Oil and Gas Tax Newsletter

NORTH DAKOTA OFFICE OF STATE TAX COMMISSIONER

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Income and Oil Taxes Division

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LEGISLATIVE CHANGES TO THE GROSS PRODUCTION TAX AND OIL EXTRACTION TAX LAWS

The 2001 Legislative Assembly enacted two bills that change the provisions of the gross production tax and oil extraction tax laws. **HB 1064** relates to the publication of the annual gas base rate adjustment, tax payment, computation of tax on incorrect returns, time for claiming credits or refunds, and date limitations under the gross production and oil extraction tax. **SB 2205** revises the trigger price that determines the application of oil extraction tax rates and exemptions. Changes are described in more detail below.

HB 1064: PUBLICATION OF GAS BASE RATE ADJUSTMENT AND OTHER CHANGES

North Dakota Century Code (N.D.C.C.) § 57-51-02.2 was amended to remove the requirement that the annual gas base rate adjustment be published as a rule in the North Dakota Administrative Code (N.D.A.C.). The Commissioner is still required by statute to send written notice to affected producers by June 1 of each year. Notice is also sent to all gas purchasers, is included in all newsletters, is provided in mailings to new operators, and is published on the Commissioner's web site at ***www.ndtaxdepartment.com.***

N.D.C.C. § 57-51-05 was amended to clarify that all oil produced and sold, either at the time of production or from inventory, is subject to tax. In the administration of the tax, returns are filed at the time oil or gas is sold and proceeds are distributed thus making funds available for payment of the tax. Inventory volumes are not sold at the time of production and tax is not reported and paid until those volumes are sold.

N.D.C.C. §§ 57-51-02.2, 57-51-05, 57-51-09, 57-51-19, 57-51.1-01, and 57-51.1-03 were amended to remove references to effective dates that are no longer necessary to the application of the statute. All of the referenced effective dates that were removed have expired and are no longer necessary.

The effective date of this legislation is August 1, 2001.

SB 2205: OIL EXTRACTION TAX EXEMPTION TRIGGER

Prior to the implementation of this legislation, N.D.C.C. § 57-51.1-01 included a trigger provision which provided that, if the average price of a barrel of crude oil was $33 or more for any consecutive five-month period in any year, certain oil extraction tax exemptions and rate reductions were no longer in effect and the applicable tax rate was 6.5%. After the trigger provision would become effective, if the average price was less than $33 for any consecutive five-month period in any year, the rate reductions and any remaining exemptions would be reinstated.

N.D.C.C. § 57-51.1-01 was amended and reenacted to create a definition of "trigger price" to identify the specific price used to determine when the exemption trigger takes effect. Trigger price means $35.50, which is indexed for inflation each year. By December 31 of each year, the Commissioner must compute an indexed trigger price for the following calendar year by applying the rate of change in the producer price index for industrial commodities for the twelve-month period ending June 30 of that year, as published by the United States Department of Labor.

The definition of "average price" was amended to mean the monthly average of the daily closing price for a barrel of West Texas Intermediate Cushing crude oil, as those prices appear in the Wall Street Journal, minus $2.50. In computing the monthly average price, the most recent daily closing price is considered the daily closing price for those days when the market is closed.

For the trigger provision to take effect, the average price of a barrel of crude oil must exceed the trigger price for each month in any consecutive five-month period. The applicable oil extraction tax exemptions and rate reductions will no longer be in effect and the tax rate will be 6.5%. When the average price for a barrel of crude oil is less than the trigger price for each month in a consecutive five-month period, the rate reductions and any remaining exemptions would be reinstated.

The effective date of this legislation is for production occurring after June 30, 2001.

GAS TAX RATE FOR FISCAL YEAR 2002

In keeping with the provisions of N.D.C.C. § 57-51-02.2, the Commissioner has determined that the gas tax rate for the fiscal year beginning July 1, 2001, through June 30, 2002, is $.0772 per mcf. The gross production tax on gas produced during this time period must be calculated by taking the taxable production in mcf times the $.0772 gas tax rate.

The annual average of the gas fuels producer price index was calculated at 146.1. A gas base rate adjustment of 1.9300 was computed by dividing the annual average price index by the denominator specified by statute, (i.e., 146.1 divided by 75.7). The gas rate was then computed by multiplying $.04 times the gas base rate, with the resultant rounded to four places after the decimal, (i.e., .04 times 1.9300).

NEW DATABASE SYSTEM

The Commissioner would like to extend his appreciation to producers and purchasers for their patience and cooperation in implementing the conversion to the new database system. As expected, we have experienced some minor bumps along the way, but overall we are very pleased with the transition.

The client server database system has been in use for almost a year. Although we continue to fine-tune the system, we feel we have achieved major processing improvements. The system provides the resources for real-time storage and access to data. With the database query capabilities, we are able to compile statistical data and respond to information requests in a timely manner.

PRODUCER WAIVERS

With the implementation of the database system, the Commissioner began to grant waivers of the requirement that producers file oil and gas reports each month. In order to receive a waiver, the producer must agree to have the purchaser submit tax due with their return, in addition to other requirements. To date, a majority of producers have taken advantage of the oil and gas waiver opportunity and no longer are required to submit a monthly oil or gas report. Even though a waiver is granted, it does not apply to the Form 5, which is still required to be submitted to the North Dakota Industrial Commission each month. If you are a producer and have not submitted a waiver application, the Commissioner encourages you to consider doing so. Waiver applications are available on the Commissioner's home page at ***www.ndtaxdepartment.com,*** by contacting our office at (701) 328-3593, or e-mail at oiltax@state.nd.us.

ELECTRONIC FILING

The Commissioner would like to thank oil and gas purchasers for their assistance and cooperation in achieving 100% participation from them in the electronic filing program. The Commissioner has the authority, by statute, to require purchasers to file oil and gas reports electronically. With the completion of the new database, the expectation was to work with purchasers over a period of several months to help them choose an appropriate electronic filing option, conduct testing, and ultimately submit reports electronically. Purchasers were very receptive to electronic filing, which allowed us to complete the process in a fraction of the time we anticipated.

The Commissioner would also like to thank producers that made the decision to take advantage of electronic filing. Even though producers participate on a voluntary basis, 38% of the producers that submit reports, do so electronically. We encourage producers that do not file electronically to consider the advantages of doing so.

Of the original oil and gas reports currently received from purchasers and producers, 82% are submitted electronically. The most common option chosen to electronically report is an Excel spreadsheet as an attachment to an e-mail. EDI (electronic data interchange) is the option used for some of the larger reports with the files submitted using an FTP connection or attaching to an e-mail.

The Excel spreadsheet, in a format required for electronic filing, and the EDI documentation are available on the Commissioner's home page at ***www.ndtaxdepartment.com***, by contacting our office at (701) 328-3657 or e-mail kschatz@state.nd.us.

Electronic filing provides benefits to both the Commissioner and the taxpayer. With the elimination of the data entry function and reduction of other human intervention comes a decrease in the number of errors that are experienced. This reduces the need to file amended returns to make corrections and decreases the time required for the filing and processing functions. Another important advantage is the reduced cost and time involved in filing and processing returns.

ELECTRONIC PAYMENTS

To make the entire oil and gas reporting process paperless, several producers and purchasers that file electronically have also elected to make their payments electronically. Some producers that continue to file paper reports have also chosen to pay electronically. Electronic payments total 29% of all payments received for original oil and gas reports.

The Commissioner allows an ACH (Automated Clearing House) credit to be used for submitting tax payments. An ACH credit is originated by contacting your bank and providing the Commissioner's bank routing number, account number, the amount of your payment, and the date you wish the funds to be transferred. You will also be required to provide addenda record information to insure that the payment is properly applied to the related tax report. Payments must be initiated by the due date of the report to be considered timely. You will need to check with your financial institution to see if there is a charge to initiate these transactions.

When paying multiple returns electronically, an addenda record is required for each report being paid. Two options, depending on your internal and financial institution capabilities, are available for submitting multiple payments. The first option is to use the CCD+ format, which allows one addenda record to be attached to an ACH credit. This requires a separate ACH credit, with an attached addenda record, to be submitted for each report. The second option is to use the CTX format, which allows several addenda records to be attached to a single ACH credit. One ACH credit for the total amount of multiple reports can be submitted because of the addenda record capabilities.

You can find the information needed to start making payments electronically on the Commissioner's home page at ***www.ndtaxdepartment.com***, by contacting our office at (701) 328-3657, or e-mail kschatz@state.nd.us.

HOME PAGE

If you have an Internet connection, the Commissioner encourages you to take advantage of the abundance of information available on the department's home page at ***www.ndtaxdepartment.com.*** Statutes, applications, forms, instructions, publications, and other useful information are available for several of the tax types. Many of the forms and applications are available in a fill-in format so they can be completed on screen and printed. Information is also available on electronic filing and electronic payment options offered by the Commissioner. You can also link to the State of North Dakota's home page at ***www.discovernd.com***, where links to the various state agencies are available.

The following is the specific information available from the Oil and Gas Tax Section on the home page:

- Oil and gas tax law and rules.
- Oil and gas historical overview.
- Report due date schedule.
- Schedule of observed State holidays.
- Frequently asked questions.
- Notification of gas tax rate adjustment.
- Newsletters and other publications.
- Oil and gas reporting instructions.
  - Oil and gas manual and electronic filing Excel spreadsheet formats and instructions.
  - EDI (electronic data interchange) formats and instructions.
  - Enhanced recovery reports and schedules in Excel spreadsheet formats.
  - Oil and gas producer waiver forms and instructions.
  - Pool code, posting code, and gas tax rate tables.
  - EFT (electronic funds transfer) and check payment voucher forms and instructions.

You can contact the Oil and Gas Tax Section by e-mailing us at ***oiltax@state.nd.us***.

COMPLIANCE

The compliance portion of the new database system has recently been completed. The compliance program is designed to check for discrepancies between the taxpayer's reported sales volumes and the volumes reported to the North Dakota Industrial Commission by the operator on their monthly Form 5. In addition, volumes are compared by pool and well code to insure proper volumes are reported for the specific tax rates. If a discrepancy is revealed, the error is reviewed and, if necessary, a worksheet is mailed to the reporting parties requesting them to address the error. Resolution of the discrepancy will usually require the tax report or the Form 5 to be amended.

Value, royalty, and most well code issues will no longer be addressed in conjunction with the compliance program but will be assigned to the audit staff for review.

OIL VALUATION

The value of oil for tax and royalty reporting purposes is an issue that is prevalent throughout the country. N.D.C.C. § 57-51-02 states that tax is levied on the gross value at the well for all oil produced, less that portion which is exempt. N.D.A.C. § 81-09-02-01 defines gross value at the well to mean fair market value at the time of production.

Fair market value includes the value of any consideration received from the sale and should be included in determining taxable value. A premium or bonus is considered additional consideration and can be a specific dollar per barrel amount paid over and above the posted price or can be implied, including an incremental value embedded in a signature bonus, location differential, or an exchange agreement price differential that does not reflect apparent value of the respective crudes. Transportation costs, as defined in N.D.C.C. § 57-51-01, may be deducted in determining gross value.

Exchange and buy/sell agreements under which a producer exchanges oil at one location for oil at another location may not represent the fair market value of the production being traded, even though the contract may appear to be arm's-length. Fair market value must reflect the total consideration received under any agreement. In the absence of an arm's-length contract, gross value is determined by using the first applicable of the three methods given under N.D.C.C. § 57-51-02.3.

REMINDERS

When submitting a report electronically you will receive an acknowledgment via an e-mail reply usually within 24 hours. If you do not receive an acknowledgment, you should contact this office to inquire if your electronic report was received.

For reports to be considered timely, the report and the payment must both be submitted by the due date. Checks and paper reports must be postmarked by the due date, electronic reports must be transmitted by the due date, and you must contact your bank to initiate an electronic payment by the due date.

To claim an exempt royalty interest, documentation to support a claim must be submitted within ninety days after the first report is filed on a new property.

Producers are encouraged to review production and reporting history and take full advantage of tax incentives by receiving certifications from the Industrial Commission. It is the producer's responsibility to make certain that the Commissioner receives a copy of the certification within the 18-month deadline. If the 18-month deadline is approaching and a producer is not certain that a certification has been received by the Commissioner, it is advisable to contact this office.

To verify an API number, well code, or other information relating to an existing well, call (701) 328-2747 or e-mail ***oiltax@state.nd.us***. Any oil producer or purchaser filing a report on a particular well for the first time is especially encouraged to contact us for information on the well's current tax status.

Each operator of an oil pipeline must file a report showing its volume gains and volume losses for the calendar year. The report can be filed in the form of the pipeline's "over and short" reports compiled during the ordinary course of business. These reports are due by the twenty-fifth of February following the end of calendar year.

IF YOU NEED ASSISTANCE

If you have additional questions about the oil and gas tax requirements, please contact:

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