House Legislative Analysis Section
House Office Building, 9 South
Lansing, Michigan 48909
Phone: 517/373-6466

EARMARK OIL AND GAS TAXES

House Bill 4154 (Substitute H-1)
Sponsor: Rep. Ken Bradstreet

House Bill 4155 (Substitute H-1)
Sponsor: Rep. David Mead

First Analysis (11-9-99)
Committee: Conservation and Outdoor Recreation

THE APPARENT PROBLEM:

Currently, a tax referred to as the "severance tax," equal to five 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 million, or two percent, is deposited into the Orphan Well Fund, if the unexpended balance in that fund is less than $3 million, 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 (DEQ) costs in administering these activities. The remainder -- projected at $21 million for fiscal year 1999-2000 -- 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, but not enacted, during the 1997-98 legislative session 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, and to specify that the revenue could only be used for services impacted by oil and gas development (see HLAS analysis of House Bills 5983 and 5985, dated 9-23-98). The legislation has been reintroduced, but without restrictions on the use of the funds.

THE CONTENT OF THE BILLS:

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

*At least $1 million, 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.) if the unexpended balance in that fund is less than $3 million.

*The remaining revenue received during each fiscal year that is not allocated for the 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 Bill 4154</u> would amend Public Act 48 (MCL 205.314) to require that, effective October 1, 1999, 25 percent of the revenue received during each fiscal year would be returned to the counties, cities, villages, and townships from which the oil or gas was removed.

<u>House Bill 4155</u> would add a new section to the act (MCL 205.314a) to specify that the county from which the oil or gas was removed, and the city, village, or township from which the oil or gas was removed, would each receive 50 percent of these revenues. The bills are ti-barred to each other.

MCL 205.314

FISCAL IMPLICATIONS:

The House Fiscal Agency (HFA) estimates that the bills would result in a decrease in state revenues amounting to approximately $5.5 million. (11-8-99)

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. In testimony before the House Conservation and Outdoor Recreation Committee, representatives from many local units of government related how these costs affect their communities. Most stressed the high cost of maintaining roads in areas that bear a constant high volume of traffic from tankers carrying brine or petroleum products over roads designed for light local traffic. Such roads are especially susceptible to heavy truck damage during spring thaws, and an increase in traffic also requires an increase in law enforcement costs and in emergency, fire, and medical services. In addition, some communities complained of the stench from the wells, and the fact that they “litter” the landscape.

Some communities also reported that, while most oil and gas companies are careful about the environmental impact of their work, a few leave contaminated sites and soil erosion in their wake. There is also the irrefutable fact that, at some time in the future, the environment will have to be restored and reforested. In addition to cleaning up a damaged environment and deforested sites, local units of government are often left holding the bag in other ways. 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. The provisions of the bill would provide a cushion to reduce the impact on local communities.

For:

The provisions of the bills might have the effect of preventing many local governmental units in northern lower Michigan from drafting ordinances to ban oil and gas development. Written testimony presented to the House Conservation and Outdoor Recreation Committee pointed out that the proposed legislation would have greater significance for local units of government in that area of the state than it might for other communities, according to the particular unique geographic characteristics and resources of each area. For example, local tax bases benefit from the geographic characteristics of an area located near a natural harbor or other transportation corridor, since these features promote industrial growth and other business development. Tourist centers and agricultural areas, with their related distribution and processing infrastructures, also benefit local tax bases. Communities in the Upper Peninsula, where tax bases have never benefitted greatly from geographic characteristics such as transportation corridors, tourism, agricultural communities, or shipping ports, have nevertheless benefitted from other natural resources in the form of mineral rights. Local governments there collect severance taxes assessed on the mining of copper, silver, gold, iron ore. However, the severance taxes collected on oil and gas production are treated differently from those collected on mineral ore resources. Michigan, unlike most other large oil and gas producing states, retains the taxes on oil and gas production. Therefore, local units of government in those areas where there are deposits of natural gas and oil do not benefit directly in the same way that other communities benefit from their unique geographic resources. Consequently, rather than bear the costs related to damaged environments and infrastructures, many local government have determined that they do not want oil and gas development, and have drafted local ordinances restricting or banning it.

Against:

Returning a percentage of the revenues collected from severance taxes to local governments would have other consequences that have not been provided for under the bills: The severance tax act went into effect in 1929. Its title describes the act as: “An act levying a specific tax to be known as the severance tax upon all producers engaged in the business of severing oil and gas from the soil; . . . and to exempt those paying such specific tax from certain other taxes.” Therefore, oil and gas companies do not pay income taxes or “value added” taxes, such as the single business tax (SBT). The Department of Treasury has fought against this exemption from the SBT, maintaining that the severance tax is paid in lieu of all other taxes on the values created by oil and gas interests, and that the exemption should apply only to *ad valorem* property taxes, and not to taxes arising out of those interests.

However, the Court of Appeals has not upheld this position (*Bauer* v. *Dep't of Treasury [1993], 512 N 42, 203 Mich App 97, [1993]*, and *Cowen* v. *Dep't of Treasury [1994], 516 N.W.2d 450, 204 Mich App 428*). Consequently, it seems likely that there would be a move to have the laws regarding the collection of severance taxes restructured should the state lose even more of these revenues.

Against:

When similar versions of the bills were proposed during the 1997-98 legislative session, it was intended at that time that 50 percent, and not 25 percent, of the revenues from the severance tax on oil and gas production be disbursed to local communities. Some communities have calculated that this higher percent is needed to reimburse them for the cost of supporting heavy industrial development. In fact, in 1997 the Northeast Michigan Council of Governments (NEMCOG) formed an ad hoc group, consisting of various elected officials and representatives from road commissions across northern lower Michigan, to ensure that revenues be returned to the areas from which resources are extracted. The group, called "GOALIES" (Gas, Oil, and Land Impact Environment Statewide), lobbied the legislature to have at least 50 percent of the severance taxes refunded to the respective counties. In addition, many counties have adopted resolutions supporting the issue.

POSITIONS:

The Michigan Oil and Gas Association (MOGA) supports the bills. (11-4-99)

The Michigan Townships Association supports the bills. (11-8-99)

The Michigan Association of Counties supports the bills. (11-8-99)

The Michigan Municipal League supports the bills. (11-8-99)

Representatives of the following cities, counties, and organizations testified before the House Conservation and Outdoor Recreation Committee in support of the bills (11-4-99):

*The City of Gaylord

*Montmorency and Alpena counties

*The Northeast Michigan Council of Governments (NEMCOG)

The Michigan Northern Counties Association (MNCA), an organization of county commissioner delegates from 32 member counties in northern lower Michigan, submitted written testimony to the House committee, including resolutions from numerous counties and townships, supporting the bills. (11-4-99)

The Department of Treasury opposes the bills. (11-8-99)

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.