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SFA BILL ANALYSIS

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Senate Bills 135, 136, and 137 (as passed by the Senate)
Sponsor: Senator Walter H. North
Committee: Economic Development, International Trade and Regulatory Affairs

Date Completed: 12-8-99

RATIONALE

Public Act 48 of 1929 requires oil and gas producers to pay to the State Treasurer a severance tax of 5% of the gross cash market value of the total production of gas or 6.6% of the gross cash market value of the total production of oil. Two percent of the tax paid to the State Treasury, but not less than $1 million, must be credited to the Orphan Well Fund created under Part 616 of the Natural Resources and Environmental Protection Act. Whenever the Fund's unspent balance exceeds $3 million, further revenues may not be credited to it until the unspent balance falls below $3 million. The remaining revenue that is not allocated annually to the Orphan Well Fund, must be credited to the State's General Fund and used for any purpose for which the General Fund is made available by law. It is estimated that $25.5 million will be collected for fiscal year (FY) 1999-2000 and deposited in the General Fund. Officials of communities where oil and gas wells are located believe that they should receive a portion of these revenues to defray maintenance costs of roads and infrastructure that experience extensive wear and tear from the transportation of heavy drilling equipment. It has been suggested that a portion of severance tax revenue be dedicated to these local governments for this purpose.

CONTENT

The bills would amend Public Act 48 of 1929 to dedicate 25% of severance tax revenue to the local units of government from which the oil or gas was removed, for specific purposes.

<u>Senate Bill 135</u> would require that, beginning October 1, 2000, 25% of the revenue received during each fiscal year be returned to counties, cities, villages, and townships from which the oil or gas was removed, as proposed in Senate Bills 136 and 137.

<u>Senate Bill 136</u> would require that the revenue be used by a county, city, village, or township only for road improvements, public environmental projects, and reclamation of contaminated or damaged land.

<u>Senate Bill 137</u> would require that the revenue be disbursed as follows: 50% to the county from which the oil or gas had been removed, and 50% to the city, village, or township from which the oil or gas had been removed.

Senate Bills 136 and 137 are tie-barred to Senate Bill 135.

MCL 205.314 (S.B. 135)
Proposed MCL 205.314b (S.B. 136)
Proposed MCL 205.314a (S.B. 137)

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

While the economies of local communities benefit from the oil and gas production that occurs in their areas, the cost of maintaining public roads, bridges, and infrastructure damaged by heavy equipment has strained the budgets of some local governments. Large trucks hauling well-drilling equipment and petroleum products travel to drilling sites along local gravel or black-topped roads that are not designed to handle heavy loads. Consequently, roads are damaged and deteriorate at faster rates than expected under normal traffic. Because local governments must pay for road repair and maintenance from their limited budgets, some road work has been delayed. In addition, some sites have suffered environmental damage due to drilling. It also is expected that as oil and gas resources decline in the future and drilling operations cease, the environment in these areas will have to be restored and reforested. While money in the Orphan Well Fund is available for this type of work, it may be used only to plug abandoned or improperly closed oil or gas wells, or for response activity or site restoration at oil and gas wells where the operator is not known, for which all owners and operators are insolvent, or where there is an imminent threat to public health and safety. The bills would provide additional revenue to local governments where drilling sites are located to be used for road improvements as well as public environmental projects, and reclamation of contaminated or damaged land.

Response: Each local community where drilling sites are located has different problems to be addressed. Instead of earmarking the funds for specific purposes, the bills should provide for the funds to be dispersed to the general fund of local governments, and allow local officials to set priorities on how the money would be spent.

Opposing Argument

According to the Department of Treasury, the bills would set an unfair precedent in regard to the distribution of tax revenues. Under the bills, some local governments would receive funds because they had oil and gas operations located in their communities, but other communities that did not have drilling sites would not receive funds. Instead, local road and environmental problems at oil and gas drilling sites should be addressed through revenue sharing payments.

Legislative Analyst: L. Arasim

FISCAL IMPACT

The fiscal impact of these bills on the State and local units of government would be three-fold:

First, the amount of money available to the State General Fund would be reduced. Senate Bill 135 would return 25% of oil and gas severance tax collections to the counties, cities, villages, and townships from which the oil or gas was removed.

The State currently levies a tax based on the gross cash market value of oil and gas severed. The tax rate on oil is 6.6%, gas 5%, and 4% on stripper wells and marginal properties. Consequently, as oil and gas prices fluctuate, so too do severance tax collections. Recent declines in commodity prices have dramatically affected State severance tax receipts. According to current estimates, the State will collect only $25.5 million in revenues from these sources in FY 1999-2000. This is $16.7 million less than the $42.2 million average collected annually between FY 1985-86 and FY 1996-97.

Under current law, not less than $1.0 million of FY 1999-2000 collections will be credited to the Orphan Well Fund, depending on the Fund's unexpended balance. That distribution would remain unchanged under these proposals. However, if Senate Bill 135 were approved, only $18,375,000 (75%) of the remaining $24.5 million would flow to the State's General Fund. The balance, $6,125,000 (25%) would be directed to local units of government for the purposes outlined in Senate Bill 136.

These bills would have a second fiscal impact: increased revenues for local units of government to use on specific projects. Again based on FY 1999-2000 oil and gas severance tax collections, Senate Bill 137 would provide $3,062,500 for the counties and $3,062,500 for the cities, villages, or townships from which the oil or gas had been removed. Oil and gas production in Michigan is concentrated in the northern Lower Peninsula. However, there is currently no way to determine how severance tax disbursements would be distributed among counties, cities, villages, or townships under these proposals.

The absence of reliable data to track severance tax collections results in the third fiscal impact on the State: an administrative cost to the Department of Treasury to develop a system that would track oil and gas severance tax payments based on the local unit of government from which the commodity was removed. For example, the State would have to distinguish payments from single producers with well-heads in different jurisdictions. The costs to develop and maintain this type of system cannot be determined. Finally, these bills do not specify who would be responsible to redistribute these collections, though there would likely be additional, indeterminate costs associated with this activity.

Fiscal Analyst: P. Alderfer