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staff for the Taxation Committee
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ALLOCATION OF OIL AND GAS TAX REVENUES TO OR FOR THE BENEFIT OF POLITICAL SUBDIVISIONS - BACKGROUND MEMORANDUM

Two bills were enacted in 2007 to provide a greater share of oil and gas gross production tax revenue to political subdivisions--Senate Bill No. 2178 and House Bill No. 1044. During deliberation on Senate Bill No. 2178, an amendment was added directing a Legislative Council study of "allocation of oil and gas tax revenues to or for the benefit of political subdivisions with emphasis on determining whether allocations sufficiently address oil and gas development infrastructure impact to political subdivisions." The Legislative Council assigned that study to the interim Taxation Committee.

North Dakota imposes two separate taxes on oil production--the oil extraction tax and the oil and gas gross production tax. Although only under the oil and gas gross production tax are any direct revenue allocations made to political subdivisions, both the oil extraction tax and the oil and gas gross production tax are described in this memorandum.

OIL EXTRACTION TAX ALLOCATION HISTORY

On November 4, 1980, the voters of North Dakota approved initiated measure No. 6 on the general election ballot and established an oil extraction tax as a companion tax to the oil and gas gross production tax that had existed since 1953. The oil extraction tax rate was established at 6.5 percent of the gross value of oil at the well.

Initiated measure No. 6 contained a statement of intent that it would increase funding for education, provide funds for Grafton State School, provide for energy conservation and development programs, equalize the tax structure and revenue sources of the state, provide an income tax credit, and provide a credit for the county 21-mill property tax levy for schools. The initiated measure provided that revenue from the oil extraction tax was to be deposited in a development fund to be allocated 45 percent to the state school aid program, 10 percent to a special resources trust fund to be used for improvements at Grafton State School and for funding energy conservation programs, and 45 percent to the state general fund to offset the income tax and property tax credits provided in the measure. The oil extraction tax allocation provision was codified in North Dakota Century Code (NDCC) Section 57-51.1-07.

The 1983 Legislative Assembly amended NDCC Section 57-51.1-07 to provide for 90 percent of the oil extraction tax collections to be deposited in the general fund and 10 percent in the resources trust fund. In addition, it provided for the money in the resources trust fund to be used for payment of bonds on water-related projects and removed the language authorizing the funding to be used for improvements at Grafton State School. The amendment did not remove the authority to use resource trust fund money on energy conservation programs.

The 1985 Legislative Assembly further amended NDCC Section 57-51.1-07 to provide that the money in the resources trust fund may also be used for planning for and constructing water-related projects, including rural water systems.

In June 1990, the Constitution of North Dakota was amended to establish the resources trust fund as a constitutional trust fund and to provide that the principal and income of the fund could be spent only upon legislative appropriations for constructing water-related projects, including rural water systems and energy conservation programs.

In November 1994, the voters of North Dakota approved a constitutional amendment, which is now Article X, Section 24, of the Constitution of North Dakota, to provide that 20 percent of oil extraction tax collections be allocated to the common schools trust fund (50 percent of the 20 percent) and the foundation aid stabilization fund (50 percent of the 20 percent).

The 1995 Legislative Assembly approved Senate Bill No. 2025, providing for oil extraction taxes to be allocated 20 percent to the resources trust fund; 20 percent pursuant to Article X, Section 24, of the Constitution of North Dakota; and 60 percent to the general fund.

OIL AND GAS GROSS PRODUCTION TAX ALLOCATION HISTORY

The oil and gas gross production tax is imposed under NDCC Chapter 57-51. As enacted in 1953, the oil and gas gross production tax was a tax of 4.25 percent of gross value at the well of oil and gas. In 1957 the rate of the tax was increased to the current rate of 5 percent of gross value at the well of oil and gas. The total net proceeds collected from the gross production tax increased from $306,000 in fiscal year 1954 to over $76 million in fiscal year 1982 and over $104 million in fiscal year 2006.

From 1957 to 1981, the distribution formula for proceeds of the gross production tax remained the same. During that time, the first 1 percent of gross value at the well of oil and gas produced was credited to the state general fund. After deduction of the first 1 percent of tax revenue in each county, the balance was distributed:

1. Of the first $200,000, 75 percent went to the producing county and 25 percent to the state general fund.
2. Of the next $200,000, 50 percent went to the producing county and 50 percent to the state general fund.

3. All remaining revenue was distributed 25 percent to the producing county and 75 percent to the state general fund.

The 1981 Legislative Assembly amended the distribution formula in NDCC Section 57-51-15. This amendment did not change the disposition of the first 1 percent of gross value at the well of oil and gas produced which is credited to the state general fund. Remaining tax revenue from oil and gas produced in each county was distributed:

1. Of the first $1 million, 75 percent went to the producing county and 25 percent to the state general fund.
2. Of the next $1 million, 50 percent went to the producing county and 50 percent to the state general fund.
3. All remaining revenue was distributed 25 percent to the producing county and 75 percent to the state general fund.

The overall effect of the 1981 amendment was to give each producing county $600,000 per year more than prior to 1981 if that county generated $2.5 million or more in annual gas gross production tax revenue.

Another change in allocations made in 1981 was imposition of a cap, or maximum, upon revenues producing counties could receive from the gross production tax for each year of the 1981-83 biennium. The caps were based on the population of each county and increased in the second year of the biennium. At the close of fiscal year 1983, these caps were scheduled to expire. The amounts allocated to a county which exceeded the cap imposed were instead deposited in the state general fund. The maximum amount that a producing county could receive in fiscal year 1983 was:

1. For counties with 3,000 or fewer population - $3,800,000.
2. For counties with population from 3,001 to 5,999 - $4,000,000.
3. For counties with 6,000 or more population - $4,500,000.

The manner in which revenues received by a county are allocated within the county was also changed in 1981. Prior to 1981, NDCC Section 57-51-15 provided for allocation of 40 percent of county revenues to the county road and bridge fund, 45 percent to school districts within the county, and 15 percent to incorporated cities within the county. After the 1981 amendment, county revenues were distributed 45 percent to the county general fund, 35 percent to the school districts within the county, and 20 percent to the incorporated cities within the county. The 1981 legislation also imposed caps upon revenues that may be received by school districts and cities. School districts were limited to a maximum of 70 percent of the county per pupil cost times the number of pupils in attendance or in the school census, whichever is greater, unless the district has an average daily attendance or school census fewer than 400, in which case that district could receive up to 120 percent of the county average per pupil cost times the number of pupils in attendance or in the school census, whichever is greater. Incorporated cities were limited to a distribution not exceeding $500 per capita in any fiscal year. Amounts exceeding the caps for school districts or cities revert to the county general fund.

In 1983, caps for county revenues from oil and gas gross production taxes were extended and increased. The caps were extended only through the 1983-85 biennium and the maximum amounts that a producing county could receive in a fiscal year were:

1. For counties with 3,000 or fewer population - $3,900,000.
2. For counties with a population from 3,001 to 5,999 - $4,100,000.
3. For counties with 6,000 or more population - $4,600,000.

In 1985 the caps on county revenue from oil and gas gross production taxes were made permanent law at the rates established in the 1983 bill.

In 1989 an allocation was provided of up to $5 million per biennium from the first 1 percent of oil and gas gross production tax revenues to the oil and gas impact grant fund and a continuing appropriation was provided in that amount for allocation by the Energy Development Impact Office to oil and gas-impacted political subdivisions.

In 2005 the oil and gas gross production tax allocation for the oil and gas impact grant fund was increased from $5 million to $6 million per biennium beginning with the 2007-09 biennium.

Senate Bill No. 2178 (2007) allows a county that reaches the annual cap on oil and gas gross production tax revenue to receive an additional $1 million in revenues if the county levies a total of at least 10 mills for county road and bridge, farm-to-market and federal-aid road, and county road purposes. Proponents of the bill said counties are experiencing increased road impact and increased road maintenance costs so the bill provides that the additional $1 million of revenues to counties is not for allocations for political subdivisions in the county but must be credited entirely to the county general fund.

House Bill No. 1044 (2007) increases allocations to a producing county from oil and gas gross production taxes by revising the schedule for division of revenues between the producing county and the state general fund as follows:

1. The first $1 million is allocated to the producing county.
2. Of the next $1 million, 75 percent goes to the producing county and 25 percent to the general fund.
3. Of the next $1 million, 50 percent goes to the producing county and 50 percent to the state general fund.
4. All remaining revenue is distributed 25 percent to the producing county and 75 percent to the state general fund.

The net effect of House Bill No. 1044 for a county is a potential increase in allocations to the county of up to $750,000 per year. The allocation change in House Bill No. 1044 does not become effective until August 1, 2008.

SPECIAL PROVISIONS AFFECTING STATE GENERAL FUND ALLOCATIONS OF OIL AND GAS TAX REVENUES

Under NDCC Section 57-51.1-07.2, all revenue deposited in the state general fund during a biennium from combined oil and gas gross production taxes and oil extraction taxes exceeding $71 million must be transferred to the permanent oil tax trust fund. Earnings of the permanent oil tax trust fund may be transferred to the state general fund at the end of each fiscal year but the statute provides that the principal of the permanent oil tax trust fund may not be expended except upon a two-thirds vote of the members elected to each house of the Legislative Assembly.

Under NDCC Section 57-51.1-07.3, 2 percent of the state's share of oil and gas gross production tax and oil and extraction tax revenues must be deposited in the oil and gas research fund, not exceeding $3 million per biennium. All money deposited in the oil and gas research fund is provided as a continuing appropriation to the Oil and Gas Research Council.

The 2007 Legislative Assembly approved House Concurrent Resolution No. 3045, which will be on the state general election ballot in November 2008, to establish a constitutional permanent oil tax trust fund. If approved by the voters, the measure will require all oil and gas production or extraction tax revenue exceeding $100 million during a biennium to be transferred to the permanent oil tax trust fund. The measure would require interest earnings of the permanent oil tax trust fund to be transferred to the general fund at the end of each fiscal year. The measure would prohibit expenditures from the principal of the permanent oil tax trust fund except upon a vote of three-fourths of the members elected to each house of the Legislative Assembly and not more than 20 percent of the principal could be expended during any biennium. If the measure is approved by the voters, it becomes effective on July 1, 2009. If the measure is approved by the voters, Senate Bill No. 2178 repeals the statutory provision for a permanent oil tax trust fund under NDCC Section 57-51.1-07.2 effective July 1, 2009.

ENERGY DEVELOPMENT IMPACT GRANT HISTORY

The 1975 Legislative Assembly enacted Senate Bill No. 2031, which established a coal severance tax and a coal impact aid program. The bill established the Coal Development Impact Office within the Governor's office and provided an appropriation of $5 million to the Coal Development Impact Office for grants to cities, counties, school districts, and other taxing districts impacted by coal development. Thirty-five percent of coal severance tax revenues were allocated to a special fund for coal impact grants. The 1975 coal tax and impact aid program legislation was effective for only two years.

The 1977 Legislative Assembly enacted legislation effective for an additional two years to impose a coal severance tax and provide for a coal impact aid program. The 1977 legislation contained the same provisions relating to the Coal Development Impact Office but provided an appropriation in a separate bill to allow coal development impact grants of approximately $6.7 million.

In 1979, legislation was enacted to move the Coal Development Impact Office from the Governor's office to the Board of University and School Lands. Power to appoint the director of the Coal Development Impact Office was given to the Board of University and School Lands, subject to Senate confirmation. The coal severance tax was again enacted in 1979 but without an expiration date, as had been included in the 1975 and 1977 legislation. The 1979 coal severance tax continued the allocation of 35 percent of coal severance tax revenues to a special fund for distribution for coal development impact grants. A separate 1979 bill provided an appropriation to the Coal Development Impact Office of approximately $8.2 million for allocation of coal development impact grants.

In 1981 the Legislative Assembly enacted House Bill No. 1502 to change the Coal Development Impact Office to the Energy Development Impact Office and to allow the office to provide impact grants for coal development and oil and gas development. Separate 1981 legislation provided an appropriation of $22 million for energy development impact grants, funded by approximately $12 million from the coal development impact fund and $10 million from the state general fund. In 1983 an appropriation of approximately $19.9 million was appropriated to the Energy Development Impact Office for grants to coal or oil development-impacted political subdivisions.

In 1987, legislation eliminated the 35 percent allocation of coal severance tax revenues to the coal development impact fund and increased from 20 percent to 35 percent the allocation of tax revenues to coal-producing counties and increased from 30 percent to 50 percent the allocation to the state general fund. The 1987 legislation provided an appropriation of approximately $1 million to the Energy Development Impact Office for coal development impact grants for the 1987-89 biennium. A separate bill enacted in 1987 provided an appropriation of $2 million for oil development impact grants by the Energy Development Impact Office.

In 1989, taxes on the coal industry were restructured and coal impact grants were eliminated. The requirement of Senate confirmation was eliminated for the director of the Energy Development Impact Office in 1989. Rural development impact grants of $2 million were appropriated to the Energy Development Impact Office. In addition, a statutory allocation was created to deposit up to $5 million per biennium in the oil and gas impact grant fund. A continuing appropriation was provided to the oil and gas impact grant fund for grants through oil development-impacted counties through the Energy Impact Development Office.

Since 1989, oil impact grants have been administered by the Energy Development Impact Office as a division of the Board of University and School Lands. The 2005-07 appropriation for grants from the fund was $4,888,100 and $111,900 was appropriated for administrative expenses to make the total appropriation $5 million. Under 2007 House Bill No. 1013, an appropriation of $5,888,100 was provided for oil impact grants and $111,900 was provided for administrative expenses to make the total appropriation $6 million.

SUGGESTED STUDY APPROACH

To complete its mission of determining whether allocations sufficiently address oil and gas development infrastructure impact to political subdivisions, it is suggested that the committee consider the following:

1. Recent and anticipated oil and gas gross production tax allocations among political subdivisions.
2. Recent oil development impact grants to oil-producing counties and the appropriate relationship between impact funds and direct allocations.
3. The degree of impact to infrastructure in producing counties and surrounding counties from oil and gas development.
4. Recent county infrastructure spending in oil-producing counties.
5. Historical data on highway construction, maintenance, and equipment costs.
6. How to determine appropriate shares of local and state funding for infrastructure maintenance in oil-producing counties, including a review of methods used in other oil and gas-producing states for allocating similar resources between states and political subdivisions.