Fiscal Note 2015 Biennium

GOVERNOR'S OFFICE OF BUDGET AND PROGRAM PLANNING

Bill #	HB0339	**Title:**	Generally revise natural resource tax laws
Primary Sponsor:	Miller, Mike	**Status:**	As Introduced

- ☐ Significant Local Gov Impact
- ☑ Needs to be included in HB 2
- ☑ Technical Concerns
- ☐ Included in the Executive Budget
- ☐ Significant Long-Term Impacts
- ☐ Dedicated Revenue Form Attached

FISCAL SUMMARY

	FY 2014 Difference	FY 2015 Difference	FY 2016 Difference	FY 2017 Difference
Expenditures:				
General Fund	$431,173	$130,229	$23,000	$0
State Special Revenue	($46,000)	($67,000)	($23,000)	$0
Revenue:				
General Fund	($3,866,000)	($714,000)	($244,000)	($218,000)
State Special Revenue	($4,482,000)	($827,000)	($283,000)	($252,000)
Net Impact-General Fund Balance:	($4,297,173)	($844,229)	($267,000)	($218,000)

Description of fiscal impact: HB 339 proposes to generally revise the valuation of oil and natural gas for purposes of determining the state's production tax. The bill essentially redefines the gross value of production as being the gross value of production net transportation and processing costs (volume x price – costs). In addition, HB 339 allows for the deduction of costs including depreciation on investment, property tax payments, indirect costs, and overhead costs. HB 339 is retroactive back to FY 2009 (see technical note).

FISCAL ANALYSIS

Assumptions:

1. Currently, producers of oil and natural gas pay the production tax based on the well-head price of the product being produced. HB 339 will allow filers to deduct from the well-head price: transportation costs incurred for both oil and natural gas and other deductions related to natural gas processing. The following table shows the relevant data for actual oil (first table) and gas production (second table) tax returns for FY 2009 through FY 2012, and forecasted values for FY 2013 through FY 2017. For FY 2016 and FY 2017,

OBPP growth rates were applied to both production levels and Montana prices, and average tax rates were assumed to remain constant. It also provides the common nationally quoted market price for oil, West Texas Intermediate (WTI), and the price of natural gas, Henry Hub.

	FY	Barrels	MT Price	Gross Value	Tax Rate	Tax	Non-Tax Value	WTI
Actual	2009	29.929	71.92	2,152.399	9.70%	203.277	56.681	69.76
Actual	2010	26.790	60.47	1,620.102	10.20%	160.377	43.691	75.20
Actual	2011	24.781	78.58	1,947.329	9.90%	188.114	51.144	89.42
Actual	2012	24.481	88.21	2,159.382	9.50%	199.126	55.693	95.04
Forecast	2013	25.332	85.57	2,167.661	9.30%	195.545	56.257	89.07
Forecast	2014	25.997	82.48	2,144.073	9.30%	194.228	55.645	89.51
Forecast	2015	26.573	78.80	2,093.921	9.40%	191.020	54.343	84.15
Forecast	2016	26.754	77.00	2,060.113	9.40%	188.662	53.071	82.50
Forecast	2017	26.075	83.74	2,183.598	9.40%	200.386	51.830	89.37

	FY	MCF	MT Price	Gross Value	Tax Rate	Tax	Non-Tax Value	Henry Hub
Actual	2009	108.884	5.03	547.756	8.80%	46.279	24.422	5.94
Actual	2010	97.972	3.12	305.969	9.80%	28.668	14.269	4.21
Actual	2011	85.445	3.42	291.906	9.90%	27.486	13.262	4.14
Actual	2012	76.080	2.90	220.641	9.90%	20.747	10.149	3.04
Forecast	2013	71.991	2.83	204.028	10.00%	19.525	9.373	3.27
Forecast	2014	64.930	3.90	253.128	10.10%	24.349	11.629	4.54
Forecast	2015	58.273	4.32	251.467	10.00%	23.960	11.553	5.37
Forecast	2016	53.518	3.80	203.358	10.00%	19.188	11.477	4.19
Forecast	2017	52.914	3.73	197.572	10.00%	18.617	11.402	4.09

2. The following table shows the difference (in millions) in the actual or forecasted gross values of production using Montana prices and the nationally quoted price. Reasons for this differential are discussed below.

	FY	Value of Differential for Oil	Value of Differential for Gas
Actual	2009	-64.673	98.735
Actual	2010	394.417	106.945
Actual	2011	268.495	62.221
Actual	2012	167.184	11.014
Forecast	2013	88.570	31.603
Forecast	2014	182.871	41.395
Forecast	2015	142.291	61.653
Forecast	2016	147.152	21.084
Forecast	2017	146.880	18.807

3. This price differential exists for several reasons, including transportation costs, quality differences, pipeline capacity constraints, and other factors. In FY 2009, the average oil price in Montana was greater than WTI, but this is assumed to be an anomaly due to the large price fluctuations that occurred in that year.
4. For fiscal note purposes, it is assumed that because the majority of producers already receive the discounted Montana oil and gas prices from buyers, most of the transportation costs born through the process of getting

the oil and gas from the well head to the refineries would not reduce the gross value of production as defined in HB 339.

5. It is also assumed that the majority of oil and gas produced is transported from the well head to nearby holding tanks, and that the buyers pay the producers the discounted Montana prices for the product at these holding tanks. It is assumed that the producers bear all of the transportation costs associated with getting the product to the holding tanks—costs which have historically fluctuated significantly. HB 339 would allow these costs to be deducted prior to calculating the gross value of production.
6. The provisions of HB 339 also allow producers to claim additional deductions related to the processing of natural gas and for fiscal note purposes, an additional 25% of the natural gas gross value differential is estimated to be deductible. The fiscal impact of the natural gas processing cost deduction is likely to be understated.
7. The estimated effective tax rates and non-taxable amounts contained in assumption #1 are expected to remain the same. The estimated effect of HB 339 on total revenue (in millions) is presented in the table below.

FY	Oil Revenue	Gas Revenue
2009	0.000	-2.080
2010	0.000	-2.620
2011	0.000	-1.540
2012	0.000	-0.273
2013	0.000	-0.790
2014	0.000	-1.045
2015	0.000	-1.541
2016	0.000	-0.527
2017	0.000	-0.470

8. As mentioned in assumption #3, because of the large variation in FY 2009 prices, the average of FY 2010 and FY 2011 are used to calculate the reduced revenue that would be received in FY 2009 as a result of HB 339.
9. For FY 2009 through FY 2012, the refunded revenue is assumed to be paid from each fund in a proportional manner in which the funds were originally distributed. For FY 2013 through FY 2017, the refunded amount or the reduction in revenue is assumed to be distributed proportional to the distribution of the FY 2012 oil and natural gas production tax revenue.
10. Because the bill does not have an effective date, the refunded revenue for FY 2009 through FY 2013 is assumed to occur in FY 2014. By rule, the changes to revenue for prior periods are distributed in proportion to the current distribution. Therefore, the FY 2012 distributions are expected to remain constant with the exception of the expiration of provisions of SB 329 of the 2011 Legislative Session (which cap oil and gas revenues that school districts receive at 130% of their maximum budgets). The following table shows the change in revenue for each fund receiving oil and gas revenues for FY 2014 through FY 2017.

	FY 2014	FY 2015	FY 2016	FY 2017
Total Revenue Reduction	**(8.348)**	**(1.541)**	**(0.527)**	**(0.470)**
BOGC	(0.079)	(0.015)	(0.005)	(0.004)
O&G Natural Resource Account	(0.149)	(0.027)	(0.009)	(0.008)
Remainder	(8.120)	(1.499)	(0.513)	(0.457)
"County" Revenue	(3.835)	(0.708)	(0.242)	(0.216)
Counties and Schools	(3.314)	(0.612)	(0.209)	(0.216)
Guarantee Fund	(0.365)	(0.067)	(0.023)	0.000
County Impact Fund	(0.130)	(0.024)	(0.008)	0.000
State School Impact Fund	(0.026)	(0.005)	(0.002)	0.000
"State" Revenue	(4.286)	(0.791)	(0.271)	(0.241)
Natural Resources Projects	(0.093)	(0.017)	(0.006)	(0.005)
Natural Resources Operations	(0.087)	(0.016)	(0.005)	(0.005)
Orphan Share Fund	(0.126)	(0.023)	(0.008)	(0.007)
University Millage	(0.114)	(0.021)	(0.007)	(0.006)
General Fund	(3.866)	(0.714)	(0.244)	(0.218)

11. It is estimated that HB 339 will require 1.00 FTE in FY 2014 and 2015 with a personal service cost of $53,757 per year. The FTE is required to manage the workload associated with the creation of the new deductible cost reporting and the handling of amended tax returns, and for compliance and auditing purposes. In addition, it will cost the Department of Revenue $12,416 in FY 2014 and 9,472 in FY 2015 in other operating costs.

Office of Public Instruction

12. Revenue in the state special revenue Guarantee Account is used as the first source of funding for K-12 BASE Aid. A reduction of revenue in FY 2014 – FY 2016 would require a reduction in expenditures and the expenditures would be required to backfilled from the general fund. This would be $46,000 in FY 2014, $67,000 in FY 2015, and $23,000 in FY 2016. In addition, since the entire amount of revenue is distributed each fiscal year to schools, there is no revenue in the account to refund the amounts for FY 2009 – FY 2013 for the retroactive applicability of the bill. Therefore, it is assumed this refund would be paid from the general fund. This amount would be $319,000 in FY 2014 only.

	FY 2014 Difference	FY 2015 Difference	FY 2016 Difference	FY 2017 Difference
Fiscal Impact:				
FTE	1.00	1.00	0.00	0.00
Expenditures:				
Personal Services	$53,757	$53,757	$0	$0
Operating Expenses	$12,416	$9,472	$0	$0
Guarantee Account Backfill	$319,000	$0	$0	$0
TOTAL Expenditures	$385,173	$63,229	$0	$0
Funding of Expenditures:				
General Fund (01)	$431,173	$130,229	$23,000	$0
State Special Revenue (02)	($46,000)	($67,000)	($23,000)	$0
TOTAL Funding of Exp.	$385,173	$63,229	$0	$0
Revenues:				
General Fund (01)	($3,866,000)	($714,000)	($244,000)	($218,000)
State Special Revenue (02)	($4,482,000)	($827,000)	($283,000)	($252,000)
TOTAL Revenues	($8,348,000)	($1,541,000)	($527,000)	($470,000)
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
General Fund (01)	($4,297,173)	($844,229)	($267,000)	($218,000)
State Special Revenue (02)	($4,436,000)	($760,000)	($260,000)	($252,000)

Technical Notes:

Department of Revenue

1. HB 339 states that if employing a hierarchy of attempts to find a marketable gross value fails, the operator must use a posted price in the field or in the area. The bill fails to provide direction to the operator if there is not a posted field price.
2. HB 339 does not have an effective date, so it is assumed to be October 1, 2013. Therefore, the retroactive portion of this legislation would begin for the final quarter of FY 2013 and apply retroactively back five years to FY 2009.

Office of Budget and Program Planning

3. HB 339 provides allowances for costs associated with storage and processing, as well as expectations of a reasonable return on investment, and the fiscal impact of these allowances is unclear. As such, the fiscal impact provided for in this fiscal note may be understated.
4. Estimating the costs associated with assumption 5 is not feasible at this point due to lack of available data. As such, the fiscal impact provided for in this fiscal note may be understated.

Department of Natural Resources and Conservation

5. Gross value is recognized as the revenue received by the seller exclusive of any deductions. HB 339 redefines gross value as including deductions for various costs and expenses from the revenue received by the seller. The result is a net value after deductions. In Section 1(3)(b), transportation costs are deducted from the gross value. Transportation and processing costs are deducted from gross value to determine the valuation shown in HB 339, but the value after deductions is also called the gross value.

6. A conflict is created if the definition of gross value pursuant to HB 339 was applied to state school trust royalty obligations. Gross value under HB 339 is calculated after deductions for various costs and expenses. State school trust royalty reservations in oil and gas leases issued by the State Board of Land Commissioners (Land Board) are free of costs or deductions.
7. Should HB 339 apply to state school trust royalty obligations, the fiscal impact to these obligations would likely be in excess of $1 million annually.
8. 77-3-432, MCA, recognizes that the determination of royalties must be equivalent to the full market value, as ascertained by the Land Board. The Land Board has implemented this provision by including language in oil and gas leases for state school trust lands that provides for valuation at the location where product is delivered to the credit of the lessee, free of costs or deductions. A scenario could present itself that HB 339 would prevent the Land Board from implementing the royalty reservation terms it has determined represent full market value to the school trusts.
9. Section 2 of HB 339 allows retroactive application. Assuming a retroactive period of seven years is applied (per 77-3-435(2), MCA), an additional royalty loss of $10.9 million could be generated.

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Sponsor's Initials	*Date*	*Budget Director's Initials*	*Date*