



Senate Fiscal Agency
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BILL ANALYSIS



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Senate Bill 784 (as enrolled)
 Senate Bill 785 (as enrolled)
 Senate Bill 786 (as enrolled)

Sponsor: Senator Loren Bennett (S. B. 784)
 Senator George A. McManus, Jr. (S.B. 785)
 Senator Joanne G. Emmons (S. B. 786)

Senate Committee: Natural Resources and Environmental Affairs
 House Committee: Conservation, Environment and Great Lakes

PUBLIC ACT 133 of 1996
PUBLIC ACT 134 of 1996
PUBLIC ACT 135 of 1996

Date Completed: 11-1-96

RATIONALE

Michigan, like many states, faces a number of environmental challenges, including finding ways to finance the cleanup of many underground storage tank sites left unfunded after the insolvency of the Michigan Underground Storage Tank Financial Assurance (MUSTFA) Fund, and the cleanup of "orphan shares" or "orphaned sites", i.e., the contaminated commercial or industrial sites or sections of sites for which no culpable party can be found, or for which the culpable party no longer exists. The Governor has recommended changing the funding of environmental cleanup programs from the current long-term bonding approach to a "pay-as-you-go" method.

As part of this funding change, it was suggested that the State sell its royalty interest in the approximately 2,700 oil and gas wells that it currently leases in Antrim, Crawford, Montmorency, Oscoda, and Otsego Counties. The Department of Natural Resources leases these wells to 19 operators, and receives a one-sixth royalty interest on leases made after 1981, and a one-eighth royalty interest on leases made before 1981. Apparently, the wells may qualify for tax credits under Section 29 of the Internal Revenue Code, which offers credits for the production of certain qualified fuels. Since the State is exempt from Federal income taxes, it cannot take advantage of these credits. Other entities, such as utility companies, however, may be able to use the credits. It was suggested that if the State were to sell the economic share of its royalty interest in the wells, it would reap two benefits: 1) the amount received from the sale of

the economic interest, and 2) the amount the purchaser would bid in addition to the economic share of the royalty interest for the Section 29 tax credit, which could then be used to fund environmental cleanup activities.

CONTENT

Senate Bills 784 and 785 amended the Natural Resources and Environmental Protection Act to allow the Department of Natural Resources (DNR) to sell the economic share of royalty interests it holds in certain hydrocarbons and to exempt the revenue from the sale from the Michigan Natural Resources Trust Fund. Senate Bill 786 amended Public Act 48 of 1929, which provides for a severance tax on oil and gas extraction, to exempt from the tax income received by oil and gas producers from certain hydrocarbons purchased from the State.

The bills are tie-barred to each other. Following is a more detailed description of the bills.

Senate Bill 784

The bill allows the DNR to enter into contracts for the sale of the economic share of royalty interests it holds in hydrocarbons produced from Devonian or Antrim shale qualifying for the nonconventional fuel credit contained in Section 29 of the Internal Revenue Code. The DNR must assure that revenue to the Natural Resources Trust Fund (NRTF) under these contracts will not be less than the revenue the Fund would have received if the contracts were not entered into. The sale may

occur under contractual terms and conditions considered appropriate by the DNR and approved by the State Administrative Board. Funds received from the sale must be transmitted to the State Treasurer for deposit as follows:

- Net proceeds allocable to the nonconventional fuel credit must be credited to the Environmental Protection Fund created by the bill. ("Net proceeds" means the total receipts received from the sale of royalty interests under these provisions less costs related to the sale, including legal, financial advisory, geological or reserve studies, and accounting services.)
- Proceeds related to the production of oil or gas from Devonian or Antrim share must be credited to the NRTF, or other applicable fund as provided by law.

The bill created the Environmental Protection Fund in the State Treasury and allows the State Treasurer to receive money or other assets from any source for deposit into the Fund. The State Treasurer is responsible for directing the investment of the Fund and for crediting to the Fund any interest and earnings from Fund investments.

Money in the Fund may be spent, upon appropriation, only for such purposes as are specifically provided by law, and any money in the Fund at the close of the fiscal year must remain in the Fund and not lapse to the General Fund.

Senate Bill 785

The bill exempts from the Michigan Natural Resources Trust Fund money received by the State from net proceeds allocable to the nonconventional fuel credit contained in Section 29 of the Internal Revenue Code.

Senate Bill 786

The bill exempts a producer who extracts oil or gas from the soil from paying a severance tax on income received from the hydrocarbons produced from Devonian or Antrim shale qualifying for the nonconventional fuel credit contained in the Internal Revenue Code and acquired under a royalty interest sold by the State.

MCL 324.503 (S.B. 784)
324.1902 (S.B. 785)
205.303 (S.B. 786)

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

The bills will provide an important new source of funding for environmental cleanup activities. According to the Department of Management and Budget, the total estimated value of the tax credit, based on 1994 production and price levels, is \$6 million. If this production level is assumed through December 31, 2002, when the tax credits expire, the nominal value of the credit alone will be about \$40 million, less brokerage and administrative costs. A portion of this money will be reimbursed to the State, and eventually used to provide new revenues for environmental cleanup, and will do so without diverting money from the Natural Resources Trust Fund. The procedure already has been tested in the State of New Mexico, which, according to the Department of Management and Budget, concluded the sale of its royalty interests and allocable Section 29 tax credits in May 1995.

Legislative Analyst: L. Burghardt

FISCAL IMPACT

According to the Department of Management and Budget, the bills could generate as much as \$6 million annually in additional revenue to the "Environmental Protection Fund" over the next seven years, for a total of \$42 million. The availability of this revenue will be contingent upon a favorable ruling by the Internal Revenue Service prior to the sale of any royalty interests.

The above estimate assumes that the amount of oil production that will qualify for this program (based on Section 29 of the Internal Revenue Code) is approximately 6 trillion BTUs, with the tax credit at \$1 per million BTU. It also assumes that all the State's "economic shares in the royalty interests allocable to the nonconventional fuel credit" will be sold at current market prices.

Participants in the program will be exempt from paying severance tax. Using the conversion of 1.01 million BTU per MCF (thousand cubic feet), the amount under consideration is worth approximately \$10 million. Without the exemption, this would generate approximately \$500,000 in severance tax revenue, for deposit to the General Fund.

The State might incur additional costs under the bills for administration of the sale of the royalties, or contracting with a third party to handle the transactions. This would reduce net available revenues, as would any discounts or changes in market prices.

Fiscal Analyst: G. Cutler

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.