Prepared by the North Dakota Legislative Council
staff for the Natural Resources Committee
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# POTASH MINING AND TAXATION - BACKGROUND MEMORANDUM

Section 5 of 2011 House Bill No. 1046 (Appendix A) directs the Legislative Management to study potash mining and taxation issues.

House Bill No. 1046 otherwise creates a taxation structure for the mining of potash and potash byproducts. In addition, Section 4 of the bill states that it is legislative intent that during the 2013-15 biennium, $2 million be made available to loans to potash development-impacted political subdivisions to be repaid from future proceeds of tax allocations under the potash and byproducts mining taxation. Under North Dakota Century Code (NDCC) Section 57-65-07, as created by Section 2 of the bill, the new tax is appropriated and must be apportioned as determined by the 63rd Legislative Assembly.

House Bill No. 1046 was recommended by the 2009-10 interim Taxation Committee. The Taxation Committee during that interim reported the following information:

> Representatives of business entities in the initial stages of establishing mining operations in North Dakota for potash and uranium provided information to the committee. It was estimated to be three years to five years before potash production would begin in North Dakota and five years before uranium mining would begin.
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> Potash operations in North Dakota would be conducted via solution mining. Potash deposits in North Dakota are located at a depth of 6,000 feet to 9,000 feet. Extraction of potash would be similar in many respects to oil and gas drilling operations. A solution would be injected into the potash deposit to dissolve and suspend the potash in a solution which would be brought to the surface and processed to extract the potash. The impact of potash mining would be similar to oil and gas production impact because drilling rigs would be similar and many truckloads of water would have to be hauled by road for solution mining. However, the impact of potash production would initially be confined to a concentrated area. Initial potash extraction operations would be focused in Divide, Burke, Renville, and Bottineau Counties.
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> Unless a property tax exemption is provided, the pipelines and processing facility associated with potash mining would be subject to local property taxes. The processing facility would allow extraction of potash from the solution drawn from the well, but the potash then would have to be shipped to a fertilizer processing facility to make it commercially marketable. It appears processing potash into fertilizer is not done in the United States or Canada, and the potash is shipped to China for processing into fertilizer. The committee expressed hope that a fertilizer processing facility could eventually be located in North Dakota.
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> Water needs for mining potash are substantial, but it appears wastewater from oil extraction operations could be used in potash mining. Potash mining was described as environmentally safe and that almost all of the water used in operations could be recycled.
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> The Tax Department and Industrial Commission staff spent time examining potash taxation laws and rates of other states. The group recommended a bill draft to the committee for consideration that would have imposed a 5 percent extraction tax for potash and a 4 percent extraction tax on byproducts of potash production. The bill draft was intended to also cover taxation of uranium but was amended by the committee to tax only potash and byproducts from potash production at a rate of 4 percent.

The bill as recommended by the Taxation Committee would have established a 4 percent tax on extraction of potash and potash byproducts. The bill would have provided the tax is in lieu of property taxes of a potash processing plant, mining facility, or satellite facility. The bill would have provided that 20 percent of the tax revenues are allocated to the producing county and 80 percent are to be dedicated to state income tax reduction. Although the bill passed, there were major amendments.

House Bill No. 1046, as passed, established a tax of 2 percent of the sales price of potash and a tax of 4 percent of the gross value or potash byproducts extracted in the state. The bill did not provide for allocation of revenue from the taxes. It was not anticipated that potash mining will occur before 2013 and that an allocation formula would be established in 2013. The bill provided the land and process plant, mining facility, or satellite facility is to be assessed and taxed by local taxing authorities. This study was added in the first amendment adopted in the House.

Before House Bill No. 1046, there was not any provision for state taxation of potash. A review of the legislative history of House Bill No. 1046 reveals four major concerns. These concerns include:

1. The allocation of tax revenue to the state and political subdivisions and the distributions of allocations within the entity receiving the allocation.
2. Impact funding to address development-related impacts before there is sufficient revenues from taxation.
3. The rates of taxation for potash and potash byproducts which balance the want to not tax at so high a level that it prohibits mining or so low a level that it does not address impacts and the one-time nature of the mining of a natural resource.

4. Regulation of mining so as to promote safety and to protect the environment, especially ground water.

## ALLOCATION AND IMPACT

The allocation among the state and political subdivisions and the distribution within the state and a particular subdivision was a major issue described in the legislative history. In short, allocation was not dealt with and left for future Legislative Assemblies because potash mining was not expected to occur in this state for three years to five years. The following is the tracking of the allocation issue through the official versions of House Bill No. 1046 from referral to the House Finance Committee, to the Senate Finance and Taxation Committee, to the Senate Appropriations Committee, to the conference committee, and the final version.

The bill as introduced allocated 80 percent to reducing individual income tax rates and 20 percent to counties that produce potash and potash byproducts in the proportion that the taxes on potash and byproducts removed in the county were to the total taxes.

As amended by the House Finance and Taxation Committee and passed out of the House, the bill provided that the first $1 million in taxes from production within each spacing unit must be allocated to the county or counties within the spacing unit. These funds were to be deposited in the county road and bridge fund. After the $1 million allocation, in the first year 60 percent was to be allocated to the producing county and 40 percent to the state general fund. In the year following, 50 percent was to be allocated to the producing county and 50 percent to the state general fund. In the following year, 40 percent was to be allocated to the producing county and 60 percent to the state general fund. In the following years, 30 percent was to be allocated to the producing county and 70 percent to the state general fund. As for the distribution for the state, before money was to be placed in the state general fund, 30 percent was to be deposited into the legacy fund. As for the distribution to the county, 10 percent was to be deposited into a special potash impact grant fund for the county after the first $1 million is allocated. Amounts deposited into the county potash impact grant fund would have been allocated through grants through the board of county commissioners to or for the benefit of the county, township, or cities within the county. Grants were meant to meet initial impacts that affect basic governmental services and impacts directly necessitated by potash development impact.

As reported by the Senate Finance and Taxation Committee, the allocation was for the first $1 million in taxes from each mining permit area, instead of a spacing unit, to be allocated to the county or counties within the mining permit area. These funds were to be deposited in the county general fund, instead of the county road and bridge fund. After the $1 million allocation, the producing county was to be allocated 10 percent, and the state was allocated 90 percent for deposit in the general fund. However, 5 percent of the allocations to counties was to be retained by the State Treasurer and deposited in the state general fund until a total of $2 million had been deposited in the state general fund. As for impact funding, a direct appropriation of $2 million was appropriated to the Energy Development Impact Office for the purpose of impact grant funding for potash development-impacted political subdivisions. These grants were triggered by a building permit being issued for a potash processing plant in this state.

As reported by the Senate Appropriations Committee, instead of an appropriation of $2 million, the bill provided for legislative intent that the 63rd Legislative Assembly appropriate $2 million to the Energy Development Impact Office for the purpose of impact grant funding for potash development-impacted political subdivisions.

As reported from the conference committee and enacted, the bill provided that taxes collected on potash and potash byproducts are appropriated and must be apportioned as determined by the 63rd Legislative Assembly. In addition, the bill contained legislative intent for $2 million for loans, not grants, to potash development-impacted political subdivisions to be repaid from the future proceeds of tax allocations from potash and byproduct taxes.

A guide for revenue allocation from potash and byproduct taxes is the allocation of oil and gas tax revenue. Attached as Appendix B is a chart on the estimated allocation of oil and gas tax collections for the 2011-13 biennium as approved by the Legislative Assembly.

As a continuance of the comparison to oil and gas allocations, the following provides information on oil and gas impact funding. The procedure for oil and gas impact funding changed last legislative session. Under 2011 House Bill No. 1013, the amount in the oil and gas impact grant fund was increased from $8 million to $100 million per biennium. This money is from the first one percentage point of the oil and gas gross production tax. The bill also changed the name of the Energy Development Impact Office to the Energy Infrastructure and Impact Office. The bill transferred the authority to make grants for oil and gas impact from the Energy Development Impact Office to the Board of University and School Lands. The Energy Infrastructure and Impact Office is to make recommendations to the board on grants to political subdivisions. The recommendations are to include recommendations for 35 percent of impact funding to go to cities of 10,000 or more population and the remainder to go to smaller cities and counties, school districts, and other political subdivisions impacted by oil and gas development. This impact grant funding was further altered by 2011 Senate Bill No. 2150. This bill appropriated $5 million from the oil and gas impact grant fund for grants to school districts that can demonstrate rapid enrollment growth. In addition, 2011 Senate Bill No. 2325 appropriated $350,000 from the oil and gas impact grant fund for updating and maintaining reports for transportation infrastructure needs for all the county and township roads.

## RATES

There are basically three taxes that were considered for imposition on potash:

1. A tax on the potash.
2. A tax on the byproducts.
3. A property tax on facilities and land.

As introduced, House Bill No. 1046 imposed a 4 percent tax on the whole production of potash. The tax on byproducts was 4 percent of the gross value of all subsurface mineral byproducts and was taxed when it was sold. As the bill passed the House, the tax remained at 4 percent on all potash produced in the state, and the tax on byproducts was 4 percent of the gross value on sale of the potash byproducts.

The bill, as reported by the Senate Finance and Taxation Committee, provided for a tax rate of 1.5 percent on potash and 4 percent on byproducts. The tax remained at 1.5 percent for potash and 4 percent for byproducts as the bill was reported by the Senate Appropriations Committee. As a result of the conference committee, the final version placed the rate at 2 percent for potash and 4 percent for byproducts.

As rates changed so did the application of property tax. The section relating to property tax read as follows for the bill as introduced:

> **57-65-05. Potash and byproducts tax to be in lieu of other taxes.**
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> The payment of the taxes imposed by this chapter is in lieu of all ad valorem taxes upon any processing plant, mining facility, or satellite facility producing potash or byproducts. The land on which the processing plant, mining facility, or satellite facility is located must be assessed and taxed as other property within the taxing district in which the property is situated. The tax under this chapter is not in lieu of income taxes nor excise taxes upon the sale of minerals or byproducts at retail.

An ad valorem tax is a tax imposed proportionally on the value of something rather than on its quantity or some other measure. A tax on the value of real property is an ad valorem property tax. In the introduced version, the payment of potash and byproduct tax was in lieu of all ad valorem taxes on the processing plant, mining facility, or satellite facility. This did not include the real property on which the plant or facility was located, so the land was assessed and taxed as real property. In addition to the property tax on land, income tax and excise tax on the sale of potash and byproducts at retail were allowed. As passed by the House, NDCC Section 57-65-05 was changed to read as follows:

> **57-65-05. Potash and byproducts tax to be in lieu of other taxes.**
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> ~~The payment of the taxes imposed by this chapter is in lieu of all ad valorem taxes upon any processing plant, mining facility, or satellite facility producing potash or byproducts.~~The payment of the taxes under this chapter must be in full and in lieu of all ad valorem taxes by the state, counties, cities, school districts, and other taxing districts upon any property rights attached to or inherent in the right to producing potash and potash byproducts; upon producing potash and potash byproducts leases; upon machinery, appliances, and equipment used in and around any well producing potash or potash byproducts and actually used in the operation of the well; and upon any investment in property. The land ~~on which~~and the processing plant, mining facility, or satellite facility ~~is located~~ must be assessed and taxed as other property within the taxing district in which the property is situated. The tax under this chapter is not in lieu of income taxes~~ nor excise taxes upon the sale of minerals or byproducts at retail~~.

The bill, as changed in the House, provided that the payment of potash and byproduct tax was in lieu of all ad valorem tax by any governmental entity on any property rights inherent in producing potash, on leases, on machinery, and on investment property. This did not include the land on which the plant or facility was located and the plant or facility, so the land and plant or facility was taxed as real property. In addition to the tax on land and the plant or facility, income tax was allowed, but the bill removed the excise tax on the sale of potash and byproducts at retail from being an allowable tax. As passed by the Senate, NDCC Section 57-65-05 was changed to read as follows:

> **57-65-05. Potash and byproducts tax to be in lieu of other taxes.**
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> The payment of the taxes under this chapter must be in full and in lieu of all ad valorem taxes by the state, counties, cities, school districts, and other taxing districts upon the processing plant, mining facility, or satellite facility and any associated pipelines; any property rights attached to or inherent in the right to producing potash and potash byproducts; upon producing potash and potash byproducts leases; upon machinery, appliances, and equipment used in and around any well producing potash or potash byproducts and actually used in the operation of the well; and upon any investment in property. The land ~~and the processing plant, mining facility, or satellite facility~~ must be assessed and taxed as other property within the taxing district in which the property is situated. The tax under this chapter is not in lieu of income taxes.

This was the same version as the final version. The final version of the bill was different from the House version in that the bill added the processing plant, mining facility, or satellite facility and any associated pipelines to the list of exemptions from an ad valorem tax.

## REGULATION

The Department of Mineral Resources has jurisdiction over subsurface mineral extraction under NDCC Section Chapter 38-12 and North Dakota Administrative Code (NDAC) Chapter 43-02-02 as it relates to subsurface mineral exploration and development and NDAC Chapter 43-02-02.1 as it relates to underground injection control that includes solution mining for potash. As part of the statutory authority, the commission may require the furnishing of bonds; the delivery of exploration data; the filing of monthly production reports; the conducting of all exploration, development, and production operations to prevent pollution of freshwater supplies, provide for the protection of the environment and public safety, and to ensure the optimum recovery of the mineral resource; and the reclamation of all land disturbed. The commission acting through the director of mineral resources may regulate the drilling and abandonment of exploration test holes and producing wells; promulgate and enforce rules, regulations, and orders; and inspect all exploration, development, and production sites. As part of the statutory rulemaking authority, rules have been adopted as stated above.

## SUGGESTED STUDY APPROACH

The committee may wish to discuss the positives and negatives regarding different allocation, impact, rate, and regulation decisions made during the last interim and the last legislative session. As to regulation, the committee may desire to review present regulation to see if it is sufficient. Additional information may be received from the potash industry and impacted parties. These impacted parties may include surface owners, townships, cities, counties, and school districts.

The committee may compare this state with other states with potash mining. According to the United States Geological Survey, most domestic production is from New Mexico. There is a deep solution mine in Michigan. Another state with potash production is Utah. In comparing this state to other states, it is important to compare the type and amount of mining and the entire tax structure.

ATTACH:2