North Dakota Office of State Tax Commissioner

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Oil & Gas Tax Newsletter

News and developments

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Legislative changes to the gross production tax and oil extraction tax laws

The 2003 Legislative Assembly enacted two bills that change the provisions of the gross production tax and oil extraction tax laws. **HB 1145** provides for a temporary exemption from the gross production tax for gas produced from shallow gas wells. **HB 1210** revises the eligibility requirements for qualifying a two-year inactive well and a work-over well for an oil extraction tax exemption. **SB 2311** creates an oil and gas research council and establishes an oil and gas research fund. Changes are described in more detail below.

Inside this issue:

HB 1145: Gross production tax exemption for shallow gas wells

A new section was created in North Dakota Century Code (N.D.C.C.) § 57-51 to provide for a temporary gross production tax exemption for gas produced from shallow gas wells. Shallow gas produced during the first 24 months of production from a well completed or recompleted in a shallow gas zone after June 30, 2003, is exempted from gross production tax. New subsections were created in N.D.C.C. § 57-51-01 to define “shallow gas” and “shallow gas zone”.

This legislation is effective August 1, 2003 through June 30, 2007.

HB 1210: Eligibility requirements for two-year inactive and work-over wells

Subsection 12 of N.D.C.C. § 57-51.1-01 was amended for changes to the definition of “Two-year inactive well”. A two-year inactive well means any well certified by the Industrial Commission that did not produce oil in more than one month in any consecutive twenty-four month period before being recompleted or otherwise returned to production after July 31, 1995. A well that has never produced oil, a dry hole, and a plugged and abandoned well are eligible for status as a two-year inactive well. The requirement that a well could not have production in more than one month in the two years prior to the date of application was removed.

A new subsection to N.D.C.C. § 57-51.1-03.1 was created that states to receive from the first day of eligibility, a tax exemption on production from a two-year inactive well for exemption from the oil extraction tax, the Industrial Commission’s certification must be submitted to the Tax Commissioner within eighteen months after the end of the two-year inactive well’s qualification period. This eighteen month qualification requirement makes the two-year inactive well exemption consistent with other oil extraction tax exemptions.

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N.D.C.C. § 57-51.1-03 was amended to remove the requirement that a well operator must file a notice of intent with the Industrial Commission prior to commencement of a work-over project.

This legislation becomes effective August 1, 2003.

SB 2311: Oil and Gas Research Council

A new section to N.D.C.C. ch. 57-51.1 creates an oil and gas research council. The council's purpose is to coordinate a program designed to demonstrate to the general public the importance of the state oil and gas exploration and production industry, to encourage and promote the wise and efficient use of energy, to promote environmentally sound exploration and production methods and technologies, to develop the state's oil and gas resources, and to support research and educational activities concerning the oil and natural gas exploration and production industry.

The new section also establishes an oil and gas research fund and provides for a continuing appropriation from the state's share of oil and gas gross production tax and oil extraction tax.

The North Dakota Industrial Commission has been assigned the responsibility to operate, manage, and control the council. The council is to be composed of seven members, four of whom must currently be engaged in and have at least five years of active experience in the oil and natural gas exploration and production industry.

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Gas tax rate for fiscal year 2004

In keeping with the provisions of N.D.C.C. § 57-51-02.2, the Tax Commissioner (Commissioner) has determined that the gas tax rate for the fiscal year beginning July 1, 2003, through June 30, 2004, is $.0615 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 $.0615 gas tax rate.

The annual average of the gas fuels producer price index was calculated at 116.3. A gas base rate adjustment of 1.5363 was computed by dividing the annual average price index by the denominator specified by statute, (116.3 ÷ 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, (04 x 1.5363).

Annual oil trigger price adjustment

If the average price of a barrel of crude oil (monthly average daily closing price for a barrel of west Texas intermediate Cushing crude oil minus two dollars and fifty cents) exceeds the trigger price for each month in any consecutive five-month period, certain exemptions and rate reductions become ineffective. The exemptions and rate reductions are subsequently reinstated if the average price is less than the trigger price for each month in any consecutive five-month period.

In keeping with the provisions of N.D.C.C. § 57-51.1-01, the Commissioner has determined that the oil trigger price for the calendar year January 1, 2003, through December 31, 2003, is $33.88.

The annual average of the industrial commodities producer price index for fiscal year 2002 was calculated at 131.7. A base rate adjustment of .95435 was computed by dividing the annual average price index by the base rate index of 138.0, which was determined using the 2001 fiscal year average, (131.7 ÷ 138.0). The effective trigger price of $33.88 was then computed by multiplying the trigger price of $35.50 specified by statute times the base rate adjustment, ($35.50 x .95435).

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.

"Fair market value includes the value of any consideration received from the sale and should be included in determining taxable value."

Reporting the value of oil on the monthly T-12 oil report

The Commissioner has designed the T-12 Oil Report to provide for the reporting of oil value information. The information is reported by completing the Posting Code, Additional Value, Transportation Deduction, and Other Deduction fields on the report. The Posting Code is a required field, the other fields are required to be completed if applicable.

The Posting Code field is to include the applicable code from a list assigned and provided by the Commissioner. The list includes published postings and/or combinations of postings used by various companies. The list is available online at ***www.ndtaxdepartment.com*** or by contacting the Commissioner's office. If you are using a posting that is not on the list please request that a code be assigned.

The Additional Value field should include any value added to the posted price such as a bonus or differential. The Transportation Deduction field should include any transportation deduction as allowed by statute. The Other Deductions field should include deductions such as those for gravity or a differential. The posted price plus any additional value, less any deductions, should equal the value reported for tax purposes. All of these fields should be entered as positive amounts.

It is essential that the oil value information is reported correctly. The Commissioner monitors postings and reviews the reported value information to ensure compliance with the tax statutes.

Electronic payments

The Commissioner encourages you to take advantage of the electronic options available for submitting tax payments. To make the entire oil and gas reporting process paperless, several producers and purchasers have elected to make their payments electronically.

The Commissioner allows for an ACH (Automated Clearing House) credit or a wire transfer to be used for submitting tax payments. These options are 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 ensure 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.

"The Commissioner allows for an ACH (Automated Clearing House) credit or a wire transfer to be used for submitting tax payments."

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 ACH credit CCD+ format, which allows one addenda record to be attached to the transaction. This requires a separate ACH credit, with an attached addenda record, to be submitted for each report. Wire transfer capabilities are similar to this option. The second option is to use the ACH credit CTX format, which allows several addenda records to be attached to a single transaction.

You can find the electronic payment information online at ***www.ndtaxdepartment.com,*** by contacting our office at (701)328-3657, or e-mail kschatz@state.nd.us.

Tax Department web site

If you have access to the Internet, the Commissioner encourages you to take advantage of the abundance of information available on the department's web site at ***www.ndtaxdepartment.com.*** Statutes, applications, forms, instructions, and other useful publications 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 access the State of North Dakota's home page at ***www.discovernd.com***, where links to the various state agencies are available.

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

Common reporting errors

The Commissioner has found errors that are common to reports submitted by several filers. These errors do not allow the reports to be processed until changes are made to the reports or replacement reports are submitted. An explanation of the proper reporting procedures should help filers avoid these common errors.

Electronic reports submitted on an Excel spreadsheet are required to be submitted on the template that is provided by the Commissioner. The template provides the proper format necessary to upload the file to the Commissioner's database system. DO NOT change the names of the "coversheet" and "worksheet" spreadsheet tabs, enter any data in the cells directly below the last line entry, or link to another file.

You are required to complete all of the fields on the report unless an exemption applies or the additional value or deductions fields do not apply.

Enter the correct production month in the correct format (June 2003 = 200306 not 062003).

If the "Total Remitted with Return" on an amended report results in a credit amount, be sure to indicate on the coversheet how you want the credit amount applied (C for credit or R for refund).

Use of the sequence number appears to be confusing to many filers. The sequence number is to be used when reporting more than one line entry for an individual well for a period. In subsequent periods, when you are amending a well for a previous period you must use the same sequence number that was used to originally report the well entry you are trying to amend. If adding an additional well entry on an amended return you must use another sequence number.

The "Tax Previously Paid" field must include the total amount paid for a well entry on a previous return. If this amount exceeds the "Total Tax Due", the "Tax Paid with Report" will result in a credit amount; if it is less than, it will result in additional tax due.

Incorrect well codes and pool codes are very common errors on reports. The Commissioner's database verifies the current status of well and pool codes for individual wells while processing, if the wrong codes are reported the report will suspend and require changes before processing can be completed. Filers should verify these codes and make updates as necessary to avoid incorrect reporting.

"For reports to be considered timely, the report and the payment must both be submitted by the due date."

Reminders

The Commissioner offers individual training sessions on proper reporting procedures and extends an invitation to any company who feels this would be beneficial. Contact Kevin Schatz at (701)328-3657 if you are interested.

Submit ALL electronic reports to the oiltax@state.nd.us for processing. Reports will not be processed if e-mailed to other addresses. 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 us.

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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.

When the Commissioner contacts you about changes to a well's status, be sure to update your database system to avoid incorrect reporting in subsequent periods.

Please verify that the "Other Party" reported on the worksheet is correct. The Commissioner's compliance program reconciles volumes reported by a producer and purchaser and issues discrepancy notices. If the Other Party is reported in error a discrepancy notice will be issued.

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

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