

Dewey Oster: I really don't know how that is done when you tax production. Our office has nothing to do with the taxation. We simply record things.

Rep. Schmidt: Is it the county auditor's job to find out whether they're mining or not?

Dewey Oster: No, I don't believe so.

Vice Chairman Drovdol: I think it's supposed to be the oil and gas division when they give out permits. It's not the recorders job or the county's job.

Rep. Pinkerton: If someone files to reup their mineral acres before the 20 years, and there's an entry in the abstract, and they pay the \$20, is the landowner required to pay anything? Or the surface owner?

Dewey Oster: What we're speaking of here is a mineral claim. There is usually a \$10 recording fee to record that. That simply pertains to severed minerals if you are a severed mineral owner then you would file this claim. You should do that every 20 years if you haven't used those minerals. Usage is broadly stated in the code. It can be an oil and gas lease, a coal lease, a conveyance of some sort. If you're showing that you used those minerals then you qualify and wouldn't have to file that claim. Some file it regardless.

Vice Chairman Drovdol: The only person that can claim the minerals is the surface owner and there theirs so he wouldn't have to refile it as a surface owner.

Rep. Pinkerton: When they refile at the 20 years, is it the surface owner whose minerals are severed?

Rep. Winrich: Typically a property is abstracted when it changes hands or when it's sold, correct?

Dewey Oster: I suspect that is true, but not necessarily so. Usually an abstractor will tell you to bring an abstract up to date if you're selling or if you're going to mortgage it. It isn't necessarily something you have to do.

Rep. Winrich: Do you record the abstracts for your county? Are those on file somewhere?

Do they simply go with whoever has the property.

Dewey Oster: That's sometimes a misconception that the recorder has abstracts. We don't. We have the documents that make up an abstract. The abstractor is a licensed business, and it's licensed by the state. We don't have anything on file but we have the documents that make up the abstract. That's what I'm getting at has to be done to determine mineral ownership. The abstractor is somebody that produces the abstract. The landowner usually has the abstract.

Ann Johnsrud offered testimony in opposition to HB 1281. See Testimony 4, attached.

Mark Sovig offered testimony in opposition to HB 1281. See Testimony 5, attached. In response to a couple of things, you look at these minerals and owners aren't paying taxes.

What's your budget surplus? How much of that is due to the taxes that are being paid on the production of those minerals. If you look at the unconstitutionality of it, what that stemmed on is the fact that you can't just tax severed minerals. You would have to tax all minerals. The minerals that I own, both severed and under surface, what is that going to do to the property value of that land. I request that you don't consider passage of this bill.

Rep. Headland: In the case where you can't locate the mineral rights owner, what do you do with the royalties?

Mark Sovig: An operating company or someone that's doing the drilling, they are required then to set up trust accounts. Royalties based on that ownership goes into that trust account and stays there for a certain amount of time. Usually with the county then it goes to the state's unclaimed property fund. It isn't that it isn't paid. It is set aside.

Ron Ness offered testimony in opposition to HB 1281. See Testimony 6, attached.

Robert Harms offered testimony in opposition to HB 1281. See Testimony 7, attached. One other thing is the idea that mineral interests don't pay taxes, and somehow are a burden on the county. Mineral interests don't pay taxes when they aren't productive, but they also don't require fire protection and police protection or having impacts to the roads. Only when they become productive do they then become a burden upon the county. If this is an issue of paying taxes, then I have a bit of a problem with the end result of this bill. If the mineral interest isn't being taxed, if the owner isn't paying the tax and then loses the minerals, is it fair that that mineral interest go to the surface owner who somehow is no longer is obligated to pay tax?

Jeb Oehlke offered testimony in opposition to HB 1281. See Testimony 8, attached.

Brian Kramer: I'm here representing North Dakota Farm Bureau. We certainly support the concept Rep. Thorpe has brought forward. We have policies supporting that concept to apply a tax to the mineral interest as a way of trying to reattach those mineral interest to the surface. The concept of applying tax and if they do not pay that tax, giving the surface owner the opportunity to pay that tax and reattach it. We do have some problems with the bill as Mr. Harms alluded to. What do you do in the case once that is reattached to the surface. Do you pay the \$2.00 tax? Does the surface owner have to pay that \$2.00 tax. If that is the case then that increases our property taxes, and we've all heard the discussion about how high our property taxes are. Whether that's in town or in the rural areas. We certainly appreciate the attempt to bringing those mineral interests back in line with the surface ownership.

Vice Chairman Drovdol: Any other testimony in opposition to HB 1281. My question has to do with lines 21 through 24 on the first page where on line 22 it says, "If there are any unpaid taxes under this chapter against mineral interests underlying a property, a lease of the minerals may not be recorded and a drilling permit may not be issued for that property."

Robert Harms: That kind of provision would have a negative impact on the industry. I think that's going to be a problem.

Vice Chairman Drovdol: If one person owned 1/10th of an acre and didn't pay his \$2.00 tax would that mean you couldn't drill on that whole area?

Robert Harms: If there are any unpaid taxes against mineral interests underlying a property, a lease of the mineral interest may not be recorded and a drilling permit may not be issued for that property. It is difficult sometimes to find those small mineral interest owners. It may not be an intentional failure to pay tax.

Vice Chairman Drovdol: Anybody else wish to testify in opposition to 1281? Any testimony neutral on 1281.

Rep. Froseth: Ron Ness' testimony included this yellow sheet and the very first paragraph says, "For more than 100 years, periodic attempts have been made in North Dakota to tax severed mineral acres. In 1907 the Legislature enacted which is now 57-02-24 which requires assessors to list and assess severed mineral interests for property tax purposes. The law is still in existence, but the law is not followed because it is impossible as a practical matter to locate the owners and to assess the value of minerals in place in the earth." Is that law still on the books?

Ron Ness: You are correct. That law is still on the books, and as the recorders mentioned today, it should be removed so we would consider a hog house amendment. The Supreme Court ruled on the tax.

Claude Sem: My name is Claude Sem. I'm from Minot, North Dakota. I, too, am an owner of real estate in western North Dakota. I also have severed mineral acres in western North Dakota. Some day members of this committee and all representatives and citizens of North Dakota need to address severed mineral acres. I can tell you the western North Dakota

landowners are proponents who like this bill or some aberration of it. I have had many farmers come to me in support of some type of bill like this and do not feel that the taxation is fair.

There are many people out there that don't even know that they own mineral acres. Some of the comments that were made today, I would take issue to without a question. Some of the things like how do we administer that, that's a big issue. I can understand that could be a nightmare. I would look at that as an opportunity for the counties and that is a problem.

Here's a big opportunity here, not only for the state taxes for equal representation of the taxes, but also for the county to prove economically how to administer this. One recommendation, if I could add it, would be this bill gets moved into some type of study committee or interim or something like that.

Rep. Froseth: Would it be possible that those minerals should need to go into a trust so they are all held together in a trust? Would that help solve this problem at all? It would be kind of hard to do now because those minerals have been fragmented out so far.

In that case you suggested, at that time, the minerals were held in a trust with those 60 people being accounts of that trust. It would be easy to find them. You know where they're at.

Vice Chairman Drovdol: Any other testimony in neutral on HB 1281. Seeing none, I'll close the hearing on 1281.

Woody Thorpe: Those cities who are going to be assessed the \$2.00, I understand there's production on those town sites, with this bill, when there's production, the tax ends. So, that shouldn't be a problem. If you would want to consider hog housing the thing with some other verbage, going for a study, I would certainly support that.

Vice Chairman Drovdol: I think the Natural Resource Committee is considering a study of minerals. We will close the hearing on 1281.

2009 HOUSE STANDING COMMITTEE MINUTES

Bill/Resolution No. HB 1281

House Finance and Taxation Committee

Check here for Conference Committee

Hearing Date: February 4, 2009

Recorder Job Number: 8622

Committee Clerk Signature

Minutes:

Vice Chairman Drovdal: I have a “do not pass” motion from Representative Weiler and a second by Representative Headland. Any discussion?

Representative Froelich: I guess this has been studied before, but I guess I will resist a “do not pass”. We have to realize there is a problem out there (inaudible).

Representative Weiler: Representative Drovdal did say that Natural Resources Committee is considering a study already which would address that.

Representative Headland: The fact that the Supreme Court has twice ruled that it is unconstitutional to tax severed rights, I think that pretty much eliminates the need to even study it. What are you going to do? You have to change the Constitution.

Representative Pinkerton: Mr. Sims left a sheet with me that he had done some research on. Apparently it is fairly current and talks about metal rights ownership in Minnesota and severed rights. I haven't had a chance to read it, but he indicated that it was probably a workable deal. It does seem like there could be some things out there. I haven't read it, but I will be glad to share it with you.

Vice Chairman Drovdal: We could look at that in Natural Resources. A roll call vote on a
“do not pass” on HB 1281 resulted in 10 ayes, 3 nays, 0 absent/not voting.

Representative Drovdal will carry the bill.

FISCAL NOTE
Requested by Legislative Council
01/13/2009

Bill/Resolution No.: HB 1281

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

	2007-2009 Biennium		2009-2011 Biennium		2011-2013 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues						
Expenditures						
Appropriations						

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

2007-2009 Biennium			2009-2011 Biennium			2011-2013 Biennium		
Counties	Cities	School Districts	Counties	Cities	School Districts	Counties	Cities	School Districts

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

HB 1281 provides for the assessment of severed mineral interests.

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

Section 2 of HB 1281 will increase revenue to the county general fund in any county in which severed mineral interests are recorded. There is no information available upon which to compute this potential revenue increase for counties.

Section 4 of HB 1281, by repealing Subsection 32 of NDCC Section 57-02-08, will require ad valorem assessment of coal, oil, and gas, where the ownership has not been severed from the surface ownership, to be assessed with the land for property tax purposes. That will increase the valuation of those properties, and increase the property taxes by an amount that cannot be determined.

Overall, the fiscal impact of HB 1281 cannot be determined.

3. **State fiscal effect detail:** *For information shown under state fiscal effect in 1A, please:*

A. **Revenues:** *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*

B. **Expenditures:** *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*

C. **Appropriations:** *Explain the appropriation amounts. Provide detail, when appropriate, for each agency and fund affected. Explain the relationship between the amounts shown for expenditures and appropriations. Indicate whether the appropriation is also included in the executive budget or relates to a continuing appropriation.*

Name:	Kathryn L. Strombeck	Agency:	Office of Tax Commissioner
Phone Number:	328-3402	Date Prepared:	01/31/2009

Date: February 4, 2009

Roll Call Vote #: 1

2009 HOUSE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. 1281

House FINANCE AND TAXATION Committee

Check here for Conference Committee

Legislative Council Amendment Number _____

Action Taken Do Pass Do Not Pass Amended

Motion Made By Weiler Seconded By Headland

Representatives	Yes	No	Representatives	Yes	No
Chairman Wesley R. Belter	/		Representative Froelich		/
Vice Chairman David Drovdal	/		Representative Kelsh		/
Representative Brandenburg	/		Representative Pinkerton		/
Representative Froseth	/		Representative Schmidt	/	
Representative Grande	/		Representative Winrich	/	
Representative Headland	/				
Representative Weiler	/				
Representative Wrangham	/				

Total (Yes) 10 No 3

Absent _____

Floor Assignment Rep. Drovdal

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

REPORT OF STANDING COMMITTEE

HB 1281: Finance and Taxation Committee (Rep. Belter, Chairman) recommends DO NOT PASS (10 YEAS, 3 NAYS, 0 ABSENT AND NOT VOTING). HB 1281 was placed on the Eleventh order on the calendar.

2009 TESTIMONY

HB 1281

2-3-2009

Introduction

My name is Brian Argabright. I live at 4478 10th Ave N, Velva ND 58790. I support House bill NO. 1281.

I have a bachelor degree in accounting from the University of North Dakota and a Master degree in management from the University of Mary. I am the accountant for a large farm in northern North Dakota. In the course of this employment, I deal with severed mineral acres every year.

Definitions:

I believe it is important that we ~~are~~ have a clear understanding what severed mineral acres are. On all real estate there is the surface owner. That is what is commonly referred to as the property owner. This person may or may not own the rights to the mineral buried below in his property. This is the person who pays the real estate tax to the county, townships, school districts, fire districts, and any other governmental units that may levy taxes. They also pay for all the cost of keeping track of the ownership of both the surface acres and the subsurface acres.

On some real estate, the right of ownership, to the minerals underneath the surface, has been, by contract, divided. This is then defined as severed ownership. This has been a process that has existed since oil and other minerals were first discovered. They have been severed because there is a perceived value for these rights. This value may be real or not. They may resold, leased, or disposed of, just as the surface owner may do. When real estate has its mineral ownership severed, you actually have two owners of that parcel of land; surface owners and mineral owners.

House Bill 1281:

This bill is designed to tax the mineral ownership of the real estate. This is not, a double taxation of the surface owners. This bill goes on to distinguish between mineral acres that are producing oil, coal, or other minerals and those that do not. Once the severed acres go into production, the tax this bill would produce will not apply. It only applies to the non-producing severed mineral acres.

The surface owner currently pays all the real estate taxes levied. They pay for all abstracting cost for both the surface transfers and the sub-surface owner's transfers. When an abstract is updated, there may be multiple transfers of severed mineral acres. The surface owner pays for each of these entries, whether or not they were a party to the transaction. All the court house functions are paid by the real estate tax base of the surface owner. Counties spend an incredible amount of time keeping track of severed mineral acres. All these expenses are paid by the surface owner.

Recently I was in Towner, North Dakota, my county seat. I took several books of real estate ownership and randomly look up parcels. I found about 90 per cent of the parcels had severed mineral acres. The ownership of these acres does not pay any taxes. At the small rate of \$2.00 per acre, this would bring in over a \$1,000,000 (Million Dollars) of additional revenue to my county. Would it be a lot of work to get it better organized? Yes! The investment by the counties would be rewarded by additional revenue for generations.

As a surface owner, I believe I am a good steward of the land. I would cherish the opportunity to pay the severed mineral acre taxes on my farm. In today's environment of ever growing real estate taxes to the property owner, this is a welcome relief. It is unrealistic to believe that current real estate taxes will be reduced, without cutting even the most basic services governmental units provide. Even today most of all real estate and such things as mobile homes are taxed. They are taxed because there is a perceived value. If there was no perceived value in the mineral acres, they would not have been severed. These severed acres should be taxed to support governmental units, just as the surface owner does.

Opposition:

I have talked to both democrats and republicans about this proposed bill. I have found that a resounding majority, in the neighborhood of 70%, support this legislation. The people who object are absentee mineral owners, who own mineral acres and are waiting for the big bonanza. I expect oil companies like EXON and others would hate this. They would finally have to pay taxes and support the communities where their assets are located.

Summary:

This is a bill that has been long overdo. Mineral owners have long taken advantage of the surface owners. The surface owners pay all the costs of keeping track of both his surface acres and the mineral owner's acres. Through taxes the surface owners pay all the cost of the counties, townships, schools, fire districts and others. Until, mineral acres actually go into production, they have a free ride.

NOT VERY MANY TIMES IN OUR LIVES, DO WE HAVE THE OPPORTUNITY TO DUE SOMETHING THAT POSITIVELY AFFECTS THE LIVES OF SO MANY, FOR GENERATIONS TO COME. PASSING THIS BILL IS ONE OF THOSE TIMES. I HOPE THAT YOU GIVE THIS BILL A POSSITIVE APPROVAL.

Testimony 2

HB NO. 1281
TAXATION OF SEVERED MINERAL INTERESTS
February 4, 2009

TO: Chairman Belter
Members of the ND House Finance and Taxation Committee

From: Ruth Stevens, Nelson County Recorder/Clerk of District Court
President of the ND County Recorder's Association

Chairman Belter and members of the Finance and Taxation Committee

I am here as President of the ND County Recorder's Association, and with me are members of our Legislative committee. We are here to let you know that our whole association is opposed to this bill.

Dewey Oster from McLean County will present testimony regarding our opposition to the bill, and Ann Johnsrud, McKenzie County Recorder, will present testimony about tracking mineral and royalty owners on just 1 parcel of land. Dewey and Ann are very familiar with oil activity in their counties and know the "ins and outs" of tracking mineral interests.

I ask you to listen to their testimony, which reflects the feelings of the ND County Recorders in this room today, as well as the feelings of those that are not here.

We ask for a "Do Not Pass" on this bill.

Thank you for your time and consideration.

(TAXATION OF SEVERED MINERAL INTERESTS)

04FEBRUARY09

TO: ND HOUSE FINANCE AND TAXATION COMMITTEE

FM: DEWEY OSTER, McLEAN COUNTY RECORDER
NORTH DAKOTA COUNTY RECORDER'S ASSOCIATION LEGISLATIVE COMMITTEE

Chairman Belter and members of the Finance and Taxation Committee

The members of ND County Recorder's Association go on record in total opposition to this bill.

Legislative activity involving taxation of severed minerals has been on the agenda for many decades. It has always failed. It is impossible to tax minerals and do it fairly and equitable without first compiling complete abstracts of title on all lands within the state of North Dakota.

This point alone renders this bill impossible....simply not feasible....cost prohibitive.

This bill appears to have no appropriation to do the necessary title work. Does this mean that the task would rest on the shoulders of the recorders?

Recorders, while being well-versed and knowledgeable when it comes to the real estate records, are not qualified to complete such abstracting work, nor do we have the time or adequate staffing. We are not licensed abstractors nor attorneys with oil/gas expertise. (NDCC 43-01-14 & 15 and 27-11-01 & 11-18-01 are applicable.)

Presently, minerals are taxed in North Dakota when there is mining and production and that is the way it should stay.

We ask that this bill receives a "Do Not Pass".

Testimony 4

To: Chairman Belter
Members of the North Dakota House Finance and Taxation Committee

From: Ann Johnsrud
McKenzie County Recorder

RE: HB 1281

Chairman Belter and Members of the Finance and Taxation Committee,

For the record, my name is Ann Johnsrud, McKenzie County Recorder, representing the North Dakota Recorders Association and McKenzie County.

I am here today to offer testimony in regard to tracking mineral and royalty owners in the County Recorders offices. McKenzie County is the largest county by size, 1,754,892.8 acres; 1,630,990 acres privately owned and 123,902.8 acres being National Grasslands, Theodore Roosevelt National Park and the Fort Berthold Reservation. We are an "oil county".

I requested information from a trained, professional petroleum landman doing title research in McKenzie County, as to the time, cost and complexity of identifying mineral owners. A title search was completed on a 320 acre tract (a half section). This search required examining and interpreting 1275 documents. Each document examined required a written summary including the type of instrument, book and page, document number, grantor, grantee, date of execution, date of recording, description, specifics relating to the "grants" recited in each instrument and referenced reservations, exceptions and any other pertinent information contained within the four corners of the document that may affect the nature of the mineral ownership. There were 55 mineral owners and 150 royalty owners identified. The estimate to complete this tract was a minimum of 5 weeks, working 7 days a week, 10 hour days. The cost for the professional landman to complete the title search was \$11,000.00. If all mineral tracts were researched by 320 acre tracts (which experience says they are not) McKenzie County would have 5500 tracts to search. As previously stated by Mr. Oster, counties would have to hire trained professionals to do this work due to the complexity of mineral ownership. I hope you can appreciate the amount of work and cost such a task would entail.

I would like to defer to Mr. Mark Sovig, an Independent Landman experienced in professional title research who will testify as to the legal concerns, the difficulty of administrating such a bill and the cost of identifying ownership and maintaining such a data base.

We ask for a "Do Not Pass" on this bill.

Thank you for your time and attention and I would answer any questions you may have.

To: Chairman Belter
Members of the North Dakota House Finance and Taxation Committee

From: Mark Sovig
Independent Landman, Surface/Mineral Owner, Severed Mineral Interest Owner

Re: HB 1281

I speak in opposition to HB 1281 as an owner of severed mineral interests, a surface owner with underlying mineral interests, and as a professional landman. I believe this bill is unconstitutional, is in direct conflict with accepted bodies of law, precedence and procedure that have long existed, and would be impossible to implement.

The following bullets provide a few of the constitutional and legal impediments to implementing the bill:

- The arbitrary classification of a "second-class" of mineral owner violates the concept of uniformity of taxation within a class of property within the Constitution of North Dakota; and too, the standard of equality under the 14th Amendment to the U.S. Constitution.
- The arbitrarily set \$2 per acre tax ignores assessment/valuation requirements and is unfair. I.e., is the value of a mineral acre in Mountrail County the same as one in Steele County?
- Legal procedure for tax lien foreclosure requires public auction and does not allow for the arbitrary selection of a third party buyer. It also requires a redemption time period.
- The bill provides for every "interest" vs. "acre" to be taxed. This can be interpreted as "double taxation". I.e., a single owner pays \$320 for a 160 acre tract; the same tract owned by a family of four would pay \$1,280.
- The bill is in direct conflict with federal law providing for forced pooling.

Beyond the constitutional and legal impediments, the following bullets address difficulty of administration:

Determining Ownership

- Will require creation of an abstract & title opinion for every square inch of land in the state
 - Who will do it? Additional staff & training –vs- contracting
 - Who has the expertise necessary to interpret legal documents, Duhig rule, 3rd party reservations, lapse of interest procedures, etc.?
 - How much time will be required to determine ownership across the state?
 - Who will be responsible for curing title? Locating owners?
 - Cost?

Maintenance Tasks, Operation & Administration

- Staff requirements?
- Who tracks: ownership changes, address changes, divorces, deaths, probates, court actions, mortgages, judgments, liens, start of oil production, end of oil production, pooled interests, unitized interests, non-producing acreages held by production on other acreage, etc.
- Equipment requirements
- Database development & support
- Report generation
- Additional postage

- Increased employee turnover
- Interference with core responsibilities
- Conflicts of interest
- Confidentiality
- Cost?

Mineral interest is real property and must be assessed/valued and the tax levied

- How do you determine the value, what minerals exist, in what quantity and quality?
- What about archeological resources?
- Why are gravel and scoria resources exempted?
- Cost?

Where will you find enough qualified labor?

What costs will be incurred defending lawsuits brought against the State/County?

Who assumes liability for incorrect ownership determination?

Estimate of Ward County Ownership Determination Costs:

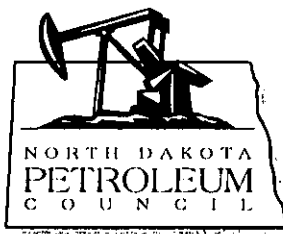
- Assumes "perfect world – clean title" i.e. extremely conservative
- $57 \text{ twps} * 36 \text{ sect/tpw} * \frac{1}{2} \text{ sect/day} * \$400/\text{day} = \$1.64 \text{ million}$
- Excludes: copies & time to build abstracts, generation of ownership reports, 2nd party review, attorney opinion letter/warranted title. At least double the above cost
- Excludes: Town sites (30,000+ parcels in Minot), plats, outlots, rights-of-way, lakes & streams ?\$6 million
- Excludes: title curative and locating owners ?\$

Finally, mineral ownership determination is an interpretive process based on current theory and case law. A Supreme Court ruling such as Duhig vs Peavy-Moore Lumber Co. or Malloy vs Boettcher, which were retroactive, can change an interpretation radically.

Mineral interests are severed from the surface in several ways. In many cases it began with a mineral reservation by the United States in the initial Patent issued for the land. Most State School lands sold to private individuals reserved a percentage of the minerals to the State to provide income for education in the State. The vast majority of severed mineral interests in the state came about when a private owner of the surface and minerals decided to sell what was rightfully his/hers. The surface was sold and the owners kept part or all of the minerals. Or, the surface and mineral owner decided to sell part of his mineral interest only without the surface. Either is well within the rights of the owner.

While there are inherent difficulties regarding severed minerals and the sometimes difficulty of locating a very small percentage of mineral owners, this bill provides no solution to that issue. Nor do I believe that that is its intent. Please do not consider its passage.

TESTIMONY 6



Ron Ness
President
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House Bill 1281
House Finance & Taxation Committee
February 4, 2009

Chairman Belter and Members of the Committee, my name is Ron Ness. I am the President of the North Dakota Petroleum Council. The North Dakota Petroleum Council represents 160 companies involved in all aspects of the oil and gas industry and has been representing the industry since 1952. We appear before you today in opposition to HB 1281.

HB 1281 imposes an unconstitutional tax on severed minerals. Legislation taxing severed minerals has been attempted for more than 100 years, with the first bill in 1907. Laws attempting to do what HB 1281 have been overturned twice by the North Dakota Supreme Court in 1928 and 1951. The proposed severed mineral tax, and its method of valuation, raises serious constitutional issues relating to Equal Protection.

For example, some producing severed minerals may be worth \$1,000 per acre or more, yet severed minerals in other areas of the state may be worth only \$5 per acre. Assessing a \$2 per acre, per year, tax on all severed minerals regardless of value would obviously pose serious constitutional issues. Even if the state did find a legal way to tax severed minerals, enforcement of the tax would be extremely burdensome. Under any given section of land in North Dakota, there may be from 1 to 300 or more severed mineral owners. It takes land companies, title attorneys, and oil companies sometimes literally hundreds of hours to determine ownership, locate, and figure out the percentage of ownership under any one section of land a well may be drilled upon. One well took twelve weeks of attorney time. You can

imagine the time and costs incurred with this type of effort by a county. Who is going to pay the costs of the county to determine the identity of the severed mineral owners and to collect the tax? The administrative burdens and costs would likely far outweigh the benefit in most counties.

Currently, severed minerals are taxed when production is established and revenue is being generated from the mineral interests. The severed mineral owner must pay a gross production tax and oil extraction tax to the State in the same percentages as do the oil companies. The gross production tax is essentially in lieu of the property tax. Mineral owners must also pay state and federal income taxes on all oil and gas royalty proceeds and lease bonus proceeds. There is simply no reason to add yet another tax to mineral interests.

The North Dakota Petroleum Council opposes this bill and urges a Do Not Pass recommendation. I would be happy to answer any questions.

ownership, there was not a taking of property that required compensation under the 14th Amendment of the United States Constitution.

TAXATION OF SEVERED MINERAL INTERESTS ^{100 VAS.}

For more than 100 years, periodic attempts have been made in North Dakota to tax severed mineral interests out of existence. In 1907 the Legislative Assembly enacted what is now codified as NDCC Section 57-02-24, which requires assessors to list and assess severed mineral interests for property tax purposes. The law is still in existence, but the law is not followed because it is impossible as a practical matter to locate the owners and to assess the value of minerals in place in the earth.

In 1923 the Legislative Assembly enacted an annual state tax of three cents per acre for severed mineral interests. The revenue from the tax was to be paid into the state general fund. If the tax was delinquent for three years, proceedings were instituted to declare the title to the mineral interest forfeited to the state. The North Dakota Supreme Court in *Northwestern Improvement Co. v. State*, 220 N.W.2d 436 (1928) ruled that the tax on severed minerals was unconstitutional. The court concluded that the law provided an unreasonable and arbitrary classification for property tax purposes based on severance of ownership of minerals. The court concluded that the statute violated the uniformity of taxation within a class of property requirement of Section 176 (now Article X, Section 5) of the Constitution of North Dakota.

In 1947 the Legislative Assembly again attempted to tax severed mineral interests. The 1947 law attempted to avoid the Supreme Court objections from 1928 by not imposing a "property" tax. The 1947 law provided for an "excise tax" of three cents per acre on severed mineral interests. The tax did not apply when mineral rights are developed or for mineral leases held for development purposes. The North Dakota Supreme Court in *Northwestern Improvement Co. v. County of Morton*, 47 N.W.2d 543 (1951) ruled the 1947 legislation unconstitutional. The court ruled that the standard of uniformity under Section 176 (now Article X, Section 5) of the state constitution is substantially the same as the standard of equality under the 14th Amendment to the United States Constitution. The court concluded that the limitation on the power of the Legislative Assembly to classify property is equivalent to the limits of the 14th Amendment to the United States Constitution which, by requiring equal protection of the laws, precludes purely arbitrary classification. The court stated "It is obvious to this court that the manner or method by which mineral rights are severed from the surface of the land cannot be made the full basis of the classification of such mineral rights for taxation purposes."

In 1953 another attempt was made to impose a tax to eliminate severed mineral interests. This time, the attempt was made to avoid the Supreme Court's conclusion that tax cannot be levied against only severed mineral interests. The Legislative Assembly passed a bill that would have taxed all mineral interests and conveyed severed mineral interests to the owners of the surface estate in the event of tax foreclosure. The bill was vetoed by the Governor, who pointed out that the opportunity for the surface owner to regain mineral interests would be at the expense of property owners who had retained their mineral rights and who would have been taxed on those interests.

A mineral tax of 25 cents per acre for severed mineral interests would have been imposed by 1981 Senate Bill No. 2421. The bill was defeated in the Senate.

A mineral tax of 25 cents per acre, which could be increased to 35 cents per acre by the board of county commissioners, would have been imposed by 1983 Senate Bill No. 2410. The bill was defeated in the Senate.

A tax of 25 cents per acre on severed mineral interests would have been imposed by 1989 House Bill No. 1361. The bill was withdrawn before its first committee hearing.

In addition to the constitutional impediments to imposing a tax on severed minerals, numerous practical problems exist. According to an attorney engaged in oil and gas title work, there are more than 70,000 square miles of property in the state for which title work would be required if severed mineral interests were taxed and there are approximately 2.5 million severed mineral interest owners who would need to be identified and taxed by county officials. The potential existence of severed mineral interests under city lots, rights of way, lakes and streams, and platted lands would further complicate the title work and administrative problems. In addition to administrative problems for county officials, title attorneys working for the oil and gas industry would face an increased workload because it would be necessary to check the status of paid or unpaid taxes on severed mineral interests. This increase in title work and the resulting increase in costs would cause counties and the oil and gas industry to oppose legislation to impose taxes on severed mineral interests.

SEVERED MINERALS TAXES IN OTHER STATES

It was requested that this memorandum review provisions of law in Colorado and any other states that impose taxes on severed mineral interests. Contacts with officials in other states have not provided any reliable information on whether the following provisions of law are enforced in other states and how effective they are in reuniting severed mineral interests with the ownership of the surface estate.

2005

The following is a summary of provisions of law in other states which we have been able to identify.

Colorado

Colorado imposes a property tax on severed mineral interests. The owner of the surface estate from which a mineral interest has been severed may require the assessor of the county to assess and tax severed mineral interests underlying the property (Colorado Revised Statutes (CRS) 39-1-104.5). If property taxes on severed minerals remain unpaid, upon a sale of the tax lien for the severed mineral interests, the surface owner has the right of first refusal to acquire the mineral interests.

Colorado property taxes on severed mineral interests are imposed at different rates depending on whether the property is producing oil and gas. Nonproducing severed mineral interests are valued at 29 percent of actual value in the same manner as other real property (CRS 39-1-104). The valuation for assessment of producing oil and gas properties is set by the legislature and is determined by reference to the prior year's production and a specified year's prices (CRS 39-1-103, 39-1-104, 39-7-102).

Alabama

Alabama levies a stamp tax upon recording of every lease, deed, instrument, transfer, or evidence of sale of severed mineral interests. The rate of the tax is 5 cents per acre conveyed for terms of 10 years or less, 10 cents per acre for terms of 10 years to 20 years, and 15 cents per acre for terms of more than 20 years. The tax must be paid before an instrument may be recorded so there is no possibility of forfeiture of the property to reunite the surface and mineral estates.

Florida

Florida law subjects subsurface mineral rights to separate taxation. Subsurface mineral rights that have been sold or otherwise transferred or acquired by reservation are treated as an interest in realty subject to taxation separate and apart from the surface ownership of the property.

Indiana

Indiana law provides that all property in the state is subject to taxation unless expressly exempt. Indiana law defines real property to include an estate, right, or privilege in mines or minerals, if the estate, right, or

privilege is distinct from the ownership of the surface of the land.

Kentucky

Kentucky law requires all property to be assessed at its fair cash value. The Kentucky Revenue Cabinet values and assesses unmined coal, oil, and gas reserves, and any other mineral or energy resources owned, leased, or otherwise controlled separately from the surface real property, at no more than fair market value in place.

Mississippi

Mississippi imposes a stamp tax on filing and recording of any instrument relating to leasing, conveying, transferring, excepting, or reserving a mineral or royalty interest. The rate of tax is three cents per acre for a term of 10 years or less, six cents per acre for a term of 10 years to 20 years, and eight cents per acre for a term of more than 20 years. Like the Alabama stamp tax, there is no possibility of forfeiture to reunite the surface and mineral estates.

New Mexico

New Mexico imposes a tax on each person owning a complete or fractional interest in any oil, gas, or carbon dioxide at the time of production. The tax is imposed on the assessed value, which is an amount equal to 150 percent of the value of the product after deductions for royalties and transportation and application of the uniform assessment ratio for property. The rate of the tax is different in each taxing district because the rate applied is the property tax rate for nonresidential property in the taxing district.

Ohio

Ohio law provides for imposition of property taxes on mineral rights owned separately from the surface.

Tennessee

Tennessee law provides for imposition of property taxes against mineral interests and all other interests in real property which are owned separately from the surface estate.

Texas

Texas law provides for assessment and taxation of taxable leaseholds, mineral interests not being produced, and oil or gas interests.

TESTIMONY 7

Northern Alliance *of* **INDEPENDENT PRODUCERS**

January 4, 2009

Chairman Belter and Members of the Finance and Taxation Committee

The Northern Alliance opposes HB 1281, which mandates the taxation of severed minerals and embarks on a cumbersome process for the county recorders and auditors that is unwieldy and unworkable. More specifically, we oppose the bill for the following reasons:

1. The Bill treats gravels and clay differently than other minerals, which is unfair and could produce undesirable results. If severed minerals are to be taxed, then all should be taxed in the same manner.
2. That rate of tax of \$2.00 per acre and the interest rate of 12% is too high, and is confiscatory in nature, imposing unfair burdens on legitimate property ownership in North Dakota. The real purpose of the bill appears to be an effort to restore to the surface owner, something that he did not buy, and does not own.
3. Because of the sometimes fractional nature of severed minerals in North Dakota, the collection of the tax by the County is unwieldy and will impose an enormous burden upon the County Auditor and Recorder's offices.
4. The notice provisions required of the recorder are also unwieldy and unworkable again because of the sometimes fractional nature of severed minerals.
5. Finally, and perhaps most importantly the bill produces an unfair consequence that threatens mineral ownership in North Dakota, and for what end, is unclear. An example will help illustrate the point:
 - a. Grandma died in 1985, owning 1400 acres of land and minerals in McKenzie Co.
 - b. She had 7 children, all of whom had children, most of whom live in ND.
 - c. The farmland was inherited by a son.
 - d. The minerals were "severed" from the farmland in her estate, and distributed to her children with the hope that her farm might someday have an "oil well".
 - e. If any children didn't pay the taxes, then their brother (as the surface owner) would have the right to "redeem" and eventually own the family minerals.

We recommend a DO NOT PASS on HB 1281.

TESTIMONY 8



**Testimony of Jeb Oehlke
House Bill 1281
February 4, 2009**

Mr. Chairman and committee members my name is Jeb Oehlke. I represent the North Dakota Chamber of Commerce, the principle business advocacy group in the state. Our organization is an economic and geographical cross section of North Dakota's private sector and also includes state associations, local chambers of commerce, development organizations, convention and visitors bureaus and public sector organizations. For purposes of this hearing we also represent fifteen local chambers with total membership over 6,500 members. A list of those associations is attached. As a group we stand in opposition to HB 1281 and urge a Do Not Pass recommendation from the committee.

Owning a mineral interest in land is not the same as owning the surface estate. The surface estate is readily available for development, agricultural production, recreation, etc. However, the mineral interest in land is intangible. You cannot build a house and raise your children on your mineral interest. You cannot farm your mineral interest. You cannot go camping and hunting on your mineral interest. The value of a mineral interest comes to its owner when the minerals are removed from the ground, which is currently when taxes are levied on those minerals, and the taxes paid at that time are significant.

One aim of this bill is to double bill property taxes by taxing an intangible interest in land as well as the surface estate, but only if they are owned by separate individuals. The individual who owns both the surface estate and the mineral interest will only have to pay property taxes on the surface estate.

The other intention of this bill, from my reading of it is to punish those individuals who own a mineral interest in land, but do not live on the land. Many of the title searches for mineral leases require tracking down the owners, or partial owners, of mineral interests who may not even realize they own it. It was something retained in the sale of the land generations ago and since then has been split several ways by deed, will, or intestate succession. If this bill were to pass these owners, who are not easily ascertainable, would likely become delinquent in their property taxes because they would have no notice that any property taxes were due. They would end up being deprived of a property right which was rightfully theirs without even receiving notice that the property right was being taken away.

We urge this committee to send HB 1281 out of committee with a Do Not Pass recommendation. I am happy to answer any questions.

THE VOICE OF NORTH DAKOTA BUSINESS



The following chambers are members of a coalition that support our 2009 Legislative Policy Statements:

- Beulah Chamber of Commerce – 130 members
 - Bismarck-Mandan Chamber of Commerce – 1,200 members
 - Chamber of Commerce of Fargo Moorhead – 1,800 members
 - Devils Lake Area Chamber of Commerce
 - Grafton Area Chamber of Commerce
 - Greater Bottineau Area Chamber of Commerce – 155 members
 - Harvey Area Chamber of Commerce
 - Hettinger Area Chamber of Commerce – 145 members
 - Jamestown Area Chamber of Commerce – 360 members
 - Kenmare Association of Commerce
 - Minot Chamber of Commerce – 700 members
 - North Dakota Chamber of Commerce – 1100 members
 - Oakes Area Chamber of Commerce – 170 members
 - Wahpeton Breckenridge Chamber of Commerce – 290 members
 - Williston Chamber of Commerce – 450 members
- Total Businesses Represented = 6,500 members

THE VOICE OF NORTH DAKOTA BUSINESS