

SENATE BILL NO. 2205

Introduced by

Senators Wardner, Krauter, Lyson

Representatives Haas, Rennerfeldt, Warner

1 A BILL for an Act to amend and reenact sections 57-51.1-01, 57-51.1-02, and 57-51.1-03 of the
2 North Dakota Century Code, relating to determination of the trigger price that determines
3 application of oil extraction tax rates and exemptions; and to provide an effective date.

4 **BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF NORTH DAKOTA:**

5 **SECTION 1. AMENDMENT.** Section 57-51.1-01 of the North Dakota Century Code is
6 amended and reenacted as follows:

7 **57-51.1-01. Definitions for oil extraction tax.** For the purposes of the oil extraction
8 tax law, the following words and terms shall have the meaning ascribed to them in this section:

- 9 1. "Average daily production" of a well means the qualified maximum total production
10 of oil from the well during a calendar month period divided by the number of
11 calendar days in that period; and "qualified maximum total production" of a well
12 means that the well must have been maintained at the maximum efficient rate of
13 production as defined and determined by rule adopted by the industrial commission
14 in furtherance of its authority under chapter 38-08.
- 15 2. "Average price" of a barrel of crude oil means the monthly average ~~daily~~ price for a
16 barrel of west Texas intermediate cushing crude oil, as those prices appear in the
17 Wall Street Journal, midwest edition, minus two dollars and fifty cents.
- 18 3. "Horizontal reentry well" means a well that was not initially drilled and completed as
19 a horizontal well, including any well initially plugged and abandoned as a dry hole,
20 which is reentered and recompleted as a horizontal well after March 31, 1995.
- 21 4. "Horizontal well" means a well with a horizontal displacement of the wellbore drilled
22 at an angle of at least eighty degrees within the productive formation of at least
23 three hundred feet [91.44 meters].

- 1 5. "Oil" means petroleum, crude oil, mineral oil, casinghead gasoline, and all liquid
2 hydrocarbons that are recovered from gas on the lease incidental to the production
3 of the gas.
- 4 6. "Property" means the right which arises from a lease or fee interest, as a whole or
5 any designated portion thereof, to produce oil. A producer shall treat as a separate
6 property each separate and distinct producing reservoir subject to the same right to
7 produce crude oil; provided, that such reservoir is recognized by the industrial
8 commission as a producing formation that is separate and distinct from, and not in
9 communication with, any other producing formation.
- 10 7. "Qualifying secondary recovery project" means a project employing water flooding.
11 To be eligible for the tax reduction provided under section 57-51.1-02, a secondary
12 recovery project must be certified as qualifying by the industrial commission and
13 the project operator must have achieved for six consecutive months an average
14 production level of at least twenty-five percent above the level that would have
15 been recovered under normal recovery operations. To be eligible for the tax
16 exemption provided under section 57-51.1-03 and subsequent thereto the rate
17 reduction provided under section 57-51.1-02, a secondary recovery project must
18 be certified as qualifying by the industrial commission and the project operator
19 must have obtained incremental production as defined in subsection 5 of section
20 57-51.1-03.
- 21 8. "Qualifying tertiary recovery project" means a project for enhancing recovery of oil
22 which meets the requirements of section 4993(c), Internal Revenue Code of 1954,
23 as amended through December 31, 1986, and includes the following methods for
24 recovery:
 - 25 a. Miscible fluid displacement.
 - 26 b. Steam drive injection.
 - 27 c. Microemulsion.
 - 28 d. In situ combustion.
 - 29 e. Polymer augmented water flooding.
 - 30 f. Cyclic steam injection.
 - 31 g. Alkaline flooding.

h. Carbonated water flooding.

i. Immiscible carbon dioxide displacement.

j. New tertiary recovery methods certified by the industrial commission.

It does not include water flooding, unless the water flooding is used as an element of one of the qualifying tertiary recovery techniques described in this subsection, or immiscible natural gas injection. To be eligible for the tax reduction provided under section 57-51.1-02, a tertiary recovery project must be certified as qualifying by the industrial commission, the project operator must continue to operate the unit as a qualifying tertiary recovery project, and the project operator must have achieved for at least one month a production level of at least fifteen percent above the level that would have been recovered under normal recovery operations. To be eligible for the tax exemption provided under section 57-51.1-03 and subsequent thereto the rate reduction provided under section 57-51.1-02, a tertiary recovery project must be certified as qualifying by the industrial commission, the project operator must continue to operate the unit as a qualifying tertiary recovery project, and the project operator must have obtained incremental production as defined in subsection 5 of section 57-51.1-03.

9. "Royalty owner" means an owner of what is commonly known as the royalty interest and shall not include the owner of any overriding royalty or other payment carved out of the working interest.

10. "Stripper well property" means a "property" whose average daily production of oil, excluding condensate recovered in nonassociated production, per well did not exceed ten barrels per day for wells of a depth of six thousand feet [1828.80 meters] or less, fifteen barrels per day for wells of a depth of more than six thousand feet [1828.80 meters] but not more than ten thousand feet [3048 meters], and thirty barrels per day for wells of a depth of more than ten thousand feet [3048 meters] during any preceding consecutive twelve-month period beginning after December 31, 1972. Wells which did not actually yield or produce oil during the qualifying twelve-month period, including disposal wells, dry wells, spent wells, and shut-in wells, are not production wells for the purpose of determining whether the stripper well property exemption applies.

11. "Trigger price" means an average price of a barrel of crude oil of thirty-five dollars and fifty cents, as indexed for inflation. By December first of each year, the tax commissioner shall compute an indexed trigger price by applying to the current trigger price the rate of change of the consumer price index for industrial commodities for the twelve months ending September thirty-first of that year and the indexed trigger price so determined is the trigger price for the following calendar year.

12. "Two-year inactive well" means any well that has not produced oil in more than one month in the two years before the date of application to the industrial commission for certification as a two-year inactive well.

SECTION 2. AMENDMENT. Section 57-51.1-02 of the North Dakota Century Code is amended and reenacted as follows:

57-51.1-02. Imposition of oil extraction tax. There is hereby imposed an excise tax, to be known as the "oil extraction tax", upon the activity in this state of extracting oil from the earth, and every owner, including any royalty owner, of any part of the oil extracted is deemed for the purposes of this chapter to be engaged in the activity of extracting that oil.

The rate of tax is six and one-half percent of the gross value at the well of the oil extracted, except that the rate of tax is four percent of the gross value at the well of the oil extracted in the following situations:

1. For oil produced from wells drilled and completed after April 27, 1987, commonly referred to as new wells, and not otherwise exempt under section 57-51.1-03;
2. For oil produced from a secondary or tertiary recovery project that was certified as qualifying by the industrial commission before July 1, 1991;
3. For oil that does not qualify as incremental oil but is produced from a secondary or tertiary recovery project that is certified as qualifying by the industrial commission after June 30, 1991;
4. For incremental oil produced from a secondary or tertiary recovery project that is certified as qualifying by the industrial commission after June 30, 1991, and which production is not otherwise exempt under section 57-51.1-03; or

5. For oil produced from a well that receives an exemption pursuant to subsection 4 of section 57-51.1-03 after June 30, 1993, and which production is not otherwise exempt under section 57-51.1-03.

However, if the average trigger price of a barrel of crude oil is exceeded for each month in any consecutive five-month period ~~in any year is thirty-three dollars or more~~, then the rate of tax ~~for the following months~~ on oil extracted from all taxable wells is six and one-half percent of the gross value at the well of the oil extracted:

~~However, if after the aforementioned trigger provision becomes effective, until the~~
average price of a barrel of crude oil is less than ~~thirty-three dollars~~ the trigger price for each month in any consecutive five-month period ~~in any year, in which case~~ the rate of tax reverts to four percent of the gross value at the well of the oil extracted for any wells ~~drilled and completed after April 27, 1987, and not otherwise exempt under section 57-51.1-03, and for a qualifying secondary recovery project or for a qualifying tertiary recovery project~~ subject to a reduced rate under subsections 1 through 5.

SECTION 3. AMENDMENT. Section 57-51.1-03 of the North Dakota Century Code is amended and reenacted as follows:

57-51.1-03. Exemptions from oil extraction tax. The following activities are specifically exempted from the oil extraction tax:

1. The activity of extracting from the earth any oil that is exempt from the gross production tax imposed by chapter 57-51.
2. The activity of extracting from the earth any oil from a stripper well property.
3. For a well drilled and completed after April 27, 1987, the initial production of oil from the well is exempt from any taxes imposed under this chapter for a period of fifteen months, except that oil produced from any well drilled and completed as a horizontal well after March 31, 1995, is exempt from any taxes imposed under this chapter for a period of twenty-four months. Oil recovered during testing prior to well completion is exempt from the oil extraction tax. The exemption under this subsection becomes ineffective if the average trigger price of a barrel of crude oil is exceeded for each month in any consecutive five-month period ~~in any year is thirty-three dollars or more~~. However, the exemption is reinstated if, after the ~~aforementioned~~ trigger provision becomes effective, the average price of a barrel

of crude oil is less than ~~thirty-three dollars~~ the trigger price for each month in any
consecutive five-month period ~~in any year~~.

4. The production of oil from a qualifying well that was worked over is exempt from any taxes imposed under this chapter for a period of twelve months, beginning with the first day of the third calendar month after the completion of the work-over project. The exemption provided by this subsection is only effective if the well operator files a notice of intention to begin a work-over project with the industrial commission prior to commencement of the project and establishes to the satisfaction of the industrial commission upon completion of the project that the cost of the project exceeded sixty-five thousand dollars or production is increased at least fifty percent during the first two months after completion of the project. A qualifying well under this subsection is a well with an average daily production of no more than fifty barrels of oil during the latest six calendar months of continuous production prior to the filing of the notice required by this subsection. A work-over project under this subsection means the continuous employment of a work-over rig, including recompletions and reentries. The exemption provided by this subsection becomes ineffective if the ~~average trigger~~ price of a barrel of crude oil is exceeded ~~for each month in any consecutive five-month period in any year is thirty-three~~
~~dollars or more~~. However, the exemption is reinstated if, after the ~~mentioned~~ trigger provision becomes effective, the average price of a barrel of crude oil is less than ~~thirty-three dollars~~ the trigger price for each month in any consecutive
five-month period ~~in any year~~.
5. a. The incremental production from a secondary recovery project which has been certified as a qualified project by the industrial commission after July 1, 1991, is exempt from any taxes imposed under this chapter for a period of five years from the date the incremental production begins.
- b. The incremental production from a tertiary recovery project which has been certified as a qualified project by the industrial commission subsequent to June 30, 1991, is exempt from any taxes imposed under this chapter for a period of ten years from the date the incremental production begins.

c. For purposes of this subsection, incremental production is defined in the following manner:

- (1) For purposes of determining the exemption provided for in subdivision a and with respect to a unit where there has not been a secondary recovery project, incremental production means the difference between the total amount of oil produced from the unit during the secondary recovery project and the amount of primary production from the unit. For purposes of this paragraph, primary production means the amount of oil which would have been produced from the unit if the secondary recovery project had not been commenced. The industrial commission shall determine the amount of primary production in a manner which conforms to the practice and procedure used by the commission at the time the project is certified.
- (2) For purposes of determining the exemption provided for in subdivision a and with respect to a unit where a secondary recovery project was in existence prior to July 1, 1991, and where the industrial commission cannot establish an accurate production decline curve, incremental production means the difference between the total amount of oil produced from the unit during a new secondary recovery project and the amount of production which would be equivalent to the average monthly production from the unit during the most recent twelve months of normal production reduced by a production decline rate of ten percent for each year. The industrial commission shall determine the average monthly production from the unit during the most recent twelve months of normal production and must upon request or upon its own motion hold a hearing to make this determination. For purposes of this paragraph, when determining the most recent twelve months of normal production the industrial commission is not required to use twelve consecutive months. In addition, the production decline rate of ten percent must be applied from the last month in the twelve-month period of time.

- 1 (3) For purposes of determining the exemption provided for in subdivision a
2 and with respect to a unit where a secondary recovery project was in
3 existence before July 1, 1991, and where the industrial commission can
4 establish an accurate production decline curve, incremental production
5 means the difference between the total amount of oil produced from the
6 unit during the new secondary recovery project and the total amount of
7 oil that would have been produced from the unit if the new secondary
8 recovery project had not been commenced. For purposes of this
9 paragraph, the total amount of oil that would have been produced from
10 the unit if the new secondary recovery project had not been
11 commenced includes both primary production and production that
12 occurred as a result of the secondary recovery project that was in
13 existence before July 1, 1991. The industrial commission shall
14 determine the amount of oil that would have been produced from the
15 unit if the new secondary recovery project had not been commenced in
16 a manner that conforms to the practice and procedure used by the
17 commission at the time the new secondary recovery project is certified.
- 18 (4) For purposes of determining the exemption provided for in subdivision b
19 and with respect to a unit where there has not been a secondary
20 recovery project, incremental production means the difference between
21 the total amount of oil produced from the unit during the tertiary
22 recovery project and the amount of primary production from the unit.
23 For purposes of this paragraph, primary production means the amount
24 of oil which would have been produced from the unit if the tertiary
25 recovery project had not been commenced. The industrial commission
26 shall determine the amount of primary production in a manner which
27 conforms to the practice and procedure used by the commission at the
28 time the project is certified.
- 29 (5) For purposes of determining the exemption provided for in subdivision b
30 and with respect to a unit where there is or has been a secondary
31 recovery project, incremental production means the difference between

1 the total amount of oil produced during the tertiary recovery project and
2 the amount of production which would be equivalent to the average
3 monthly production from the unit during the most recent twelve months
4 of normal production reduced by a production decline rate of ten
5 percent for each year. The industrial commission shall determine the
6 average monthly production from the unit during the most recent twelve
7 months of normal production and must upon request or upon its own
8 motion hold a hearing to make this determination. For purposes of this
9 paragraph, when determining the most recent twelve months of normal
10 production the industrial commission is not required to use twelve
11 consecutive months. In addition, the production decline rate of ten
12 percent must be applied from the last month in the twelve-month period
13 of time.

- 14 (6) For purposes of determining the exemption provided for in subdivision b
15 and with respect to a unit where there is or has been a secondary
16 recovery project and where the industrial commission can establish an
17 accurate production decline curve, incremental production means the
18 difference between the total amount of oil produced from the unit during
19 the tertiary recovery project and the total amount of oil that would have
20 been produced from the unit if the tertiary recovery project had not been
21 commenced. For purposes of this paragraph, the total amount of oil
22 that would have been produced from the unit if the tertiary recovery
23 project had not been commenced includes both primary production and
24 production that occurred as a result of any secondary recovery project.
25 The industrial commission shall determine the amount of oil that would
26 have been produced from the unit if the tertiary recovery project had not
27 been commenced in a manner that conforms to the practice and
28 procedure used by the commission at the time the tertiary recovery
29 project is certified.

d. The industrial commission shall adopt rules relating to this exemption that must include procedures for determining incremental production as defined in subdivision c.

6. The production of oil from a two-year inactive well, as determined by the industrial commission and certified to the state tax commissioner, for a period of ten years after the date of receipt of the certification. The exemption under this subsection becomes ineffective if the ~~average~~ trigger price of a barrel of crude oil is exceeded for each month in any consecutive five-month period ~~in any year is thirty three dollars or more~~. However, the exemption is reinstated if, after the ~~aforementioned~~ trigger provision becomes effective, the average price of a barrel of crude oil is less than ~~thirty three dollars~~ the trigger price for each month in any consecutive five-month period ~~in any year~~.

7. The production of oil from a horizontal reentry well, as determined by the industrial commission and certified to the state tax commissioner, for a period of nine months after the date the well is completed as a horizontal well. The exemption under this subsection becomes ineffective if the ~~average~~ trigger price of a barrel of crude oil is exceeded for each month in any consecutive five-month period ~~in any year is thirty three dollars or more~~. However, the exemption is reinstated if, after the ~~aforementioned~~ trigger provision becomes effective, the average price of a barrel of crude oil is less than ~~thirty three dollars~~ the trigger price for each month in any consecutive five-month period ~~in any year~~.

8. The initial production of oil from a well is exempt from any taxes imposed under this chapter for a period of sixty months if:

- a. The well is located within the boundaries of an Indian reservation;
- b. The well is drilled and completed on lands held in trust by the United States for an Indian tribe or individual Indian; or
- c. The well is drilled and completed on lands held by an Indian tribe if the interest is in existence on August 1, 1997.

SECTION 4. EFFECTIVE DATE. This Act is effective for taxable events occurring after June 30, 2001.