NORTH DAKOTA LEGISLATIVE MANAGEMENT

Minutes of the

TAXATION COMMITTEE

Wednesday, October 12, 2016
Roughrider Room, State Capitol
Bismarck, North Dakota

Senator Jessica Unruh, Chairman, called the meeting to order at 9:00 a.m.

Members present: Senators Jessica Unruh, Brad Bekkedahl, Dwight Cook, David Hogue, Connie Triplett; Representatives Wesley R. Belter, Jason Dockter, Glen Froseth, Jerry Kelsh, Alisa Mitskog, Vicky Steiner

Members absent: Senators Jim Dotzenrod, Lonnie J. Laffen; Representatives Patrick R. Hatlestad, Craig Headland, Tom Kading, Jim Kasper, Marie Strinden

Others present: See Appendix A

It was moved by Representative Dockter, seconded by Senator Bekkedahl, and carried on a voice vote that the minutes of the June 30, 2016, meeting be approved as distributed.

ENHANCED OIL AND GAS RECOVERY STUDY

Chairman Unruh called on the Legislative Council staff for presentation of a bill draft [17.0206.01000] relating to an oil extraction tax credit for carbon dioxide (CO_2) used for enhanced oil recovery. Chairman Unruh said the bill draft was also considered by the interim Energy Development and Transmission Committee, but that committee refrained from taking any action on the bill draft as the interim Taxation Committee had received the majority of the background information relating to the bill draft.

The Legislative Council staff said the bill draft provides for a $10 credit against oil extraction tax for each ton of CO_2 purchased or acquired for use in enhanced oil recovery in this state. She said the bill draft requires oil producers to report to the Industrial Commission the amount of CO_2 initially injected into an oil reservoir. She said the phrase "initially injected" was selected because a portion of the CO_2 injected for enhanced oil recovery can be recovered and reinjected into the reservoir. She said this language would prevent any reinjected CO_2 from qualifying for purposes of calculating the credit. She said the Industrial Commission is required to certify to the Tax Commissioner the amount of CO_2 initially injected by each oil producer for purposes of enhanced oil recovery. She said if a purchaser of oil, rather than the producer of oil, is filing and paying the tax, the purchaser must include documentation provided by the producer which verifies the amount of the producer's credit to be deducted from the tax due.

In response to a question from Representative Froseth, the Legislative Council staff said the bill draft does not contain any limits on the total amount of credits that may be awarded.

Senator Cook said part of the problem the committee is trying to solve is the burden that might be placed on power generation facilities as a result of the new emission reduction imposed under the federal Clean Power Plan. He said it might be wise to specify that CO_2 used to calculate the credit must be CO_2 produced in this state. He said there are a lot of unanswered questions regarding the right approach to take to accomplish the goals of reduced CO_2 emissions and enhanced oil recovery.

Chairman Unruh said she agreed and the bill draft might not be the right approach to accomplishing all the stated goals.

In response to a question from Senator Triplett, Chairman Unruh said the interim Energy Development and Transmission Committee was supportive of the concept behind the bill draft, but did not take any action on the bill draft.

In response to a question from Senator Hogue, Chairman Unruh said general discussions with representatives of the Tax Department indicated the fiscal impact of the credit would be negligible in the upcoming biennium, but would be difficult to project for future periods.

Senator Cook said he was one of six legislators who traveled to Texas to tour an enhanced oil recovery field and a coal-fired power plant being retrofitted to capture CO_2. He said the work in Texas is ongoing, and has involved large investments, but it appears the technology exists to capture CO_2 emissions for use in enhanced oil recovery. He said the tour made it clear the solution to achieving enhanced oil recovery lies in incentivizing both the producers and users of CO_2. He said based on the report presented by IHS Energy, this committee primarily focused on providing incentives to oil producers. He said incentives also are needed to encourage the capture of CO_2 at power plants. He said a tremendous amount of money is required to equip power plants with the technology needed to capture CO_2 emissions.

Chairman Unruh said she also sees the need for shifting the placement of the incentive. She said other committee members have expressed similar sentiments.

Chairman Unruh called for comments from interested parties regarding the bill draft and the final report (Appendix B) provided by IHS Energy.

Mr. Jason Bohrer, President and Chief Executive Officer, Lignite Energy Council, said the Lignite Energy Council supports the goals the interim Taxation Committee is trying to achieve and said the bill draft represents a great first step toward putting a solution in place which will benefit not only the coal and oil and gas industries, but also the people of this state through infrastructure build out and new revenue streams. After participating in the recent tour in Texas, he said, it is worth taking the time to further refine the concepts that need to be placed in a bill draft to accomplish the right balance of incentives. He said he does not anticipate anything being built in the next few years, which would monetize the state's supply of CO_2 to a degree that would necessitate the bill draft the committee is considering. He said he agrees the correct mix of incentives could use some further evaluation. He said this issue does not need to be resolved within the next year.

In response to a question from Representative Froseth, Mr. Bohrer said roughly 2.5 barrels of oil are produced from conventional wells per ton of CO_2 injected. He said vertical wells in this state could already benefit from CO_2 injection, but the technology for unconventional wells is not yet in place. He said a $10 credit per ton of CO_2 injected would represent only a marginal improvement to the economic outlook as a whole. He said the credit alone would not be enough to spur industry to undertake the $800 million worth of infrastructure costs associated with capturing CO_2 emissions. He said other factors, including large federal and industrial investments, would be needed in addition to state incentives to bridge the gap in making projects economically feasible. He said industry also would need reassurance that the price of oil would remain high enough for projects to remain economical.

In response to a question from Representative Froseth, Mr. Bohrer said looking at the amount by which the credit would reduce tax collections is one way to assess revenue, but another way is to look at the amount of revenue the state is receiving which it would not have otherwise received had the oil remained in the ground.

Senator Cook said the sustainability and increased cost of electricity is another consideration the state needs to take into account if coal-fired plants are ultimately shut down as a result of the Clean Power Plan.

Mr. Boher agreed and said considerations regarding the additional recovery of oil almost can be put aside in terms of determining the value of the incentive when compared to the benefit to be gained by continued operation of coal-fired power plants. He said from the Lignite Energy Council's perspective, maintaining low electricity rates and roughly 4,000 jobs at lignite plants would be the primary benefit. He said additional tax revenue from increased oil production would be an added bonus. He said one-half of the state's coal-fired power plants would need to be shut down to comply with the Clean Power Plan. He said the potential increase in electricity rates as a result of these closures could be anywhere from 20 to 50 percent. Because coal is the cheapest source of electricity, he said, meeting demands with electricity generated from other sources would result in increased costs to consumers.

Chairman Unruh said increased regulations and increased electricity costs also can bog down the economy.

In response to a question from Representative Belter, Mr. Bohrer said the Department of Energy has invested funds in CO_2 capture projects, and industry is hopeful for additional budgetary support as Congress acts on some of its final appropriation bills. He said the view is that the next administration will be more receptive than the current administration regarding research and development projects. He said the Lignite Energy Council has engaged in outreach to the Department of Energy to illustrate the potential benefits of conducting research in this state.

Mr. Dale Niezwaag, Senior Legislative Representative, Basin Electric Power Cooperative, thanked the committee for its work and said based on the information learned during the recent trip to Texas, the bill draft could benefit from some modifications. He said work on this issue needs to continue, but it is not critical that changes be implemented during the 2017 legislative session. He said work is underway at the federal level to make changes to the federal production tax credit. He said the credit has been infrequently used as a result of its rather cumbersome and unworkable provisions. He said it would cost roughly $50 million to $70 million per ton of CO_2 captured to place the necessary capture equipment on power plants. He said these costs illustrate the need for industry, state, and federal resources to come together to make these projects work. He said advances need to be made in the technology surrounding the capture of CO_2 from new and existing sources and the production of a purer stream of CO_2. He said technology advancements also need to be made regarding the use of CO_2 for enhanced oil recovery in unconventional fields. He said these advancements, combined with incentives related to the use of CO_2 for enhanced oil recovery, need to occur for the economics to make sense for oil producers. He said the state has three options if it wishes to continue burning coal. He said the state can use CO_2 for enhanced oil recovery in conventional wells, sequester CO_2 underground, and use CO_2 for enhanced oil recovery in unconventional wells if the technology regarding CO_2 capture and injection can be further refined. He said industry intends to review the final report provided by IHS Energy, and additional information provided by the Energy and Environmental Research Center, to determine the amount of CO_2 that could be used in conventional wells and the amount of CO_2 that could be captured from coal-fired power plants in this state. He said a bill draft that centers around where these two amounts coincide would be ripe for discussion during the 2017-18 interim.

In response to a question from Senator Triplett, Mr. Niezwaag said he is not opposed to legislation being introduced during the 2017 legislative session, but further developments are expected to occur throughout 2017 that may lead to a more well-informed bill draft for introduction during the 2019 legislative session. He said the Allam Cycle pilot project should be running by April 2017, which will confirm whether this type of technology is operational. He said the next step in testing the Allam Cycle would be to build a 300 megawatt power plant. He said Minnkota Power Cooperative, Inc. and various other entities also are working on a project referred to as project tundra which focuses on capturing CO_2 from existing power plants. He said industry appreciates the work the committee has put forth in preparing a bill draft that shows the state is supportive of new technologies and finding a path forward for coal.

In response to a question from Senator Cook, Mr. Niezwaag said the Allam Cycle burns gas so it can operate using natural gas or gasified coal. He said in Texas, the Allam Cycle will initially use natural gas and then will switchto using gasified coal. He said lignite coal is better suited for the gasification process than the Wyoming coal being burned in Texas. Because lignite coal makes up roughly 60 percent of the known coal reserves worldwide, he said, the Department of Energy is excited about the prospects of any technology that would promote the capture of CO_2 from coal-fired sources.

Chairman Unruh called on the Legislative Council staff for presentation of a memorandum entitled *Tax Incentives Associated with Enhanced Recovery of Oil and Gas*, summarizing the tax incentives associated with enhanced recovery of oil and gas and the fiscal impact of each incentive. She said the memorandum updates information previously provided to the committee by indicating the usage and fiscal impact of each incentive. She said the Tax Department provided the additional data contained on the chart and said there are three incentives on which data is still being complied. She said supplemental information pertaining to the outstanding data will be provided to the committee members once it is received.

In response to a question from Representative Froseth, Mr. Joe Morrissette, Deputy Tax Commissioner, said CO_2 shipped to Canada for use in enhanced oil recovery is exempt from sales and use tax.

In response to a question from Senator Triplett, Mr. Don Boehm, Manager, Multistate Tax, Basin Electric Power Cooperative, said Dakota Gasification Company has a contract in place to sell CO_2 to a company in Weyburn, Saskatchewan. He said Dakota Gasification Company is allowed a carbon capture credit against the coal conversion facilities privilege tax for achieving a 20 percent capture of CO_2 emissions. He said the credit was enacted in 2009 and is equal to a 20 percent reduction in the general fund share of the coal conversion facilities privilege tax imposed during the taxable period. He said an additional 1 percent reduction in the general fund share of the tax is allowed for every additional 2 percentage points of CO_2 emission capture, up to a 50 percent reduction for 80 percent or more capture. He said the credit expires in 2019.

In response to a question from Senator Bekkedahl, Mr. Boehm said the CO_2 capture incentive claimed by Dakota Gasification Company in 2015 totaled $1.9 million. He said the credit provisions contain a requirement for the operator of a coal conversion facility to report to the Legislative Council on an annual basis regarding certain aspects of the CO_2 capture project.

Chairman Unruh called on Mr. Kevin Schatz, Supervisor, Motor Fuel, Oil and Special Tax Division, Tax Department, for comments regarding the 5- and 10-year oil extraction tax exemption for tertiary recovery projects as compared with other potential incentives discussed by the committee. He provided information regarding tax reporting for general oil reporting and enhanced oil recovery reporting. He said a purchaser is required to report and pay tax on a monthly basis for all purchases of oil from a producer. He said the report the purchaser submits includes both the gross production tax and the oil extraction tax. He said the report identifies the county in which the oil was produced so the Tax Department can certify to the State Treasurer the amounts to be distributed. With enhanced oil recovery, he said, the producer is required to report and pay the tax because a producer's reporting is based on production, not sales. He said producers report and pay tax on production based on a decline curve determination of primary and incremental production, which is determined by the Industrial Commission. He said the bill draft provisions likely would require the Tax Department to modify certain reporting forms to apply the credits, and database changes also would need to be made to process the credits. He said the Tax Department also would need information regarding whether a new operator would receive the original operator's credit upon the sale of property or whether the original operator would be able to retain the credit for use at a future date.

Chairman Unruh called on the Legislative Council staff for presentation of a memorandum entitled *Potential Funding Sources for Research Related to Carbon Dioxide Capture and Enhanced Oil Recovery*, summarizing various revenue streams that may be used to fund research relating to the capture and use of CO_2 for enhanced oil recovery. She summarized the allocation of revenues from the gross production tax, oil extraction tax, coal severance tax, and coal conversion tax, and reviewed potential options for redistributing a portion of that revenue for the purpose of funding research related to CO_2 capture and enhanced oil recovery.

Chairman Unruh said it is important to review the manner in which these revenues are distributed. She said there may be a need to make further investments in research and development in the future, and these revenue sources illustrate some of the funding options available. She said various other funding options also were discussed at a recent meeting of the EmPower North Dakota Commission.

REQUIRED REPORTS

Chairman Unruh called on Mr. Morrissette for presentation of a report (Appendix C) summarizing information contained in the *Report of County Statements of Revenues and Expenditures & Oil & Gas Gross Production Tax Allocations* and *School Districts Report of Gross Production Expenditure Information* regarding oil and gas gross production tax revenues received, expended, and unexpended. He said counties provide financial statements to the Tax Department which show the revenues and expenditures from various funds as well as ending fund balances. He said the issue that arises in receiving these reports is that counties maintain slightly different fund structures and not all counties place the gross production tax in the same fund or account for it in the same manner. He said the Tax Department sent out simplified gross production tax expenditure reporting forms to counties and school districts subject to the reporting requirements. He said because the reporting requirements for school districts are new as of the 2015 legislative session, this is the first time the Tax Department has had to collect that information. He said the Tax Department worked with the Department of Public Instruction in gathering this information as school districts are already required to provide financial statements and report fund balances to the Department of Public Instruction. He said the most recent information provided by school districts will be available from the Department of Public Instruction at the end of October 2016, and a supplemental report will be provided to the Legislative Council office once the last of the information is obtained.

In response to a question from Senator Bekkedahl, Mr. Morrissette said Ward County did not respond to the Tax Department's request for information. He said there were 13 school districts that did not return the reporting forms sent by the department.

In response to a question from Chairman Unruh, Mr. Morrissette said enforcement procedures and penalties are not provided in statute to address situations in which counties or school districts do not respond to the Tax Department's request for information.

Senator Cook said the failure to reply to requests for information in regard to statutory reporting requirements is unacceptable. He said it is astonishing the number of people responsible for complying with various reporting requirements who seem to not care about meeting reporting deadlines. He said penalties should be put in place to address situations in which responsible parties do not meet reporting deadlines. He said there are reasons behind the reporting requirement placed in statute and individuals should take these requirements more seriously.

Chairman Unruh said it is unacceptable for individuals to fail to respond to a request for information which pertains to a required report.

Senator Triplett said parties that failed to provide the required information should be noted in the report.

Chairman Unruh called on Ms. Carla Hahn, Accountability Manager, Department of Commerce, for presentation of an annual grantor report summary (Appendix D) of the *2015 Business Incentive Accountability Report* relating to the business incentive accountability law. She said a business must enter a business incentive agreement with a grantor before the business can receive an incentive. She said business incentive agreements must contain a description of the incentive to be granted as well as the job goals the business seeks to achieve within the first 2 years. She said recipient businesses must report progress toward achieving stated goals. She said for the period of 2011 through 2015, 748 business incentive accountability agreements were entered totaling an incentive value of $107,229,806. She said the report details the distribution of business incentives by type, public purpose, and type of business. She said the report also provides the number of agreements entered in the database by year and identifies whether the goal was to create jobs, retain jobs, or neither.

In response to a question from Chairman Unruh, Ms. Hahn said projects without specifically stated job creation or retention goals still must report on the number of jobs created annually. She said 73 percent of projects met stated job creation and retention goals within the first 2 years.

Senator Cook said it would be beneficial for the interim Political Subdivision Taxation Committee to receive this report considering the committee is studying economic development tax incentives.

In response to a question from Senator Cook, Ms. Hahn said the primary incentives relating to real estate would be the biofuels partnership in assisting community expansion family of programs offered through the Bank of North Dakota.

In response to a question from Representative Steiner, Ms. Hahn said the amount of direct cash transfers, loans, or equity investments provided to recipients are listed in table one of the report.

In response to a question from Senator Cook, Ms. Hahn said a local incentive that serves to return one-half of the sales tax collected by the restaurant likely would not be subject to the business incentive accountability law if the incentive was available to all restaurants. If an incentive is generally available, she said, it is not subject to the business incentive accountability law. She said the law applies only to an incentive granted by an entity to a particular recipient.

It was moved by Senator Bekkedahl, seconded by Representative Steiner, and carried on a voice vote that the Chairman and the Legislative Council staff be requested to prepare a report and to present the report to the Legislative Management.

It was moved by Senator Cook, seconded by Representative Belter, and carried on a voice vote that the committee be adjourned sine die.

No further business appearing, Chairman Unruh adjourned the committee sine die at 10:50 a.m.

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Emily L. Thompson
Counsel

ATTACH:4