Budget Basics

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OIL AND GAS TAX REVENUES AND ALLOCATIONS

OIL AND GAS TAXATION

Oil production is subject to a gross production tax and an extraction tax. The gross production tax is 5 percent of the value of the oil at the well and is in lieu of property tax. Tribal, federal, state, and local municipality mineral interests are exempt from the gross production tax.

The extraction tax is 5 percent of the value of the oil at the well. However, for oil production on tribal lands and straddle wells, the extraction tax may increase to 6 percent while West Texas Intermediate (WTI) oil prices exceed a trigger price. The trigger price is adjusted annually and is $119.95 for calendar year 2024. Oil production from stripper wells, usually wells that produce less than 35 barrels per day, are exempt from the oil extraction tax. Qualifying incremental production from secondary or tertiary recovery projects is partially or fully exempt from the oil extraction tax.

Natural gas is also subject to a gross production tax, which is in lieu of property tax. Natural gas is not subject to an extraction tax. The gross production tax is an adjusted tax rate multiplied by the volume of gas produced at the well. The tax rate is $0.0646 per thousand cubic feet for fiscal year 2025. Natural gas may be exempt from the gross production tax if the natural gas is used at the well site or produced in a shallow gas zone.

OIL PRODUCTION AND PRICES

In conventional oil wells, oil is produced by drilling a vertical well bore and pumping the oil to the surface. Oil production from the Bakken and Three Forks Formations uses horizontal drilling techniques; a fracturing process with water, sand, and other fluids and materials; and various methods to lift the oil to the surface. Oil production is reported as an average daily amount based on the total oil production during a month divided by the number of days in the month. The production is reported 2 months after the oil is extracted from the well.

Oil is a global commodity, and North Dakota's oil is priced based on similar qualities of light sweet crude oil. Brent oil prices are commonly used in European and other global markets; whereas WTI oil prices usually serve as the benchmark for prices in United States markets. North Dakota oil is often delivered to refineries located in coastal regions resulting in higher transportation costs. As a result, North Dakota oil may be discounted from the WTI prices because of the transportation costs. Flint Hills Resources, which has an oil refinery located south of Minneapolis, Minnesota, posts prices for North Dakota oil reflecting a discount for transportation costs. The Legislative Council reports North Dakota oil prices using the average of the WTI and Flint Hills Resources prices.

Based on the 2023 legislative revenue forecast, oil and gas tax revenue collections for the 2023-25 biennium reflect average daily oil production remaining at 1.1 million barrels per day for the biennium and reflect oil prices decreasing from $70 per barrel in the 1st year to $62 per barrel in the 2nd year of the biennium.

COLLECTIONS AND ALLOCATIONS

Oil and gas tax revenues are collected by the Tax Department and distributed by the State Treasurer on a monthly basis. The taxes are paid to the Tax Department 1 month after production. In the following month, the Tax Department compiles the collections and transfers them to the State Treasurer for distribution. As a result, the monthly tax collections and allocations are based on oil production and prices from 2 months prior. Due to the timing of the collections and allocations, fiscal year reporting is from August through July.

The forecasted oil and gas tax collections are calculated by multiplying the forecasted oil production by the forecasted oil prices and applying an effective tax rate to the total taxable value. The effective tax rate reflects a small discount compared to the official tax rate to account for the exemptions provided in law. Based on the 2023 legislative revenue forecast, estimated oil and gas tax revenue collections total $5.14 billion for the 2023-25 biennium, including $2.60 billion of gross production taxes and $2.54 billion of extraction taxes.

Pursuant to an agreement with the Three Affiliated Tribes of the Fort Berthold Reservation, the tax collections from oil and gas production on tribal lands are shared between the Three Affiliated Tribes and the state. The state's collections from oil and gas production on tribal lands are combined with the oil and gas tax collections from all other areas in the state. These combined oil and gas tax revenue collections are distributed pursuant to a formula. From the gross production tax collections, a portion is allocated to the political subdivisions located in oil and gas-producing counties, and the remainder is allocated to state funds. The extraction tax collections are allocated to state funds. A flowchart with more detailed information on the allocation of oil and gas tax revenue for the 2023-25 biennium is available online.

The next topic in the *Budget Basics* series reviews the Department of Public Instruction.