STATE OF NORTH DAKOTA
OFFICE OF STATE TAX COMMISSIONER
Cory Fong, Commissioner

To: Oil and Gas Producers and Purchasers
From: North Dakota Office of State Tax Commissioner
Date: August 2013
Subject: 2013 Legislative Changes to Gross Production Tax and Oil Extraction Tax

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House Bill 1134:

The final version of this bill, signed by the Governor, is available from the Secretary of State web site at ***www.nd.gov/sos/lr/scannedbills/1134.pdf***. Links to the North Dakota Century Code Sections applicable for gross production tax and oil extraction tax are also on the Tax Department's web site at ***www.nd.gov/tax/centurycode***. The links are listed under Oil and Gas.

House Bill 1134 provides for gross production tax, oil extraction tax, and sales tax exemptions as incentives to encourage the use of natural gas that would otherwise be flared.

North Dakota Industrial Commission Department of Mineral Resources, Oil and Gas Division (NDIC) rules allow for the flaring of natural gas for a period of one year from the date of first production. After the one-year period, the NDIC requires flaring to cease and the producer must begin to pay royalties to royalty owners for the value of any flared gas. Producers are also required to pay gross production tax on the flared gas.

When the one-year period for flaring expires, the producer must cap the well or connect it to a gas gathering line, unless the NDIC approves an exemption.

A temporary exemption from the gross production tax is available for a period of two years and thirty days from the time of first production. This applies to oil and gas wells employing a collection system to avoid flaring if the well is:

a. Equipped with an electrical generator that consumes at least 75% of the gas from the well; or

b. Equipped with a system that intakes at least 75% of the gas and gas liquids from the well for beneficial consumption by means of compression to liquid for use as fuel, transport to a processing facility, production of petrochemicals or fertilizer, conversion to liquid fuels, or separating and collecting in excess of 50% of the propane and heavier hydrocarbons; or

c. Equipped with other value-added processes as approved by the NDIC, which reduce the volume or intensity of the flare by more than 60%.

Liquids produced from a qualifying collection system utilizing absorption, adsorption, or refrigeration are exempt from oil extraction tax for a period of two years and thirty days from the time of first production.

Upon application to, and approval by, the NDIC for qualification of a collection system, the Tax Commissioner's Office will issue a notice informing the producer that a well has qualified for the applicable exemption and provide the required reporting procedures.

Sales and use tax exemptions are available for material used in the construction or expansion of a facility to compress, process, gather, collect, or refine gas. For information regarding these exemptions, please contact our Sales Tax Compliance Section at 701.328.1246 or ***salestax@nd.gov***.

House Bill 1198:

The final version of House Bill 1198, signed by the Governor, is on the Secretary of State web site at ***www.nd.gov/sos/lr/scannedbills/1198.pdf***. Links to the North Dakota Century Code Sections applicable for gross production tax and oil extraction tax are also on the Tax Department's web site at ***www.nd.gov/tax/centurycode***. The links are listed under Oil and Gas.

House Bill 1198 addresses stripper well properties and stripper wells. The bill provides for a reduced tax rate for certain wells drilled and completed outside the Bakken and Three Forks formations. House Bill 1198 eliminates the sixty-month oil extraction tax exemption for wells drilled and completed on Indian lands after June 30, 2013. This bill also provides for the withholding of income tax from certain royalty payments to nonresidents.

The NDIC has jurisdiction and authority, and is charged with recertifying stripper wells that are reentered and recompleted as horizontal wells. The reentered or recompleted well will lose its stripper status until the well's new production qualifies for stripper status.

Changes were made to the definitions of "stripper well property" and "stripper well." "Stripper well property" means wells drilled and completed, or a well reentered and recompleted as a horizontal well, before July 1, 2013, and whose average daily production meets the stripper production requirements. "Stripper well" means a well drilled and completed, or reentered and recompleted as a horizontal well, after June 30, 2013, and whose average daily production meets the stripper production requirements. The average daily production qualification for a "stripper well" in the Bakken or Three Forks formations at a depth of more than ten thousand feet was increased to 35 barrels per day. The NDIC will assign an "S4" well code to wells qualifying as stripper wells in the Bakken and Three Forks formations.

a. Stripper properties are being phased out – only wells drilled and completed prior to July 1, 2013, may be classified as part of a stripper property. Existing stripper properties will continue to maintain the stripper property status.

b. Wells drilled and completed after June 30, 2013, on an existing stripper well property will no longer automatically receive the stripper exemption. The individual well will have to qualify based on the production from that well.

c. Stripper wells reentered and recompleted as horizontal wells will lose the stripper status even if they are part of an existing stripper property. The well must qualify for stripper status based on new production from that well.

A reduced oil extraction tax rate of 2% is available for wells drilled and completed after June 30, 2013, outside the Bakken and Three Forks formations and ten miles or more outside an established field in which the NDIC has defined the pool to include these formations. The first seventy-five thousand barrels of oil produced during the first eighteen months after completion is subject to the reduced rate. The NDIC will assign an “RN” well code to wells qualifying for the reduced rate.

Initial production of oil from wells drilled and completed before July 1, 2013, on lands within the boundary of an Indian reservation, or land held in trust by the United States for an Indian tribe or individual Indian, is exempt from oil extraction tax for a period of sixty months. This exemption does not apply to production from wells drilled and completed on Indian lands after June 30, 2013.

Upon application to, and approval by, the NDIC for qualification of any of the exemptions or rate reductions, the Tax Commissioner’s Office will issue a notice informing the producer that a well has qualified for the applicable exemption or rate reduction and provide the required reporting procedures.

The bill also provides newly created income tax withholding requirements. The withholding requirements apply to royalty payments made by companies to nonresidents. For information regarding the withholding requirements, please contact our Income Withholding Tax Section at 701.328.1248 or ***withhold@nd.gov***.

Contact our office at 701.328.3657 or ***oiltax@nd.gov*** if you have any questions.