

FISCAL NOTE
Requested by Legislative Council
01/13/2015

Bill/Resolution No.: HB 1221

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

	2013-2015 Biennium		2015-2017 Biennium		2017-2019 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues						
Expenditures						
Appropriations						

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

	2013-2015 Biennium	2015-2017 Biennium	2017-2019 Biennium
Counties			
Cities			
School Districts			
Townships			

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

HB 1221 changes the provisions of the ND Uniform Principal and Income Act relating to a trust's allocation between principal and income of receipts from interests in minerals or other natural resources.

- 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.*

HB 1221 does not have any fiscal impact.

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 or a part of the appropriation is included in the executive budget or relates to a continuing appropriation.*

Name: Kathryn L. Strombeck

Agency: Office of Tax Commissioner

Telephone: 328-3402

Date Prepared: 01/21/2015

2015 HOUSE ENERGY AND NATURAL RESOURCES

HB 1221

2015 HOUSE STANDING COMMITTEE MINUTES

Energy and Natural Resources Committee Pioneer Room, State Capitol

HB 1221
1/23/2015
22442

☐ Subcommittee
☐ Conference Committee

Amanda Muscha

Explanation or reason for introduction of bill/resolution:

Relating to a trustee's allocation of receipts from interests in minerals and other natural resources.

Minutes:

Marshall W. McCullough Testimony #1

Chairman Porter: Called the hearing on HB 1221 to order

Representative Keiser: If you inherited through a trust the royalties from a producing well, how much money would you get? If it paid 50,000 this year how much would you get? You would get 10%. From a policy stand point it is an individual's money. In 1999 we adopted one of those uniform code acts. In that without any allocation discussion was the allocation formula which is 1090. 10% can be given out to the individual from the trust and 90% has to be put back into the principle in the trust. It was a very different time then. What this bill does, is it asks for an adjustment to the allocation formula and it almost reverses it. As you can see on lines 8 and 9 to the extent of the trustee accounts for receipts from an interest in minerals or other natural resources pursuant to this section, the trustee shall allocate them as follows, and the key part of this legislation is subsection d, if an amount is receive from a working interest or any other interest not provided for in subdivision a, b, or c, 15% of the net amount received must be allocated to principle and the balance to income. This is a formula and the person receiving the payments they certainly can make decisions what they want to do with their part. There is considerable language later in the bill with a lot of changes occurring. They are only technical changes. This bill is so complex, the concept, I brought 2 attorneys.

Chairman Porter: On page two in sub 5 we are not going to touch that group that the uniform law was in effect from August to this coming August, so then the net effect are really August of 15 but the next portion down all of those individuals can petition the court and have their trusts adjusted based on a petition?

Representative Keiser: I will let the attorneys answer that. I believe it could be possible. I forgot to mention that today, out in the oil basin, a lot of the new developments coming online are already going to attorneys saying hey this is what the law says and the law does allow and exclusion if it is in the contract. So there are existing contracts in our state that follow what is being proposed here. They have the foresight to take to the attorneys in

setting up the trusts so the allocation is different and this is a default provision. This uniform code is a default provision. If you do not address it in the trust it defaults to this rate. There is a very technical relationship between wells and distribution that are preexisting and ones that were existing, future.

Marshall McCullough: See testimony #1

Representative Keiser: If I read the chart correctly, in North Dakota the pre 99 law then have an allocation formula of 72.5 to 27.5 it would not be 8515 but it is much closer.

Marshall McCullough: The 72.5% was income and 27.5% was principle. In 99 it switched to almost the opposite in 9010. Wyoming, another oil producing state has saved about an original amount of 72.5 and 27.5 so they have never change to the 9010 rule.

Chairman Porter: Basically then three categories that this will create. If the person that created the trust put the minerals in the trust and they're still alive, can they elect then to redo their trust then and start over?

Marshall McCullough: There are two types of trusts, revocable and irrevocable. If it is a revocable living trust which is kind of like a will substitute it is used to avoid probate that individual could go in and amend the trust. There are irrevocable income only trusts where you put the minerals in, maybe reserve the right to receive the income saving the principle trying to protect it for future generations, because it is irrevocable they could not go back and change that trust. There is no petition available to the courts to go and change the irrevocable. A few years ago when they passed the uniform trust act and there is an authority to go back and petition to the court to change an irrevocable trust typically in the consent of the trust or the person that created it, the trustee, the person managing it, and ultimately the beneficiaries because you are changing something that was given to them. There is a mechanism yes.

Chairman Porter: So inside of this act since this is just the end default language if it has not been addressed by an attorney or the individual, or a contract. What percentage of trusts is out there that may just have fallen back to the default status and used this language?

Marshall McCullough: I think the majority of trusts have used the default language. If you read the language of the trust it just says pay the income to the income beneficiary typically there is not a further provision on that income unless there is a retirement plan asset of a 401K or IRA that someone has passed away and is then in the trust. When it comes to the actual language on a mineral interest we don't see the language allocating what income is and what income is and what principle. The trust companies are aware of it, they deal with it every day but a lot of trusts are created in a will that have a brother or sister, son or daughter, someone else be a trustee and it is the non corporate trustees that aren't looking there at the aware of the uniform principle and income act and they are automatically giving 100% of the income.

Chairman Porter: If you use the provision to go back in and petition the court and ask for an adjustment or change even based on the law was changed and I would like to update to the current law of what we are doing. Are the IRS penalties that then apply to that trust?

Marshal McCullough: Typically the IRS does not apply a penalty if it is a court approved change. There are issues where the trustees have been paying 100% of the income to income beneficiary for several years and it came to the attention of one of remainder men that while saying 90% of this money that was paid out should be mine. When it is negotiated there will be IRS consequences because basically the trust returns have been filled out incorrectly, there will be rate differentials, income that goes out to an individual, the income beneficiary that's taxed it there income tax rate, personal income tax rate, but 90% that would remain in the trust would be taxed at a trust tax rate and for IRS purposes a trust has a very consolidated rate so it would be at a higher tax. Because the money was paid out, tax was paid on it by the individual rate but it was at a lower rate so there may be penalties and interests applied.

Representative Nathe: What was the thinking behind going from the 72.5% to the 90%?

Marshal McCullough: We look back through the legislative history and we didn't see it being discussed. The uniform principle and income act was proposed by the uniform committee, and when it came to the legislature minerals were not a big deal then.

Representative Keiser: Was the 72.5 out of a previous uniform act?

Marshal McCullough: Yes

Representative Keiser: So the numbers were passed and then people began to realize they would not work everywhere?

Marshal McCullough: On page two of the bill, paragraph four is where we are trying to address the situation of the new trust created after August 1st 2015 as well as any trusts that has not yet received receipts from minimal interests. Those would fall under this new provision of the 8 15 split. On paragraph 5 that would be the pre 1999 trustee before change to 90 10. These trusts could continue in the manner that they were doing before 1999 when the 90 10 split came in. They were allowed under the old law that they could petition the court or the trustee actually had discretion to go ahead and use the new law if they wanted to. We are not changing any of those existing trusts that were in place before 99 would continue to operate exactly as they have in the past. The subparagraph b would be the August 1st of 1999 through the enactment of this would continue with the 90 10 language there would be no change to any of those trusts. They wouldn't have to go back and recapture that income. They wouldn't have to change the recording, they would continue on. If any of them wish they could go to the court (paragraph 6) and petition there if they wish to follow the new 85 15.

Chairman Porter: On 6b line 26 using intent language is that going to be confusing to the courts and allow here say or this is what dad said to me. How is that viewed by the courts using intent language?

Marshal McCullough: The factor here and we put the intent of the settler and that is the individual that created the trust would be if they are still alive. If you did the irrevocable, you are still alive you could go in and petition the court yourself. You would have your own consent. No situations where the trustee is alive he would then testify with the court. If the

trustee has passed then it would be here say if the judge would allow that. Sometimes those families know what they want.

Chairman Porter: Do we need to clarify that?

Marshal McCullough: We could clarify would be the intent of the settler or the testimony of the settler.

Chairman Porter: Just looking at what could happen if the individual had passed. If an argument happened I don't know how that would be resolved.

Marshal McCullough: Sometimes there are handwritten documents, and the judge would determine if he would listen to one side or the other or just throw it out there.

Chairman Porter: This whole component sensed is in front of a judge you think is ok the way it is?

Marshal McCullough: Yes

Chairman Porter: Unless let the judge here both sides and no one cannot prove anything then he is not going to use sub b as part of his decision?

Marshal McCullough: Yes. He would throw that out as one of the factors and look at the others.

Chairman Porter: He would have that option to do that if it wasn't clear?

Marshal McCullough: Yes.

Representative Keiser: It is at that level of finding a fact and always appealable to a higher court. The judge doesn't take it casually it has to be a preponderance of the evidence that supports whether it is verbal or written. The language is fine; it is the standard language for this kind of transaction.

Representative Lefor: So there is a 100,000 check, under current law 90,000 goes to principle and 10,000 go to income. Giving the tax consequences of it going to principal are we just moving an asset over if there are tax consequences on the principle right away?

Marshal McCullough: There are tax consequences on the principle in the year that the mineral interests are received by the trust the 15% that is paid out to the income beneficiary the trust gets a deduction for that amount and the 15% is picked up on the individual's tax returner here and the 85% would be picked up. The portion that remains in the trust is taxed within the trust and that has the compressed rates. The 15% tax bracket is about 0-2000 is taxed at 15 2000-4000 is about 25 and 28 but 12000 of the income is at the maximum trust rate.

Representative Lefor: Who loses if we change this law?

Marshal McCullough: The only person losing would be the remainder beneficiaries in the trust. Right now they would be looking at being entitled to 90% of that mineral interest that comes in when the income beneficiary ultimately passes away.

Representative Hunsakor: If I was in a trust and there were 100,000, my income would shift from 10,000 to 85,000?

Marshal McCullough: Your personal income, yes.

Representative Hunsakor: So are there many cases like that out there and would there be a rush to the courts?

Marshal McCullough: It really comes back to the intent. Where was the income to end up when the trust was created in the individual that was to receive the income then has the tax liability that goes with that? We are seeing when someone wants their income to their self they are considering 85% of that amount to be their income, but if you had set up a trust in the past where you were only seeing 10% of the income this act would not effect that. This wouldn't effect that existing trust; you would still be under the old law. Ultimately it would have no effect unless you went to the judge and asked to change.

Representative Keiser: It is important to recognize this is the default provision. It does not preclude me as a establishing a trust I can set 10 90, 5 95, 50 50, I can do whatever I want. This is what is happening to people who did not realize that we had a default provision in statute and it wasn't the intent if the person setting up the trust.

Marshal McCullough: The factors in paragraph 6 where those were taken is in the uniform principle in the income act there was a provision that was not adopted when we adopted the principle and income act that did allow for an adjustment and these were factors. It was listed that the trustee would be able to take these into consideration when they are adjusting and could adjust the income. We felt that we didn't think the trustee should have the power to do that. It should be something that is handled through the court system. That is where those factors came from. There were listed in the principle and income act as considerations.

Jacob Gierman: I am an associate attorney at the Ohnstad Twichell Lawfirm working with Marshal. This bill would do a lot of good in terms of matching the default rule to what most people would expect when they create a trust. The substantive change is we are striking 90 and replacing with 15 in two places. The discussions related to how does this apply to current trusts? The ultimate decision was that there would be a danger if we applied it to all trusts that would create major increases income payments on trusts that had been paying out 10% as income. If we switched that to 85 it could create some problems. We are applying it to new trusts created but that current trusts simply haven't been paying income out already anyways. On page 2 lines 10-19 there is a lot of language there but the language is really trying to capture what current law is already doing. For pre 1999 trusts the rule is the same as before. B is technically a new provision of law but what it is doing is saying the 90 10 rule has been in effect from 99 to 2015 and that is a fact. All we are doing is saying if the minerals were acquired in that period we are not going to change that either, we are just going to lock in the 90 10 rule because that is the most reasonable at the time to not drastically change interests. The big point is that section 6, rather than giving the

trustee power which some could argue and probably rightfully so that it might be too much power to give one trustee to be able to change things, it gives a release mechanism where no matter what rule applies you can still go to the court. This comes down to expectations and what most people expect. Changing to 100% that is not similar to other states. 85 15 is a reasonable balancing of the interest than 90%.

Chairman Porter: This bill is exactly why I do not like putting contract law in the century code because the default belongs to us. That is why people need to create their own contracts and situations on their own. It is not our job to create contracts.

Representative Keiser: Motioned a do pass

Representative Mock: Seconded the motion

A roll call vote was taken: Yes 12, No 0, Absent 1 (Representative Froseth)

The bill was passed through committee

Representative Nathe will carry the bill

**2015 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 1221**

House Energy and Natural Resources Committee

☐ Subcommittee

Recommendation: ☐ Adopt Amendment
☒ Do Pass ☐ Do Not Pass ☐ Without Committee Recommendation
☐ As Amended ☐ Rerefer to Appropriations
☐ Place on Consent Calendar
Other Actions: ☐ Reconsider ☐ _____

Motion Made By Keiser

Seconded By Mock

Representatives	Yes	No	Representatives	Yes	No
Chairman Porter	X		Rep. Bob Hunsakor	X	
Vice Chairman Damschen	X		Rep. Corey Mock	X	
Rep. Dick Anderson	X		Rep. Naomi Muscha	X	
Rep. Roger Brabandt	X				
Rep. Bill Devlin	X				
Rep. Glen Froseth	-----				
Rep. Curt Hofstad	X				
Rep. George Keiser	X				
Rep. Mike Lefor	X				
Rep. Mike Nathe	X				

Total (Yes) 12 No 0

Absent 1 (Froseth)

Floor Assignment Nathe

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

REPORT OF STANDING COMMITTEE

HB 1221: Energy and Natural Resources Committee (Rep. Porter, Chairman)
recommends **DO PASS** (12 YEAS, 0 NAYS, 1 ABSENT AND NOT VOTING).
HB 1221 was placed on the Eleventh order on the calendar.

2015 SENATE ENERGY AND NATURAL RESOURCES

HB 1221

2015 SENATE STANDING COMMITTEE MINUTES

Energy and Natural Resources Fort Lincoln Room, State Capitol

HB 1221
3/26/2015
25457

☐ Subcommittee
☐ Conference Committee

Committee Clerk Signature

Katie Oliver

Explanation or reason for introduction of bill/resolution:

Relating to a trustee's allocation of receipts from interests in minerals and other natural resources.

Minutes:

1 Attachment

Chairman Schaible called the committee back to order. Representative George Keiser was on hand to introduce the bill.

Representative Keiser: District 47. I am going to be introducing the concept but will direct all technical questions to the speaker who will follow me. In 1999 adopted the uniform principal and income act, prior to the adoption of that uniform act we were allocating trusts and the formula was that you can have 72.5% of the income allocated to the owner of the income of the trust and 27.5% would be allocated for principal. That changed when we adopted the uniform standard in 1997. The law was changed that only 10% of the income can be allocated to the recipient of the trust income and 90% had to go to principal. That was providing that in the trust agreement that a different allocation formula would occur. This bill will propose the change that up to 85% can be allocated to income and 15% would be allocated to the principal. From the House perspective we believe if it is your money it is your money, most people that fall under this provision of law can only get a certain amount.

Jacob Geierman: Attorney with Ohnstad Twichell. Presenting testimony for Marshall W. McCullough. See attachment #1. (3:54-15:30)

Senator Hogue: This is to address the default rule, what is your experience with the trusts that are set up by estate planning lawyers? Don't they have some sort of default rule in the trust document that the trustee can invade their principal in a discretionary manner or is that not the case?

Jacob Geierman: That is fairly commonly the case. Generally the common provision we would use is for support. It comes down to the trust document itself. The most common provision is to pay all income to the beneficiary so the follow-up questions is does the document define income. When I draft these documents it does, the most common provision is an 85%/15% split. I think that answered your question.

There was no further discussion and Chairman Schaible closed the public hearing on HB 1221

2015 SENATE STANDING COMMITTEE MINUTES

Energy and Natural Resources Fort Lincoln Room, State Capitol

HB 1221
4/2/2015
25754

- ☐ Subcommittee
☐ Conference Committee

Committee Clerk Signature

Katie Ainsley

Explanation or reason for introduction of bill/resolution:

Relating to a trustee's allocation of receipts from interests in minerals and other natural resources.

Minutes:

Senator Hogue: this represents significant policy change but a good policy change. It is in line with the expectations of most people who are creating trusts. I think that it is a good bill, the only concern I have is on page 2 subsection 6 of the bill. I am not clear if a trustee can make those changes before the date that was listed, August 1, 2015. The court would have to consider the factors that are on line 25-31 on page 2, lines 1-11 on page 3. The reason it is a major policy change is for those instances when you have the remainder interest and the light interest they are going to be affected differently. I think that most people would accept the idea that if I got income royalty from a producing well or if it is a producing water well or some other natural resource that when the money comes in 90% of it should not be allocated to the corpus of the trust. One trustee pointed out to me that this might be a fiscal impact; it is done differently than the income. If you make the shift that this is proposing and it would be modest. I think that it is a good bill.

Senator Murphy: As I do not have much experience in dealing with trusts, if someone would be so kind as to give me a brief explanation.

Senator Hogue: This applies to trusts set up by attorneys and how will income be allocated. Often times the trust would say that they want the money to incorporate but the trustee is authorized the income that the trust is generating. So now a royalty check is comes in and is it income or principal? What the bill is saying is in the abuses of specifications and what the corpus of the trust is. In the absence of instructions and only 15% is only applies to certain trusts after July 1, 2015.

Senator Hogue made a motion for a do pass with a second by Senator Triplett, there was no further discussion, roll was taken and the motion passed on a 7-0-0 count with Senator Hogue carrying the bill to the floor.

Senate Energy and Natural Committee

HB 1221

04/02/2015

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There was no further discussion and Chairman Schaible closed the committee work on HB 1221.

**2015 SENATE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 1221**

Senate Energy and Natural Resources Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number _____

Action Taken Do Pass

Motion Made By Senator Hogue Seconded By Senator Triplett

Senators	Yes	No	Senators	Yes	No
Chairman Schaible	X		Senator Murphy	X	
Vice Chair Unruh	X		Senator Triplett	X	
Senator Armstrong	X				
Senator Hogue	X				
Senator Laffen	X				

Total (Yes) 7 No 0

Absent 0

Floor Assignment Senator Hogue

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

REPORT OF STANDING COMMITTEE

HB 1221: Energy and Natural Resources Committee (Sen. Schaible, Chairman)
recommends **DO PASS** (7 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING).
HB 1221 was placed on the Fourteenth order on the calendar.

2015 TESTIMONY

HB 1221

MEMORANDUM

1

To: House Energy and Natural Resources Committee
 From: Marshall W. McCullough
 Date: January 23, 2015
 Re: HB 1221



Mr. Chairman and Members of the Committee,

I currently serve as President of the law firm of Ohnstad Twichell in West Fargo, North Dakota. My practice areas include estate planning, probate, and business law. I have practiced law for over 20 years in the State of North Dakota. I, and many others practicing in the estate planning field, have come to recognize an issue relating to the Uniform Principal and Income Act found at NDCC §59-04.2-19, addressing principal and income allocations made by a trustee with regard to royalty and other mineral-related receipts.

Absent specific language in a trust instrument, such statute requires the trustee to allocate 90% of most mineral-related receipts to principal and only 10% to income. My position, and the position of many of my peers, is that such a small portion actually being considered "income" is not what the general public would expect when creating a trust. Therefore, we are now advocating for an amendment to such provision of law to make the default rule more closely match the general public's expectations and also be more in line with the approaches taken by a number of other states with significant oil and gas industries. The following chart helps to show the proposed change in the context of previous North Dakota law and the approaches taken by other states:

Law	Allocate to Income	Allocate to Principal
Pre-1999 ND Law (NDCC § 59-04.1-09 repealed)	72.5%	27.5%
Current ND Law (NDCC § 59-04.2-19)	10%	90%
HB 1221 (Proposed)	85%	15%
MT, TX, OK, KS, NM, NY ¹	85%	15%
WY (W.S. 1977 2-3-821)	72.5%	27.5%
PA (20 Pa.C.S.A. 8151)	66.67%	33.33%

¹ Montana (MT ST 72-34-443); Texas (V.T.C.A. Property Code 116.174):("Equitably. . . presumed to be equitable if the amount allocated to principal is equal to the amount allowed by the Internal Revenue Code of 1986 as a deduction for depletion of the interest." Therefore, currently 15% to principal and 85% to income would be presumed "equitable" under this definition); Oklahoma (60 Okl.St. Ann. 175.411); Kansas (KS ST 58-9-411); New Mexico (N.M.S.A. 1978, 46-3A-411)(Amount that is allowed as a deduction from gross income for depletion purposes under the federal income tax law in effect at the time of severance to principal (currently 15%) and remainder to income (therefore currently 85%)); New York (EPTL 11-A-4.11).

The allocation provisions in the 1999 Act for mineral-related receipts were a significant departure from previous North Dakota law. Under the previous statute, a trustee was required to make an allocation to principal in the amount of "twenty-seven and one-half percent of the gross receipts, but not to exceed fifty percent of the net receipts remaining after payment of all expenses, direct and indirect computed without allowance for depletion." The 1999 change which is now current law is found at § 59-04.2-19. As you can see in the above chart, the 1999 bill essentially reversed the allocation rule and provides that 90% of the gross receipts must be allocated to principal and the balance of 10% must be allocated to income.

The change which is suggested within HB 1221 is to adopt the current depletion allowance allowed under the federal income tax code as the amount to be credited to principal (15%) and the balance (85% percent) to be allocated to income. The suggested change that will be made if HB 1221 is adopted simply strikes "ninety" from lines 16 and 19 of the existing Act and inserts in its place "fifteen".

While I believe 85% to income and 15% to principal to be a fair and reasonable balancing of the interests of the income and remainder beneficiaries, if the Committee is uncomfortable with such a significant change in the default rule, the approach taken by Wyoming would essentially reinstate North Dakota law before the 1999 Act, and would also be a more reasonable balancing of interests than the current rule.

Also important to note is that HB 1221 includes specific provisions relating to application of the statute to trusts currently in existence. The new allocation provisions would apply to all new trusts created after the effective date of the bill. It is my opinion that it would not be advisable to retroactively apply this revised allocation rule in a manner that immediately and drastically changes the interests of the beneficiaries. On the other hand, only applying prospectively fails to address problems for trusts created before enactment of HB 1221. Therefore, a more nuanced approach is suggested.

In subsection 4, the bill requires that, for trusts that have not received receipts from an interest in minerals, water, or other natural resources before August 1, 2015, the trustee shall allocate receipts under the new allocation provisions.

In subsection 5, the bill creates two sub-rules that closely match the provisions of current law. For trusts owning an interest in minerals, water, or other natural resources before August 1, 1999, the trustee is given discretion to allocate receipts in the manner used by the trustee before August 1, 1999, or as permitted by law in effect on August 1, 1999. For trusts that acquired an interest in minerals, water, or other natural resources after August 1, 1999, but before August 1, 2015, the trustee is required to allocate receipts in the manner required by law in effect on August 1, 1999.

In subsection 6, the bill allows a trustee to petition a court to modify the manner used to allocate receipts under the section. Subsection 6 lists a number of factors the court may consider in determining whether and to what extent the manner used to allocate receipts should be modified.

In summary, I believe the suggested changes in HB 1221 to be more consistent with the reasonable expectations of the general public creating a trust while, at the same time, adequately balancing the interests of income and remainder beneficiaries.

Marshall W. McCullough
President, Ohnstad Twichell Law Firm
West Fargo, North Dakota

To: Senate Energy and Natural Resources Committee
From: Marshall W. McCullough, President
Ohnstad Twichell Law Firm, West Fargo, ND
Date: March 26, 2015
Re: HB 1221



Mr. Chairman and Members of the Committee,

I currently serve as President of the Ohnstad Twichell Law Firm in West Fargo, North Dakota. My practice areas include estate planning, probate, and business law. I have practiced law for over 20 years in the State of North Dakota. I, and many others practicing in the estate planning field, have come to recognize an issue relating to the Principal and Income Act found at NDCC § 59-04.2-19, addressing principal and income allocations made by a trustee with regard to royalty and other mineral-related receipts.

Absent specific language in a trust, this statute requires the trustee to allocate 90% of most mineral-related receipts to principal and only 10% to income. My position, and the position of many of my peers, is that such a small portion actually being considered “income” is not what the general public would expect when creating a trust. Therefore, we are now advocating for an amendment to such provision of law to make the default rule more closely match the general public’s expectations and also be more in line with the approaches taken by a number of other states with significant oil and gas industries. The following chart helps to show the proposed change of HB 1221 in the context of previous North Dakota law and the laws of other states:

Law	Income	Principal
Pre-1999 ND Law (NDCC § 59-04.1-09 repealed)	72.5%	27.5%
Current ND Law (NDCC § 59-04.2-19)	10%	90%
HB 1221 (Proposed)	85%	15%
MT, TX, OK, KS, NM, NY ¹	85%	15%
WY (W.S. 1977 2-3-821)	72.5%	27.5%
PA (20 Pa.C.S.A. 8151)	66.67%	33.33%

¹ Montana (MT ST 72-34-443); Texas (V.T.C.A. Property Code 116.174): (“Equitably. . . presumed to be equitable if the amount allocated to principal is equal to the amount allowed by the Internal Revenue Code of 1986 as a deduction for depletion of the interest.” Therefore, currently 15% to principal and 85% to income would be presumed “equitable” under this definition); Oklahoma (60 Okl.St. Ann. 175.411); Kansas (KS ST 58-9-411); New Mexico (N.M.S.A. 1978, 46-3A-411) (Amount that is allowed as a deduction from gross income for depletion purposes under the federal income tax law in effect at the time of severance to principal (currently 15%) and remainder to income (therefore 85%)); New York (EPTL 11-A-4.11).

As shown in the above chart, the 1999 Act was a significant departure from pre-1999 law. Under the previous statute, a trustee was required to make an allocation to principal in the amount of “twenty-seven and one-half percent of the gross receipts, but not to exceed fifty percent of the net receipts remaining after payment of all expenses, direct and indirect computed without allowance for depletion.” The 1999 bill essentially reversed the allocation rule and provides that 90% of the gross receipts must be allocated to principal and the balance of only 10% must be allocated to income.

The change within HB 1221 is to adopt the 15% depletion allowance allowed under the federal income tax code at 26 U.S.C. § 613 as the amount to be allocated to principal and the remaining 85% to be allocated to income. The suggested change that will be made if HB 1221 is adopted simply strikes “ninety” from lines 16 and 19 of the bill and inserts in its place “fifteen”.

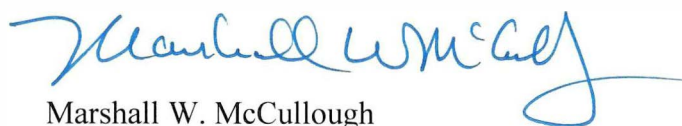
It is my opinion that it would not be advisable to retroactively apply this revised allocation rule to current trusts in a manner that immediately and drastically changes the interests of the beneficiaries. On the other hand, only applying prospectively fails to address problems for trusts created before enactment of HB 1221. Therefore, a more nuanced approach is contained within HB 1221.

In subsection 4, the bill requires that, for trusts that have not received receipts from an interest in minerals, water, or other natural resources before August 1, 2015 (the effective date of the Act), the trustee is required to allocate receipts under the new allocation provisions.

In subsection 5, the bill creates two sub-rules that closely match the provisions of current law. For trusts that owned an interest in minerals, water, or other natural resources before August 1, 1999, the trustee is given discretion to allocate receipts in the manner used by the trustee before August 1, 1999, or as permitted by law in effect on August 1, 1999. For trusts that acquired an interest in minerals, water, or other natural resources after August 1, 1999, but before August 1, 2015, the trustee is required to allocate receipts in the manner required by law in effect on August 1, 1999.

In subsection 6, the bill allows a trustee to petition a court to modify the manner used to allocate receipts under the section. Subsection 6 lists a number of factors the court may consider in determining whether and to what extent the manner used to allocate receipts should be modified.

In summary, I believe the suggested changes in HB 1221 to be more consistent with the reasonable expectations of the general public creating a trust while, at the same time, adequately balancing the interests of income beneficiaries and remainder beneficiaries. As such, I respectfully ask the Committee to give a “Do Pass” recommendation.


Marshall W. McCullough

March 24, 2015

Senate Energy and Natural Resources Committee
Chairman Donald Schaible
State Capitol
600 East Boulevard
Bismarck ND 58505-0360

Re: HB 1221

Dear Chairman Schaible:

I am writing in favor of HB 1221. Based on my experience as a lawyer involved in estate planning, probates, trust creation and administration in Western North Dakota over the past 15 years, I believe this bill comes closer to the mineral interest owners' understanding and desire that any money coming from the ownership or production of their minerals will be paid out as income to the beneficiaries of the Trust.

I have worked with mineral interest owners in Western North Dakota and all over the world relating to protecting and succession planning for their North Dakota mineral interests. From 2000 to 2012, I was an attorney with the McKennett, Stenehjem, Forsberg & Hermanson, P.C. in Williston. In October of 2012, I joined the Vogel Law Firm in Fargo, but more than 50% of my practice still involves representing clients who own mineral interests in Western North Dakota, including Trusts.

I have assisted many clients in preparing Trusts to hold mineral interests. In every situation, we discussed the Principal and Income Act in relation to the withholding of 90% of the net income. Every client I've ever had has chosen to add language to avoid the 90% withholding. While the client may request income be withheld for other specific reasons (Special Needs, minor beneficiaries, etc), absent these reasons, they want payment of 100% of the royalty, bonus and any other income as income to the current beneficiaries. I have never had any client, Trustee or beneficiary of a Trust request that any amount of income be withheld as principal based on the Principal and Income Act.

Additionally, I have represented several Corporate Trustees in matters where a Trust was required to withhold 90% of the income under the Principal and Income Act. This happens in two situations: either (1) a Trust that had been in existence for many years without receiving royalty, so the Trustee is now required to withhold 90% of the new royalty income; or (2) the person

March 24, 2015

Page 2

(attorney or otherwise) creating the Trust wasn't aware of the Principal and Income Act and didn't add language allowing 100% payout of the income. This causes a lot of heartache between the Trustee and the beneficiaries, who don't understand why they aren't receiving the income. In these situations, the Trust was required to pay an attorney to cure the situation, usually requiring a Court action because the Trust was irrevocable. In each of these situations, all of the beneficiaries agreed to the distribution of 100% of the royalty as income to the current beneficiaries. The Corporate Trustees that I have represented in these situations have also been in favor of 100% payout of the income.

A change from 90% to 15% could result in more of my clients agreeing to the withholding. The 15% withholding is much more palatable and consistent with the federal depletion amount. It is conceivable that a client would agree that it would be reasonable to hold 15% of the income in the Trust so future beneficiaries would receive some benefit after all of the minerals are depleted. Also, in a situation where an old Trust starts receiving royalty or a Trust is created without addressing the Principal and Income Act, a 15% withholding is reasonable enough that the current income beneficiaries either might not notice or would agree to leave it, rather than spend money on the Court action necessary to change the Trust. However, I don't believe any client or any Trust beneficiary would ever agree to withhold 90% of the income if there is any way to avoid it.

From a tax perspective, if the Trust is required to withhold 90% of the income, the Trust is then required to pay tax on that income. Passing the income on to the beneficiaries can minimize some of those taxes and allows the money to be used. Even in situations where the Trust is receiving significant income, such as \$100,000 per month or more, it is better to pass that income to the beneficiaries so it can be used to benefit others. Several of my clients have used their excess mineral income for charitable purposes, establishing scholarships, charitable foundations, donor advised funds, or supported local, national and international charities, or passed the income on to others. This type of charity is benefitting colleges, churches and other North Dakota institutions all over the state. Keeping the majority of the money circulating benefits everyone.

Thank you for your consideration.

Sincerely,



Valeska A. Hermanson



live first

1600 South Broadway
P.O. Box 1967
Minot, ND 58702-1967
(701) 837-1600
Fax: (701) 837-1610
www.firstintlbank.com
Member FDIC

March 24, 2015

Senate Energy and Natural Resources Committee
Chairman Donald Schaible
State Capitol
600 East Boulevard
Bismarck ND 58505-0360

Re: HB 1221

Dear Chairman Schaible:

I am writing in favor of HB 1221. As a Trust Officer for First International Bank & Trust for the past two years, I am involved in administering Trusts which hold North Dakota mineral interests.

I have administered Trusts in which the 90% withholding was required because either
(1) a Trust that had been in existence for many years began receiving royalty and the Trustee was required to withhold 90% of the income; or
(2) the person (attorney or otherwise) creating the Trust wasn't aware of the Principal and Income Act and didn't add language allowing 100% payout of the income.

These situations have resulted in the Trust spending money to hire an attorney to cure the situation, which usually required a court action to modify the Trust. By paying out the income we would also reduce the tax liability to the trust and would be able to pass this income on to the beneficiaries at their individual tax rates.

Sincerely,

A handwritten signature in black ink, appearing to read 'Tony Watterud', with a horizontal line extending to the right.

Tony Watterud
Trust Officer

Senate Energy and Natural Resources Committee
Chairman Donald Schaible
State Capitol
600 East Boulevard
Bismarck ND 58505-0360

Re: HB 1221


Dear Chairman Schaible:

I am writing in favor of HB 1221. As a Trust Officer for First International Bank & Trust for the past 2 years and 33 years at another bank, I am involved in administering Trusts which hold North Dakota mineral interests.

I have administered Trusts in which the 90% withholding was required because either
(1) a Trust that had been in existence for many years began receiving royalty and the Trustee was required to withhold 90% of the income; or
(2) the person (attorney or otherwise) creating the Trust wasn't aware of the Principal and Income Act and didn't add language allowing 100% payout of the income.

These situations have resulted in the Trust spending money to hire an attorney to cure the situation, which usually required a court action to modify the Trust. By paying out the income we would also reduce the tax liability to the trust and would be able to pass this income on to the beneficiaries at their individual tax rates.

Sincerely,


Mary Dissette
Trust Officer



3001 25th St. S.,
P.O. Box 10938
Fargo, ND 58103
www.firstintlbank.com

Senate Energy and Natural Resources Committee
Chairman Donald Schaible
State Capitol
600 East Boulevard
Bismarck ND 58505-0360



3001 25th St. S.,
PO Box 10938
Fargo, ND 58103
www.firstintbank.com

Re: HB 1221

Dear Chairman Schaible:

I am writing in favor of HB 1221. As a Trust Officer for First International Bank & Trust for the past 6 years, I am involved in administering Trusts which hold North Dakota mineral interests.

I have administered Trusts in which the 90% withholding was required because either
(1) a Trust that had been in existence for many years began receiving royalty and the Trustee was required to withhold 90% of the income; or
(2) the person (attorney or otherwise) creating the Trust wasn't aware of the Principal and Income Act and didn't add language allowing 100% payout of the income.

These situations have resulted in the Trust spending money to hire an attorney to cure the situation, which usually required a court action to modify the Trust. By paying out the income we would also reduce the tax liability to the trust and would be able to pass this income on to the beneficiaries at their individual tax rates.

Sincerely,

A handwritten signature in dark ink, appearing to read 'John K. Stibbe', is written over a horizontal line.

John K. Stibbe, esq.
Senior Vice President
Director of Wealth Mangement



1600 South Broadway
P.O. Box 1967
Minot, ND 58702-1967
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Member FDIC

March 24, 2015

Senate Energy and Natural Resources Committee
Chairman Donald Schaible
State Capitol
600 East Boulevard
Bismarck ND 58505-0360

Re: HB 1221

Dear Chairman Schaible:

I am writing in favor of HB 1221. As a Trust Officer for First International Bank & Trust for the past 24 years, I am involved in administering Trusts which hold North Dakota mineral interests.

I have administered Trusts in which the 90% withholding was required because either
(1) a Trust that had been in existence for many years began receiving royalty and the Trustee was required to withhold 90% of the income; or
(2) the person (attorney or otherwise) creating the Trust wasn't aware of the Principal and Income Act and didn't add language allowing 100% payout of the income.

These situations have resulted in the Trust spending money to hire an attorney to cure the situation, which usually required a court action to modify the Trust. By paying out the income we would also reduce the tax liability to the trust and would be able to pass this income on to the beneficiaries at their individual tax rates.

Sincerely,

A handwritten signature in dark ink, appearing to read 'D. Zaderaka', is written over a horizontal line.

Dean M. Zaderaka
Vice President/Senior Trust Officer



Senate Energy and Natural Resources Committee
Chairman Donald Schaible
State Capitol
600 East Boulevard
Bismarck ND 58505-0360

100 N. Main
PO Box 607
Watford City, ND 58854
701-842-2381
www.firstintlbk.com

Re: HB 1221

Dear Chairman Schaible:


I am writing in favor of HB 1221. As a Trust Officer for First International Bank & Trust for the past three years, I am involved in administering Trusts which hold North Dakota mineral interests.

I have assisted in the administration of Trusts for which the 90% withholding was required because either:

- (1) a Trust that had been in existence for many years began receiving royalty and the Trustee was required to withhold 90% of the income; or
- (2) the person (attorney or otherwise) creating the Trust wasn't aware of the Principal and Income Act and didn't add language allowing 100% payout of the income.

These situations have resulted in the Trust spending money to hire an attorney to cure the situation, which usually required a court action to modify the Trust. By paying out the income, we would reduce the Trust tax liability and be able to pass the income on to the beneficiaries at their individual tax rates.

Sincerely,


Blake Holman
Assistant Trust Officer



Senate Energy and Natural Resources Committee
Chairman Donald Schaible
State Capitol
600 East Boulevard
Bismarck ND 58505-0360

Re: HB 1221

Dear Chairman Schaible:

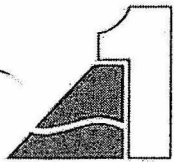
I am writing in favor of HB 1221. As a Trust Officer for First International Bank & Trust for the past 2 years and with a total of 12 years total working this business, I am involved in administering Trusts which hold North Dakota mineral interests.

I have administered Trusts in which the 90% withholding was required because either
(1) a Trust that had been in existence for many years began receiving royalty and the Trustee was required to withhold 90% of the income; or
(2) the person (attorney or otherwise) creating the Trust wasn't aware of the Principal and Income Act and didn't add language allowing 100% payout of the income.

These situations have resulted in the Trust spending money to hire an attorney to cure the situation, which usually required a court action to modify the Trust. By paying out the income we would also reduce the tax liability to the trust and would be able to pass this income on to the beneficiaries at their individual tax rates.

Sincerely,

Daniel W. Branham
Trust Officer
First International Bank & Trust
dbranham@firstintlbank.com



FIRST
INTERNATIONAL
BANK & TRUST

Senate Energy and Natural Resources Committee
Chairman Donald Schaible
State Capitol
600 East Boulevard
Bismarck ND 58505-0360

Re: HB 1221

Dear Chairman Schaible:

I am writing in favor of HB 1221. As a Trust Officer for First International Bank & Trust for the past three years, I am involved in administering Trusts which hold North Dakota mineral interests.

I have administered Trusts in which the 90% withholding was required because either
(1) a Trust that had been in existence for many years began receiving royalty and the Trustee was required to withhold 90% of the income; or
(2) the person (attorney or otherwise) creating the Trust wasn't aware of the Principal and Income Act and didn't add language allowing 100% payout of the income.

These situations have resulted in the Trust spending money to hire an attorney to cure the situation, which usually required a court action to modify the Trust. By paying out the income we would also reduce the tax liability to the trust and would be able to pass this income on to the beneficiaries at their individual tax rates.

Sincerely,

Adam Natwick
Trust Officer
First International Bank & Trust



First National Bank & Trust Co.

Of Williston

TRUST DEPARTMENT

22 East 4th Street • P. O. Box 1827

Williston, ND 58802-1827

Ph. (701) 577-9618 – Trust Department

Ph. (701) 577-2113 – Main Bank

March 24, 2015

Senate Energy and Natural Resources Committee
Chairman Donald Schaible
State Capitol
600 East Boulevard
Bismarck ND 58505-0360

Re: HB 1221

Dear Chairman Schaible:

I am writing in favor of HB 1221. As a Trust Officer for the Bank for the past 24 years, I am involved in administering Trusts which hold North Dakota mineral interests. I have administered Trusts in which the 90% withholding was required because either (1) a Trust that had been in existence for many years began receiving royalty and the Trustee was required to withhold 90% of the income; or (2) the person (attorney or otherwise) creating the Trust wasn't aware of the Principal and Income Act and didn't add language allowing 100% payout of the income. These situations have resulted in the Trust spending money to hire an attorney to cure the situation, which usually required a court action to modify the Trust. In every situation, all beneficiaries agreed to the payout of 100% of the income.

In addition, the payout of the income substantially reduces the income tax consequence to the Trust. A Trust assumes the federal and state income tax liability for all income that is not passed out to a beneficiary. The income maintained in the Trust is currently taxed according to the highest federal and state income tax rates. This can result in a significant income tax liability for a Trust, especially in light of today's high oil production levels. This significant income tax liability greatly reduces the income available to distribute to the beneficiaries.

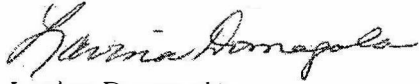
Our sources indicate some financial institutions practicing in North Dakota are against HB 1221, in an effort to hold the 90% in their financial institution to maintain or increase their fee base. This financial institution is not concerned about protecting a high administrative fee structure. We are interested in protecting North Dakotans and their assets.

"Your Asset Management and Employee Benefit Center"

1.12

Please carefully consider House Bill 1221 and consider voting in favor of this bill representing North Dakota families.

Sincerely,

A handwritten signature in cursive script, appearing to read "Lavina Domagala".

Lavina Domagala
Senior Vice-President/Trust Officer

LD/anw

1st First National Bank & Trust Co.

Of Williston

TRUST DEPARTMENT

22 East 4th Street • P. O. Box 1827

Williston, ND 58802-1827

Ph. (701) 577-9618 – Trust Department

Ph. (701) 577-2113 – Main Bank

March 24, 2015

Senate Energy and Natural Resources Committee
Chairman Donald Schaible
State Capitol
600 East Boulevard
Bismarck ND 58505-0360

Re: HB 1221

Dear Chairman Schaible:

I am writing in favor of HB 1221. As a Trust Officer for the Bank for the past 16 years, I am involved in administering Trusts which hold North Dakota mineral interests. I have administered Trusts in which the 90% withholding was required because either (1) a Trust that had been in existence for many years began receiving royalty and the Trustee was required to withhold 90% of the income; or (2) the person (attorney or otherwise) creating the Trust wasn't aware of the Principal and Income Act and didn't add language allowing 100% payout of the income. These situations have resulted in the Trust spending money to hire an attorney to cure the situation, which usually required a court action to modify the Trust. In every situation, all beneficiaries agreed to the payout of 100% of the income.

In addition, the payout of the income substantially reduces the income tax consequence to the Trust. A Trust assumes the federal and state income tax liability for all income that is not passed out to a beneficiary. The income maintained in the Trust is currently taxed according to the highest federal and state income tax rates. This can result in a significant income tax liability for a Trust, especially in light of today's high oil production levels. This significant income tax liability greatly reduces the income available to distribute to the beneficiaries.

Our sources indicate some financial institutions practicing in North Dakota are against HB 1221, in an effort to hold the 90% in their financial institution to maintain or increase their fee base. This financial institution is not concerned about protecting a high administrative fee structure. We are interested in protecting North Dakotans and their assets.

"Your Asset Management and Employee Benefit Center"

1.14

Please carefully consider House Bill 1221 and consider voting in favor of this bill representing North Dakota families.

Sincerely,

A handwritten signature in cursive script that reads "Amy Wells".

Amy Wells
Vice-President/Trust Officer

Enclosures

anw



Banking, the American State Way.

P.O. Box 1446
Williston, North Dakota 58802-1446

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www.asbt.com

March 24, 2015

Senate Energy and Natural Resources Committee
Chairman Donald Schaible
State Capitol
600 East Boulevard
Bismarck ND 58505-0360

Re: HB 1221

Dear Chairman Schaible:

I am writing in favor of HB 1221. As a Trust Officer for the Bank for the past twenty-five years, I am involved in administering Trusts which hold North Dakota mineral interests. I have administered Trusts in which the 90% withholding was required because either (1) a Trust that had been in existence for many years began receiving royalty and the Trustee was required to withhold 90% of the income; or (2) the person (attorney or otherwise) creating the Trust wasn't aware of the Principal and Income Act and didn't add language allowing 100% payout of the income. These situations have resulted in the Trust spending money to hire an attorney to cure the situation, which usually required a court action to modify the Trust. In every situation, all beneficiaries agreed to the payout of 100% of the income.

Please consider voting in favor of HB 1221.

Yours truly,

American State Bank & Trust Company

A handwritten signature in cursive script that reads 'Laurie Pederson'.

Laurie Pederson
Vice President & Trust Manager

LJP/dbm



P.O. Box 1446
Williston, North Dakota 58802-1446

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Banking, the American State Way.

March 24, 2015

Senate Energy and Natural Resources Committee
Chairman Donald Schaible
State Capitol
600 East Boulevard
Bismarck ND 58505-0360

Re: HB 1221

Dear Chairman Schaible:

I am writing in favor of HB 1221. As a Trust Officer for the Bank for the past 5 years, I am involved in administering Trusts which hold North Dakota mineral interests. I have administered Trusts in which the 90% withholding was required because either (1) a Trust that had been in existence for many years began receiving royalty and the Trustee was required to withhold 90% of the income; or (2) the person (attorney or otherwise) creating the Trust wasn't aware of the Principal and Income Act and didn't add language allowing 100% payout of the income. These situations have resulted in the Trust spending money to hire an attorney to cure the situation, which usually required a court action to modify the Trust. In every situation, all beneficiaries agreed to the payout of 100% of the income.

Yours truly,

A handwritten signature in black ink, appearing to be 'Jeremy Hansen', written over a horizontal line.

Jeremy Hansen
Trust Officer
American State Bank and Trust
701-774-4129 (direct line)
jhansen@asbt.com