HOUSE BILL REPORT
HB 2701

As Reported by House Committee On:
Technology, Energy & Communications

Title: An act relating to fossil fuel production.

Brief Description: Concerning fossil fuel production.

Sponsors: Representative Morris.

Brief History:
Committee Activity:
Technology, Energy & Communications: 1/25/08, 2/1/08 [DPS].

Brief Summary of Substitute Bill

- Establishes a severance tax on oil and gas production.

HOUSE COMMITTEE ON TECHNOLOGY, ENERGY & COMMUNICATIONS

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 12 members: Representatives McCoy, Chair; Eddy, Vice Chair; Crouse, Ranking Minority Member; McCune, Assistant Ranking Minority Member; Hankins, Herrera, Hudgins, Hurst, Kelley, Morris, Takko and Van De Wege.

Staff: Scott Richards (786-7156).

Background:

Recent high prices for crude oil and natural gas have led to oil and natural gas exploration in areas where extraction is more expensive. In recent years, parts of the state have been explored for natural gas reserves, such as the Columbia River Basin. Natural gas exploration companies must drill though thousands of feet of basalt rock to determine whether natural gas is present in marketable amounts. In addition, geological formation in southwest Washington may potentially contain reserves of coalbed methane which is a form of natural gas extracted from coal beds.

Department of Natural Resources

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

The Department of Natural Resources (DNR), through the Division of Geology and Earth Resources, regulates drilling and related activities under the Oil and Gas Conservation Act and the DNR rules. In the event of a discovery, the DNR would also regulate production to assure equitable distribution of the proceeds.

Energy Freedom Account
In 2006 the Legislature established the Energy Freedom Account in the Washington Department of Agriculture to develop a viable bioenergy industry to promote public research and development in bioenergy sources and markets, and to support a viable agriculture industry to grow bioenergy crops. In 2007 the Legislature transferred responsibility of the Energy Freedom Account to the Department of Community, Trade and Economic Development and created the Green Energy Incentive Account within the Energy Freedom Account. Appropriations made to the Green Energy Incentive Account are dedicated for refueling station development, plug-in hybrid pilot projects, and hydrogen vehicle demonstration projects.

Severance Tax
The state does not assess a severance tax for oil or gas production.

Summary of Substitute Bill:

Beginning January 1, 2009, the Department of Revenue (Department) must collect a 6 percent severance tax on the removal of oil or gas from any land or water in the state. The measure of the tax is the value of the oil or gas at the time and point of production. The value of the oil and gas is the fair market value of the oil or gas when first metered and at the point of production.

The operating producer of oil and gas production is responsible for filing the return with the Department, paying the tax due, and deducting and withholding the rateable share of the tax from payments made to other producers in proportion to their interest.

Oil and gas values that are tax exempt due to federal laws or negotiated compacts with a tribal government are not subject to the severance tax. Likewise, the value of oil or gas that is re-injected for storage is exempt from the severance tax. The value of liquid hydrocarbons that are a byproduct of carbon sequestration are exempted from severance taxes imposed by the Department.

Severance taxes collected by the Department must be deposited into two accounts: the Energy Freedom Account and the Local Government Severance Taxation Account. The Energy Freedom Account receives 80 percent of the severance taxes collected by the Department and the Local Government Severance Taxation Account receives 20 percent of the severance taxes collected by the Department.

The Legislature is required to compensate the DNR for regulating oil and gas production. Moneys from the Energy Freedom Account may be appropriated by the Legislature to recover the cost of oil and gas regulation as contained in the budget of the DNR. Moneys from the Local Government Severance Taxation Account must be used solely for making distributions to those local governments in which impacts from oil and gas production activities occur, after appropriation by the Legislature.

Oil and gas reserves and leases on the rights to develop and operate oil and gas production are exempt from property taxation.

Substitute Bill Compared to Original Bill:

The severance tax rate for oil and gas production is changed from 12.5 percent to 6 percent.

The definition of severance is modified to exempt the withdrawal of gas from underground storage.

The term "value" is modified to mean the fair market value of oil and gas when first metered and the point of production.

The value of liquid hydrocarbons that are a byproduct of carbon sequestration are exempted from severance taxes imposed by the Department.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: The bill takes effect January 1, 2009.

Staff Summary of Public Testimony:

(In support) The severance tax rate in this bill puts the state in line with other oil and gas producing states. Some states' severance taxes are higher and some are lower. There is active drilling going on in the state and this bill puts a system in place before there is a find rather than waiting to develop a system after a discovery of oil and gas. The Energy Freedom Fund is a nice fit for the revenues generated. The bill allows the Department of Natural Resources to recover their costs for regulating the development of oil and gas resources. Local governments also have a share in the revenues generated by the tax.

(In support with amendment) There is concern with the way the bill is currently drafted. The bill may unintentionally impose a tax on someone bringing oil and gas into the state who stores it for later re-use at the commercial and residential levels. The bill needs to be clarified on this issue.

(With concerns) Rate of taxation is higher than many states that impose a severance tax.

(Opposed) The severance tax should be lower and there should be reasonable exemptions provided for the cost of exploring new areas and developing regional infrastructure. If this bill passes, the 12.5 percent severance tax rate would be one of the highest in the country and would likely impact exploration activities.

Persons Testifying: (In support) Representative Morris, prime sponsor.

(In support with amendment) Collins Sprague, Avista; and Denny Eliason, Puget Sound Energy.

(With concerns) Greg Hanon, Western States Petroleum Association/Williams Gas Pipeline.

(Opposed) Bill Lingley, Exxel Energy.

Persons Signed In To Testify But Not Testifying: None.