House Legislative Analysis Section

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OIL AND GAS SEVERANCE TAX REVENUE

House Bill 4232 as introduced
Sponsor: Rep. David Mead

House Bill 4233 as introduced
Sponsor: Rep. Ken Bradstreet

First Analysis (6-26-01)
Committee: Conservation and Outdoor Recreation

THE APPARENT PROBLEM:

Currently, a tax referred to as the "severance tax", equal to 5 percent of the gross cash market value of gas production and 6.6 percent of the gross cash market value of oil production, is levied on oil and gas producers. Of the revenue received from the tax, at least $1,000,000, or 2 percent, is deposited into the Orphan Well Fund, and is used to plug abandoned or improperly closed oil or gas wells, for response activities or site restoration at wells when no owner can be found or for which the owners are insolvent, and for the Department of Environmental Quality's costs in administering these activities. The remainder -- generally, about $40 million each year -- is deposited into the state's general fund.

For many years, local communities have argued that they, too, should receive a portion of the revenues from the severance taxes collected from oil and gas wells located in their jurisdictions. While admitting that oil and gas production brings jobs to their areas, they point out that local units of government must also bear the heavy costs engendered by this industry. For example, rural roads, which are not, generally, class A roads, are damaged by heavy equipment and increased traffic; emergency management plans must be drawn up to control possible gas leaks and fires; county registers of deeds must hire additional employees to field questions regarding land titles; and oil and gas wells sometimes cause environmental damage, such as soil erosion.

Some local communities report that they have had to borrow money to meet these costs. Legislation was introduced in 1998 and in 1999 to disburse some of the revenues from severance taxes to the local counties, cities, villages, and townships from which the oil or gas is removed. However, the Senate did not take up either bill. Another version of that legislation has again been introduced.

THE CONTENT OF THE BILLS:

Currently, under Public Act 48 of 1929, which regulates the severance tax that is imposed on oil and gas production, revenue received in severance taxes during each fiscal year is deposited as follows:

**At least $1,000,000, or two percent of the revenue received, is deposited into the Orphan Well Fund established under Part 616 of the Natural Resources and Environmental Protection Act (MCL 324.61601 et al.).

**The remaining revenue received during each fiscal year that is not allocated for that Orphan Well Fund is credited to the general fund, and must be made available for any purpose for which the general fund is currently made available

<u>House Bills 4232 and 4233</u> would amend Public Act 48 to require that, effective October 2000, a percentage of the money be disbursed, instead, to local communities. The bills are tie-barred to each other.

Under the bills, 25 percent of the revenue received during each fiscal year would be disbursed as follows:

**Fifty percent to the county from which the oil or gas was removed; and

**Fifty percent to the city, village, or township from which the oil or gas was removed.

MCL 205.314 and 205.314a

BACKGROUND INFORMATION:

The following information was provided by the Department of Environmental Quality and presented to the committee by the bill's sponsor.

Traditionally, the bulk of local tax revenues in most states have come from property taxes. Consequently, one area of the state will benefit financially from its location, while another may not. For example, one area may enjoy the benefit of an advantageous location, such as a natural harbor on the Great Lakes. Another may lie on a busy transportation corridor where there is commercial development. Geographical characteristics contribute to the local infrastructure through value-based real estate and personal property taxes.

The value of mineral rights is different from other property values. While they are sold, traded and leased, since they are speculative in nature, it is impossible to assess a value-based tax on them until they are "severed" from the ground. Therefore, their value is normally deferred until the minerals are produced and severed taxes are assessed. In Michigan, beginning in the late 1800s, severance taxes were assessed on the mining of copper, silver, and gold by local governments. In this way, each local unit of government benefits directly from resources that exist exclusively in its area.

The late 1880s also ushered in a period of exploration and drilling for oil and natural gas deposits in Michigan. For some time, this continued virtually unregulated. Then, in 1929, severance taxes were collected. Public Act 48 of 1929, which levies the tax, provides that it is to be paid " . . . in lieu of all other taxes, state or local, upon the property rights attached thereto or inherent therein, or the values created thereby . . . ." During the last five fiscal years, the state has collected between $25 million and $63 million each year in severance taxes from oil and gas production. Local units of government and the counties in which the oil or gas was produced once received a portion of these taxes, but have not done so since 1947.

Most drilling for oil and gas in the state occurs in northern Michigan, whose communities usually do not have a large tax base. However, as reported in written testimony provided to House committee by the Michigan Association of Counties, the costs borne by cities, townships, and counties in those areas are substantial. Maintaining that, while receiving no revenues, they nevertheless bear the brunt of the environmental, public health, safety, and infrastructure costs for gas and oil development, some communities in northern Michigan have adopted ordinances that restrict oil and gas operations.

FISCAL IMPLICATIONS:

The House Fiscal Agency (HFA) estimates that the bills would result in a decrease in state revenues of approximately $15 million. (6-21-01)

ARGUMENTS:

For:

Although local communities gain from the higher employment that follows oil and gas development, they are also affected by costs incurred from damage to infrastructures, and from increased public services. Probably the highest cost to local communities is the cost of maintaining roads in areas where there is a large volume of truck traffic. Oil and gas companies transport brine or petroleum products in heavy tanker trucks on roads originally designed for light local traffic. Roads such as these are especially susceptible to heavy truck damage during spring thaws. In addition, oil and gas are "declining resources." While employment may be high for many years, employment in this industry eventually decreases as production slows down. As oil and gas wells approach the end of production, the revenues of local communities also decline. At the same time, local communities are often left holding the bag when gas or oil companies do a less than adequate job of protecting against soil erosion, site contamination, or restoration. As a result, animosity toward oil and gas companies has developed in some communities. The provisions of the bill would provide a cushion to reduce the impact on local communities.

POSITIONS:

The Michigan Municipal League supports the bills. (6-22-01)

The Michigan Oil and Gas Association supports the bills. (6-22-01)

The Michigan Townships Association supports the bills. (6-22-01)

The Michigan Association of Counties provided the House committee with written testimony indicating support of the bills. (6-21-01)

The Department of Treasury opposes the bills. (6-25-01)

Analyst: R. Young

■This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.