

Legislative Analysis



QUALIFYING EXPENSES RELATED TO OIL AND GAS PRODUCTION

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House Bill 6485 as reported from committee
Sponsor: Rep. Triston Cole
Committee: Commerce and Trade
Complete to 12-2-18

Analysis available at
<http://www.legislature.mi.gov>

SUMMARY:

House Bill 6485 would amend the Income Tax Act to exclude certain costs and allowances related to oil and gas production from exemption from certain categories of taxable income and from the corporate income tax. The bill would expand the deduction related to oil and gas production that was eliminated in Public Act 38 of 2011.¹

The bill states that is intended to clarify the original intent of the legislature for expenses related to oil and gas, and is accordingly retroactive and effective for all tax years beginning after December 31, 2011.

Allowable deductions for the following three categories would be clarified under the bill:

- Taxable income for a person other than a corporation, estate, or trust.
- Taxable income for a resident estate or trust.
- Corporate income tax on every taxpayer with business activities in Michigan or ownership interest or beneficial interest in permitted flow-through entities with business activities in Michigan.

For each of those categories, the bill would provide that, for the purposes of determining which expenses are not allowed as deductions, “expenses of producing oil and gas” would not include any of the following:

- Costs incurred to purchase, lease, or otherwise acquire an oil and gas property, whether proved or unproved.
- Costs incurred for exploration of an oil and gas property, whether producing or nonproducing.
- Costs incurred for processing, transportation, or marketing of the oil and gas that has been produced from an oil and gas property.
- Costs incurred for plugging and abandonment of an oil and gas property.
- Allowances for depletion that do not reduce the adjusted basis of the oil and gas property.

MCL 206.30, 206.36, and 206.523

¹ House Fiscal Agency analysis of PA 38 of 2011 (HB 4361) <http://www.legislature.mi.gov/documents/2011-2012/billanalysis/House/pdf/2011-HLA-4361-6.pdf>

BRIEF DISCUSSION:

There was considerable disagreement in committee as to the effect of the bill. Proponents argued that the recent Revenue Administrative Bulletin (RAB)² issued by the Department of Treasury would sharply limit the costs that could be deducted under the severance tax, and that the bill is intended to clarify what would and would not fall under the deduction. They stated that the deduction was formed as part of a compromise, and that the resulting provisions of Public Act 38 of 2011 were designed to protect court decisions³ allowing the deductions. As indicated in the bill language, they held that the bill clarifies the original intent of the language as enacted in 2011.

Opponents replied that the legislature's changes to the Income Tax Act in 2011 were intentionally made to prevent "double dipping" by oil and gas companies—that is, taking a double deduction for production costs. They argued that if those costs are deducted at the federal level, they should be added back in at the state level. Further, they questioned what the tax policy basis would be for allowing deductions for the same costs at both the federal and state levels.

FISCAL IMPACT:

As written, the bill would reduce income tax revenue by a projected \$4.0 million to \$5.0 million per year. Because the bill is retroactive back to tax year 2012, there would be an additional one-time revenue loss of approximately \$10.0 million in the first tax year after the changes took effect.

POSITIONS:

Representatives of the Michigan Oil and Gas Association testified in support of the bill. (11-27-18)

A representative of Dennis, Gartland & Niergarth testified in support of the bill. (11-27-18)

A representative of the Muskegon Development Company indicated support for the bill. (11-27-18)

Representatives of the Department of Treasury testified in opposition to the bill. (11-27-18)

Legislative Analyst: Jenny McInerney
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■ This analysis was prepared by nonpartisan House Fiscal Agency staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.

² https://www.michigan.gov/documents/treasury/RAB_2018-8_-_Oil_and_Gas_620525_7.pdf

³ *Bauer v Dep't of Treasury*, 203 Mich App 97 (1993) and *Elenbaas v Dep't of Treasury*, 231 Mich App 801 (1998)