



TAX BACKGROUND INFORMATION

TAX PICTURE FOR THE OIL AND GAS INDUSTRY IN MONTANA

In Montana the taxation of oil and gas production, the taxation of equipment to produce, transport, process and refine oil and gas, and the taxation of the corporate income derived from the petroleum industry have been evolving over the past decade with positive results of a system of taxation and rates of taxation that are competitive with surrounding states. The impacts of competitive rates of return have encouraged petroleum industry investments in Montana to the benefit of the industry and to the benefit of the state of Montana.

Oil and Gas Production Taxes

In 1999 Montana Petroleum Association members and industry allies were successful in getting a major tax simplification and competitiveness bill passed in Montana. Prior to 1999 horizontal drilling and new well incentives and rate consolidation legislation had been passed, but the 1999 legislation, while preserving the drilling incentives, additionally lowered the top tax rate on oil and natural gas production to a competitive 9%. Prior to the 1999 legislation the top rates were 12.5% for oil and 18.55% for natural gas.

When comparing Montana's taxation of oil and gas production to taxation in other states, one must be aware that Montana has a single tax on production, not a state severance tax plus a local or county ad valorem tax. Montana's taxation of oil and gas production is based on gross value at the wellhead and is administered by the Montana Department of Revenue (MDOR). MDOR collects the oil and gas production taxes, retains a portion of the revenues for statewide purposes and distributes a majority of the revenues to the counties where the production occurred. The local distribution of production tax revenues fund county governments, K-12 schools, including student transportation, teachers' salaries and retirement, and community colleges.

Montana's oil and gas production taxes are based on the type of production – primary, secondary, tertiary, or stripper, the age of the well – drilled before 1999 or after 1999, and whether the production takes place during a drilling incentive tax rate window – the first twelve months for a new vertical well and the first eighteen months for a new or recompleted horizontal well. A well that is brought back into production after not having produced for 5 years qualifies for the new well drilling incentive tax rates.

Montana's drilling incentive tax rates and lowered top tax rate have been instrumental in stimulating drilling activity. Montana's oil production has increased from 15.3 million barrels in 1999 to an estimated 32.7 million barrels in 2005. The number of horizontal wells in Montana began dramatically increasing after 1993, the year that legislation passed creating an eighteen month horizontal drilling incentive tax rate and a lowered tax rate for incremental production from vertical wells recompleted as horizontal wells. Montana's natural gas production responded to the lowered top tax rate with an increase from 55.6 bcf in 1999 to an estimated 89.5 bcf in 2005.

Montana's drilling incentive tax rate is 0.5% on the first twelve months of production from a vertical well and on the first eighteen months of production from a horizontal well. There is an additional, variable tax on all production of up to 0.3% for support of the oil and gas regulatory agency and for a natural resources local impact account. This tax is also administered and collected by the MDOR, and currently the variable rate is at 0.26%. Operators are paying new well production taxes of 0.76% for the first twelve months on a vertical well and for the first eighteen months on a horizontal well.

Production incentive tax rates for secondary and tertiary projects are currently suspended. The rates on production above a decline curve are 8.5% for secondary recovery projects and 5.8% for tertiary recovery projects. The trigger for suspension of the incentive rates was reached in 2004 when West Texas Intermediate crude exceeded \$30 per barrel for a calendar quarter. Oil prices, having remained above the \$30 per barrel trigger, have kept the secondary and tertiary production incentive rates suspended.

Stripper oil incentives rates were adopted to encourage the continuation of production from low volume wells. Montana has been commercially producing oil and natural gas since 1915 and has numerous historic fields still in production or being revitalized. Applying stripper well incentive rates should not be overlooked as wells decline in production or properties are purchased that have low producing wells in place.

Sales Tax - None

When determining rate of return on investments in Montana, the fact that Montana has no general sales tax needs to be in the calculation. Montana has a few selected sales and use taxes such as local option sales taxes at resort locations and use taxes on rental cars and lodging.

Oil and Gas Equipment Property Taxation

Property tax classification for "all oil and gas production machinery, fixtures, equipment, including pumping units, oil field storage tanks, water storage tanks, water disposal injection pumps, gas compressor and dehydrator units, communication towers, gas metering shacks, treaters, gas separators, water flood units, gas boosters, and similar equipment that is skidable, portable, or movable" (Montana Code Annotated 2005, 15-6-138 (1)(c)) is class eight business equipment personal property. Local mills are levied on 3% of the property's market value. All down-hole equipment in oil and gas wells is exempt from property taxation. The class eight business equipment personal property owned by a single entity in an aggregate of \$20,000 or less in market value is exempt from property taxation.

Pollution Control Equipment Property Taxation

The percent of market value that is taxable for pollution control equipment is currently at the same rate, 3%, as for business equipment personal property; however, should the business equipment tax rate be raised or the pollution control equipment tax rate be lowered in the future, this classification could be beneficial in keeping or gaining a lower tax rate for the business entity. A certification is required from the Montana Department of Environmental Quality to the MDOR as to what portion of construction costs and equipment installed is specifically for pollution control. Pollution control equipment property is class five and definition can be found at Montana Code Annotated 15-6-135(2)(a).

Corporate Income Tax

Montana corporate income tax, often referred to as “corporate license tax”, is applied to net income at a rate of 6 3/4%, except that for a taxpayer making a water’s edge election, the rate is 7%. Minimum tax is \$50.00

Tax Advice and Resources

Montana has a variety of tax incentives for new and expanding businesses that have been used by natural gas processing plants, pipelines, and petroleum refineries in Montana. Criteria are varied, and as with all tax driven decisions, tax professionals should be consulted for specific advice.

Information sources

Online sources for Montana codes (laws), administrative rules, and regulatory agency contact information:

- Montana state government, <http://mt.gov/government.asp>
- Montana Department of Revenue, <http://mt.gov/revenue>
- Montana Board of Oil and Gas Conservation (regulatory and permitting agency for oil and gas drilling and production), <http://bogc.dnrc.mt.gov>
- Montana Department of Environmental Quality (regulatory and permitting agency for air emissions and water discharge permits), <http://www.deq.mt.gov>
- Montana Petroleum Association (statewide trade association for oil and gas producers, processors and pipelines, refiners, and service providers to the petroleum industry), <http://www.montanapetroleum.org>

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