

January 2011

OIL TAX-RELATED INFORMATION FOR THE 2011-13 BIENNIUM

This memorandum provides information regarding statutory provisions relating to oil and gas gross production tax, oil extraction tax, the permanent oil tax trust fund, the oil and gas research fund, and the oil and gas impact grant fund; the legacy fund; oil prices and production; oil tax-related revenues and distributions for the 2009-11 biennium to date; and oil tax revenue projections for the 2011-13 biennium.

OIL AND GAS GROSS PRODUCTION TAX (NORTH DAKOTA CENTURY CODE CHAPTER 57-51)

The gross production tax on oil is 5 percent of the gross value at the well on oil produced. The gross production tax on gas is four cents times the gas base rate adjustment for each fiscal year as calculated by the Tax Department. Shallow gas produced during the first 24 months of production from and after the date of first sales of gas from a well completed or recompleted in a shallow gas zone after June 30, 2003, is exempted from the gross production tax. The oil and gas gross production tax is distributed per formula to the legacy fund, the oil and gas research fund, oil and gas impact grant fund (up to \$8 million per biennium under current law), the state general fund or the permanent oil tax trust fund, and political subdivisions within producing counties.

OIL EXTRACTION TAX (CHAPTER 57-51.1)

The oil extraction tax rate is 6.5 percent, but the rate may be reduced or oil may be exempt as determined by a trigger price. The trigger price is defined in statute as \$35.50 as indexed for inflation. The current trigger price is \$46.79. If the average price of a barrel of oil exceeds the trigger price for each month in any consecutive five-month period, the oil extraction tax is 6.5 percent. If the average price of a barrel of oil is less than the trigger price for each month in any consecutive five-month period, the tax rate is reduced or oil is exempted for the following activities:

- For oil produced from any well drilled and completed as a vertical well after April 27, 1987, there is no extraction tax levied for the first 15 months, and thereafter the rate is 4 percent.
- For oil produced from any well drilled and completed as a horizontal well after April 27, 1987, there is no extraction tax levied for 24 months, and thereafter the rate is 4 percent.
- For incremental production from qualifying secondary recovery projects that have used up the five-year exemption from the date

incremental production begins, the rate is 4 percent.

- For incremental production from qualifying tertiary recovery projects that do not use carbon dioxide which have used up the 10-year exemption from the date incremental production begins, the rate is 4 percent.
- For oil produced from a qualifying well that was "worked over" there is no extraction tax levied for 12 months, beginning with the first day of the third calendar month after the completion of the workover project, and thereafter the rate is 4 percent.
- For oil produced from a certified two-year inactive well there is no extraction tax levied for 10 years after the date of receipt of certification, and thereafter the rate is 6.5 percent.
- For oil produced from a certified horizontal reentry well there is no extraction tax levied for nine months after the date the well is completed as a horizontal well, and thereafter the rate is 6.5 percent.

The following activities are specifically exempt from the oil extraction tax without regard to the trigger price:

- Production from stripper wells.
- Incremental production from a qualifying secondary recovery project is exempt for five years from the date incremental production begins.
- Incremental production from a qualifying tertiary recovery project that does not use carbon dioxide is exempt for 10 years from the date incremental production begins.
- Incremental production from a qualifying tertiary recovery project that uses carbon dioxide is exempt from the date the incremental production begins.
- The initial production of oil from a well is exempt from any oil extraction tax for a period of 60 months if it meets any of the following conditions:

Is located within the boundaries of an Indian reservation;

Is on lands held in trust for an Indian tribe or individual Indian; or

Is on lands held by an Indian tribe as of August 1, 1997.

Under the July 1, 2008, agreement between the Governor and the Three Affiliated Tribes of the Fort Berthold Reservation, wells on trust lands are subject to a tax of 11.5 percent and wells on nontrust lands are subject to a tax of 5 percent. Tax revenue from

wells on trust lands are divided evenly between the tribe and state, and tax revenue from wells on nontrust lands are allocated 80 percent to the state and 20 percent to the tribe. The effect of the agreement is to allow the exemption only for wells on nontrust lands within the reservation.

A contingent rate reduction in the oil extraction tax, which can only go into effect if the trigger price rate reduction is not in effect, reduces the oil extraction tax rate for horizontal wells from 6.5 percent to 2 percent during the time the rate reduction is in effect. The rate reduction becomes effective on the first day of the month following a month for which the average price of a barrel of crude oil is less than \$55. The contingent rate becomes ineffective on the first day of the month following a month for which the average price of a barrel of crude oil exceeds \$70. The contingent rate reduction applies to oil produced during the first 18 months after completion for a horizontal well drilled and completed after April 30, 2009, and is limited to the first 75,000 barrels or the first \$4.5 million of gross value at the well of oil produced from the well. If the rate reduction is effective on the date of completion of a well, the rate reduction applies to production from that well for up to 18 months after completion, even if the price of oil rises to more than \$70. If the rate reduction is ineffective on the date of completion of a well, the rate reduction does not apply to production from that well at any time. The contingent rate reduction was in effect from May 1, 2009, through October 31, 2009. During October 2009, the average price of a barrel of crude oil exceeded \$70. North Dakota Century Code defines the average price of a barrel of crude oil used to determine the trigger and contingent rate reduction to be the monthly average of the daily closing price for a barrel of West Texas intermediate Cushing crude oil minus \$2.50.

The oil extraction tax is allocated as follows:

- Thirty percent to the legacy fund beginning July 1, 2011.
- Twenty percent to the resources trust fund for water development projects.
- Ten percent to the foundation aid stabilization fund.
- Ten percent to the common schools trust fund.
- Sixty percent to the state general fund or the permanent oil tax trust fund after allocation to the oil and gas research fund.

The constitutional and statutory provisions for distribution of the oil extraction tax will exceed 100 percent beginning July 1, 2011. The 2011 Legislative Assembly may wish to consider statutory changes to ensure the distribution formula for the oil extraction tax does not exceed 100 percent.

PERMANENT OIL TAX TRUST FUND (SECTION 57-51.1-07.2)

Section 57-51.1-07.2 (1997 Senate Bill No. 2366) establishes a permanent oil tax trust fund and

provides that all revenues deposited in the general fund during a biennium derived from taxes imposed on oil and gas under Chapters 57-51 (Oil and Gas Gross Production Tax) and 57-51.1 (Oil Extraction Tax) which exceed \$71 million are to be transferred by the State Treasurer to the permanent oil tax trust fund. The State Treasurer is to transfer the interest earnings on the fund to the general fund as they accrue. The principal of the permanent oil tax trust fund may only be spent upon a two-thirds vote of the members elected to each house of the Legislative Assembly.

LEGACY FUND

The 2009 Legislative Assembly enacted House Concurrent Resolution No. 3054, which was approved by North Dakota voters in the 2010 general election and which creates a new section to Article X of the Constitution of North Dakota to create a new North Dakota legacy fund. The measure will become effective July 1, 2011. The constitutional measure provides that 30 percent of all revenues derived from taxes imposed on oil and gas be transferred to the legacy fund. The principal and earnings of the legacy fund accruing prior to June 30, 2017, may not be expended until after June 30, 2017, and then may only be spent upon a two-thirds vote of the members elected to each house of the Legislative Assembly. Expenditures from the fund are limited to 15 percent of the principal during a biennium. Earnings of the fund accruing after June 30, 2017, will be transferred to the state general fund.

OIL AND GAS RESEARCH FUND (SECTION 57-51.1-07.3)

Section 57-51.1-07.3 (2003 Senate Bill No. 2311) establishes the oil and gas research fund. Section 57-51.1-07.3 provides that 2 percent of the state's share of the oil and gas gross production tax and oil extraction tax revenues, up to \$4 million per biennium, is to be deposited into the oil and gas research fund. All money deposited in the oil and gas research fund is appropriated as a continuing appropriation to the Oil and Gas Research Council.

OIL AND GAS IMPACT GRANT FUND

Section 57-51-15 (1989 House Bill No. 1302) establishes the oil and gas impact grant fund for deposit of revenue from oil and gas gross production taxes. Section 57-51-15 provides that one-third of one percent of the gross value of oil at the well, up to \$8 million per biennium, is to be deposited into the oil and gas impact grant fund. Money in the oil and gas impact grant fund is disbursed by the Energy Development Impact Office of the Land Department as grants to local units of government affected by oil and gas development activity. The executive budget recommends increasing the allocation to the oil and gas impact grant fund to a maximum of \$100 million.

OIL AND GAS TAX REVENUE DISTRIBUTION FLOWCHART

Attached as an appendix is a flowchart reflecting the distribution of oil and gas tax revenues for the 2011-13 biennium based on current law.

OIL PRICES AND PRODUCTION

The following table provides information from the Department of Mineral Resources relating to average North Dakota oil prices and daily production levels for the 2009-11 biennium through November 2010:

	Average North Dakota Oil Price	Average Daily Production of Barrels of Oil
July 2009	\$54.87	227,880
August 2009	\$61.41	232,365
September 2009	\$59.26	238,172
October 2009	\$65.52	240,041
November 2009	\$67.06	245,854
December 2009	\$63.96	242,107
January 2010	\$68.57	236,176
February 2010	\$67.58	261,223
March 2010	\$71.20	277,454
April 2010	\$71.26	284,492
May 2010	\$60.10	298,283
June 2010	\$63.14	314,696
July 2010	\$67.35	321,163
August 2010	\$69.07	328,883
September 2010	\$67.95	341,385
October 2010	\$74.41	342,094 (preliminary)
November 2010	\$75.60 (preliminary)	342,247 (preliminary)

OIL AND GAS TAX REVENUES

The following table provides information on actual monthly distributions of oil and gas tax revenues for

the 2009-11 biennium to date through December 2010:

Actual Monthly Distributions									
	General Fund	Permanent Oil Tax Trust Fund	Oil and Gas Research Fund	Oil and Gas Impact Fund	Resources Trust Fund	Common Schools Trust Fund	Foundation Aid Stabilization Fund	Political Subdivisions	Total
August 2009	\$28,814,213	\$89,005 ¹	\$588,045	\$1,205,112	\$3,708,878	\$1,854,439	\$1,854,439		\$38,114,131
September 2009	14,115,128	124,131 ¹	288,064	1,510,131	3,620,364	1,810,182	1,810,182	\$14,452,459	37,730,641
October 2009	23,881,587	159,105 ¹	487,380	1,424,978	4,266,878	2,133,439	2,133,439	10,070,975	44,557,781
November 2009	4,189,072	19,731,466	484,475	1,585,995	3,651,341	1,825,671	1,825,671	6,983,331	40,277,022
December 2009		28,942,441	585,855	1,707,402	4,147,702	2,073,851	2,073,851	6,289,856	45,820,958
January 2010		30,594,234	622,853	566,382	4,324,659	2,162,329	2,162,329	6,732,783	47,165,569
February 2010		30,856,996	625,085		4,358,550	2,179,275	2,179,275	5,695,998	45,895,179
March 2010		28,518,377	318,243		3,964,773	1,982,386	1,982,386	4,420,759	41,186,924
April 2010		40,420,799			5,245,925	2,622,963	2,622,963	6,616,346	57,528,996
May 2010		43,175,692			5,693,977	2,846,988	2,846,988	5,582,773	60,146,418
June 2010		88,721,611			11,847,487	5,923,743	5,923,743	5,648,302	118,064,886
July 2010								4,565,549	4,565,549
August 2010		43,461,105			5,600,893	2,800,447	2,800,447	4,387,448	59,050,340
September 2010		31,761,664			6,343,686	3,171,843	3,171,843	21,528,772	65,977,808
October 2010		43,241,561			6,513,183	3,256,591	3,256,591	12,084,863	68,352,789
November 2010		44,174,395			6,256,551	3,128,276	3,128,276	9,036,237	65,723,735
December 2010		52,063,832			7,520,245	3,760,123	3,760,123	9,777,874	76,882,197
Total	\$71,000,000	\$526,036,414	\$4,000,000	\$8,000,000	\$87,065,092	\$43,532,546	\$43,532,546	\$133,874,325	\$917,040,923

¹This amount reflects a portion of the first \$700,000 of the state's share of oil extraction tax revenue produced from wells within the exterior boundaries of the Fort Berthold Reservation which is required to be deposited in the permanent oil tax trust fund pursuant to Section 57-51.1-07.4.

DISTRIBUTION OF OIL AND GAS GROSS PRODUCTION TAXES TO POLITICAL SUBDIVISIONS

Oil and gas gross production taxes are apportioned to the state and counties pursuant to Section 57-51-15. From the tax equal to the first 1 percent of gross value at the well of oil production, a direct allocation of \$500,000 is provided for a city in an oil-producing county which has a population of 7,500 or more and more than 2 percent of its employment engaged in the mining industry. The

allocation is increased to \$1 million if the city's employment in the mining industry exceeds 7.5 percent of its total employment. Also from the tax equal to the first 1 percent of value of oil produced is a biennial allocation to the oil and gas impact grant fund up to \$8 million. Any amounts remaining from the first 1 percent are allocated to the state general fund.

After deduction of the amounts provided for above, remaining annual revenue from the tax is allocated as follows:

1. The first \$2 million is allocated to the county.

2. The next \$1 million is allocated 75 percent to the county and 25 percent to the state general fund.
3. The next \$1 million is allocated 50 percent to the county and 50 percent to the state general fund.
4. The next \$14 million is allocated 25 percent to the county and 75 percent to the state general fund.
5. All annual revenue remaining after the above allocations is allocated 10 percent to the county and 90 percent to the state general fund.

The table below provides information on the distribution of the oil and gas gross production taxes for oil produced from July 2009 through October 2010 for oil-producing counties and oil extraction tax and oil and gas gross production tax for Fort Berthold based on information from the State Treasurer. The amounts include distributions to cities and school districts within the counties:

County	2009-11 Biennium to Date Actual Revenue for Oil Production Through October 2010
Billings	\$7,349,021
Bottineau	5,314,550
Bowman	12,822,533
Burke	5,170,272
Divide	6,519,075
Dunn	13,456,243
Golden Valley	1,851,773
Hettinger	471
McHenry	89,239
McKenzie	14,406,359
McLean	423,384
Mercer	17,085
Mountrail	23,992,458
Renville	2,641,890
Slope	1,712,126
Stark	5,167,542
Ward	195,445
Williams	13,847,714
Fort Berthold	18,897,145
Total	\$133,874,325

2011-13 PRELIMINARY REVENUE FORECAST

The table below presents information on estimated oil and gas tax revenue based on the Office of Management and Budget's revised revenue forecast for the 2009-11 biennium and the executive revenue forecast for the 2011-13 biennium:

	2009-11 Biennium Legislative Forecast (May 2009) ¹	Revised 2009-11 Biennium Forecast ² (December 2010)	Executive 2011-13 Biennium Forecast ³ (December 2010)
General fund	\$71,000,000	\$71,000,000	\$71,000,000
Permanent oil tax trust fund	323,092,000	886,261,921	607,271,039
Legacy fund			612,468,299 ⁴
Political subdivisions	101,211,208	168,759,700	247,196,952
Oil and gas research fund	4,000,000	4,000,000	4,000,000
Oil and gas impact grant fund	8,000,000	8,000,000	100,000,000
Common schools trust fund	25,554,341	68,472,199	99,906,177
Foundation aid stabilization fund	25,554,341	68,472,199	99,906,177
Resources trust fund	51,108,682	136,944,397	199,812,353
Total oil and gas tax revenue	\$609,520,572	\$1,411,910,416	\$2,041,560,997

¹The legislative forecast estimated oil prices to range from \$40 to \$45 per barrel in the first year of the 2009-11 biennium and \$50 to \$55 per barrel in the second year. The daily production rate was estimated to average approximately 213,000 barrels for the 2009-11 biennium.

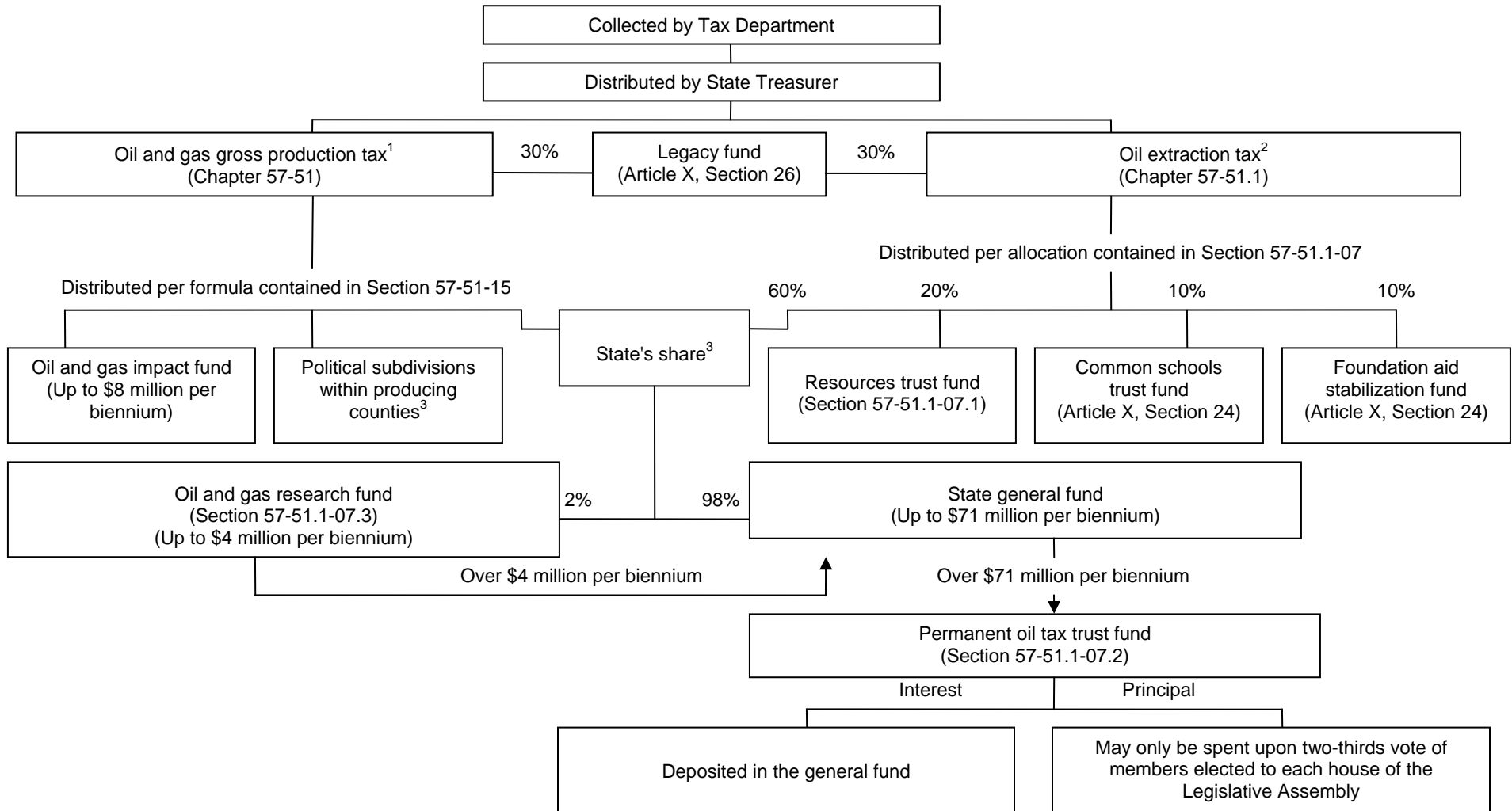
²The revised 2009-11 biennium forecast reflects actual collections for fiscal year 2010 and revised estimates for fiscal year 2011 based on an average price per barrel of \$67 and an average daily production rate of 366,250 barrels.

³The executive forecast for the 2011-13 biennium estimates oil prices to average from \$72 per barrel in the first year of the 2011-13 biennium and \$75 per barrel in the second year. The estimated average daily production rate ranges from 390,000 barrels per day to 405,000 barrels per day for the first year of the biennium and from 405,000 barrels per day to 425,000 barrels per day in the second year.

⁴Passage of constitutional measure No. 1 in the November 2010 general election resulted in the creation of a legacy fund. The legacy fund will receive 30 percent of oil and gas gross production and oil extraction taxes beginning July 1, 2011, resulting in \$612.47 million estimated to be deposited in the legacy fund rather than the permanent oil tax trust fund during the 2011-13 biennium.

ATTACH:1

Oil and Gas Tax Revenues Distribution of Funds for the 2011-13 Biennium Based on Current Law



¹The gross production tax on oil is 5 percent of the gross value at the well on oil produced. The gross production tax on gas is four cents times the gas base rate adjustment for each fiscal year as calculated by the Tax Department.

²The oil extraction tax is 6.5 percent of the gross value at the well and 4 percent in certain situations.

³The oil and gas gross production tax is distributed to the political subdivisions and to the state general fund based on each county's production and city populations.