EXTENSIONS OF REMARKS

Again, NCCNHR congratulates you, Representative Stark, on your persistence and foresight. If you need further information, contact me or Ana Rivas-Beck, J.D., Law and Policy Specialist.

Sincerely,
DONNA E. SHALALA,
Executive Director.

RELIEF FROM INTEREST AND PENALTIES ON FERC REFUNDS

HON. DENNIS MOORE
OF KANSAS
IN THE HOUSE OF REPRESENTATIVES

Tuesday, July 27, 1999

Mr. MOORE. Mr. Speaker, on July 29, the House Commerce Subcommittee on Energy and Power has scheduled a hearing on H.R. 1117, legislation introduced by my colleague from Kansas, JERRY MORAN, and cosponsored by the entire Kansas House delegation.

This legislation would provide relief from unfair interest and penalties on refunds retroactively ordered by the Federal Energy Regulatory Commission. For two decades, FERC allowed gas producers to obtain reimbursement for payment of the Kansas ad valorem tax on natural gas. In a series of orders, FERC repeatedly reaffirmed the rights of gas producers to collect the ad valorem tax, rebuking various challenges to this practice. In 1993, however, FERC reversed 19 years of precedent and ruled that the ad valorem tax was not eligible for reimbursement. FERC has since ordered all producers operating during a 5-year period in the 1980’s to refund both principal and interest associated with this tax.

With this legislation hopefully headed toward consideration by the full House of Representatives, I am taking this opportunity to place in the RECORD a letter recently sent by Kansas Senator Democratic Leader Anthony Hensley to House Commerce Committee Ranking Democrat JOHN DINGELL, concerning the legislative history of ad valorem and severance taxes in Kansas. This background will be very helpful to our colleagues as they review this issue in the weeks ahead.

HON. JOHN D. DINGELL,
House of Representatives, Committee on Commerce, Rayburn House Office Building, Washington, DC.

Dear Congressman Dingle: On June 8, 1999, the House Energy and Power Subcommittee held a hearing on the Kansas Ad Valorem Tax refund issue. This issue is extremely important to the State of Kansas and one of our most important industries, the production of oil and gas. Kansas is a 25-year veteran of the Kansas Legislature and as the Minority Leader of the Kansas Senate, I am writing to request your support of Congresswoman Jerry Moran’s legislation to alleviate what I believe is a serious miscarriage of justice.

I was a member of the Kansas Legislature in 1983 when Governor John Carlin promoted and obtained passage of a severance tax on oil and gas. Prior to 1983, Kansas did not
have a severance tax, only an ad valorem tax. And that tax, an ad valorem tax, is approximately 3.1% of the value of production and was revenue used by counties and local school districts. Oklahoma and Texas, on the other hand, had severance taxes in place since the 1960s, and ranged from 2%–5% "in addition to" a 5.4% property tax, for a total tax burden of 7.1% to 10.4%.

As you know, federal law allowed purchasers to add all of these taxes on to the Federal Power Commission's (FPC) maximum lawful price when purchasing gas. In Wyoming and Colorado, both a severance tax and a property tax were permitted to be added to the maximum lawful price. Texas had both a severance tax and a property tax, however, because of the way its property tax was structured, it was allowed to add on only the 7.5% severance tax and then defer to the FPC for the Texas ad valorem tax.

The Kansas Attorney General requested clarification from the FPC to determine whether Kansas' ad valorem tax could be added to the severance tax and at the maximum lawful price. The Kansas Corporation Commission clarified this issue and did allow the Kansas ad valorem tax as a lawful addition to the price.

In 1981, the State of Kansas needed additional funding for education, roads and infrastructure, and Governor Carlin began studying the potential for a severance tax. One of our state's most valuable natural resources was being depleted and consumed out of state, pipelines were strewn across Kansas, drilling equipment was taking up space in Kansas roads and infrastructure, and little benefit was being derived by Kansas government. The price of gas at the wellhead, sold in interstate commerce, was being controlled by the federal government at prices far below fair market value, resulting in the transfer of enormous wealth from Kansas to out of state suppliers. Certain Kansas, Colorado, Wyoming and other states were collecting taxes on oil and gas at twice the severance tax rate.

Governor Carlin proposed a severance tax which, when added to the existing ad valorem tax, would be comparable to the taxes on oil and gas production collected in other producing states. The legislature studied various severance tax proposals for three years. Oil and gas severance and property tax in neighboring states were studied carefully. A comparative chart used by the Senate Tax Committee was passing the severance tax was enclosed with the attached Memo of Severance and Property Taxes prepared by the Kansas Legislative Research Department during the 1981 severance tax debate.

One of the issues raised during legislative debate was whether both a severance tax and an ad valorem tax on gas could be added to the maximum lawful price of gas as established by the Federal Energy Regulatory Commission (FERC). We were advised that this was a common, Colorado practice—and other producing states, and that FPC Opinions 699–D allowed the pass through of the Kansas ad valorem tax. This Opinion had been adopted by the Kansas Attorney General and the Kansas Legislature relied on Opinion 699–D without further question.

Finally, in 1983, the Kansas Legislature passed a severance tax “in addition to” the existing ad valorem tax. A credit against the severance tax for ad valorem taxes paid was allowed. So, a severance tax on gas and a 4.33% tax on oil. Clearly, tax policy for our state was based on the Legislature’s reliance on FPC Opinion 699–D. Therefore, it is not for our reliance on Opinion 699–D that the tax rates have passed through without amending our state’s ad valorem tax to conform to federal requirements for pass through of both the severance and ad valorem taxes as was done in Wyoming and Colorado.

When Kansas passed the severance tax in 1983, the issue was not asking the FERC to reconsider its Opinion 699–D to prohibit Kansas producers from passing through both a severance tax and a property tax. They were denied twice by the FERC. In 1988, Colorado Interstate Gas Company appealed the FERC decision to the Washington, D.C., Circuit Court of Appeals. I am sure you are familiar with the whole scenario that has followed. Nineteen years after Opinion 699–D was issued, the FERC, with incentive from the Washington, D.C., Court in the Colorado Interstate Gas Company case, the court would require retroactive refunds to 1983 based on notice of hearings published in the federal register. Now, because the Kansas Legislative request for approval of Opinion 699–D to pass a severance tax without adjusting the methodology by which the Kansas ad valorem tax was calculated, many Kansas independent oil and gas producers were screwed.

What could the Kansas Legislature have done further to determine the reliability of Opinion 699–D? Should we have asked for a second ruling on the same scenario? Would that have allowed Kansas to rely on the Opinion? Would three, four or five opinions have allowed Kansas to rely on the ruling? Was there a better way to get final determination that we could rely on before we passed the severance tax? How can a state ever rely on a federal regulatory ruling if a court can in the future retroactively change the law and require innocent victims who complied with the law to refund large sums of money with interest?

Certainly Kansas producers have done their part to provide consumers with an abundant supply of clean, cheap fuel. But why are consumers up in arms? In 1998, the price of natural gas paid to producers at the wellhead in Kansas averaged less than $1.96 per mcf. The price of natural has at the residential burner tip, however, averaged $6.82 in the U.S.A., with prices ranging from less than $5 to over $12 per mcf from time to time. Since FERC Order 636 passed, the price of natural gas paid to producers at the wellhead has gone down while the price of natural gas paid by residential consumers has gone up. The middlemen’s share of the residential consumer’s dollar has increased from 9% to 37%; while the producer’s share has decreased from 41% to 27%. Both producers and consumers are losers in this environment while the giant interstate pipelines and local distribution companies have seen profits rise dramatically.

Now, I understand, the primary beneficiaries of deregulation—the interstate pipeline companies—and, before the Energy and Power Subcommittee in the name of consumer protection. How much of the refund will ultimately reach the consumer? That is undetermined at this time, but I am advised that any residential consumer likely will receive no more than $15 over a period of time. However, the total of these refunds is not merely a refund passed through to the consumer, equals the estimated drilling and exploration budget for all of Kansas for the next three and one-half years.

As Democrats, we need to stand up for what is right and fair in America. Consumer protection is an enormously powerful political force, but honestly, Kansas producers deserve no less. Kansas producers were perhaps the only innocent parties in this entire scenario, caught between consuming states whose people believe they have a right to cheap fuel, and the governments of producing states who believe they have a right to tax oil and gas producers into oblivion. This is not a consumer's issue. I do not believe that consumers in Kansas, Missouri, Colorado, Michigan or any other state will benefit in any way from this retroactive reversal of law by the Federal Energy Regulatory Commission. A minuscule refund to a long lost consumer cannot offset the losses which will result from the destruction of honest, hardworking, productive citizens. Exploration in Kansas is almost totally dependent on small independent operators who provide an invaluable resource to consumers. If court takes possession of this vital Kansas industry is not in any one’s best interest. I strongly urge you to support Congressman Moran’s legislation to eliminate this serious injustice.

Sincerely,

ANTHONY HENSLEY, Kansas Senate Minority Leader.

On Or After January 1, 1973, And New Deductions Of Natural Gas To Interstate Commerce On Or After January 1, 1973, Opinion No. 699-D.

DECLARATORY ORDER ON PETITION FOR CLARIFICATION (ISSUED OCTOBER 9, 1974)

Before Commissioners: John N. Nassikas, Chairman; Albert B. Brooke, Jr., Rush Moody, Jr., William L. Springer, and Don S. Smith.

The State Corporation Commission of the State of Kansas (on August 26, 1974, filed a request for clarification of Opinion No. 699 concerning the right of producers making jurisdictional sales in Kansas covered by that opinion to adjust upward the national rate prescribed therein by the amount of the Kansas ad valorem tax.

Opinion No. 699 provides in Paragraph A(5) (mimeo p. 141) that the national rate established there “shall be adjusted upward for all State or Federal severance, or similar taxes * * *”. The question presented is whether the Kansas ad valorem tax is a similar tax within the meaning of the above provision. A number of other states also have an ad valorem tax, and our determination here will not be limited to the Kansas ad valorem tax, but will apply to ad valorem taxes in general.

As Kansas points out, the bulk of the Kansas ad valorem tax is based upon production facts, as such production tax or production tax merely bearing the title “ad valorem tax”. The ad valorem tax in some other states is also similar to a production or severance tax inasmuch as it is based on the amount of production and the revenue therefrom. Consequently, we conclude that it is proper under Opinion No. 699 for producers to adjust upward for a state ad valorem tax where such tax is based on production factors.

SEVERANCE AND PROPERTY TAXES ON OIL AND GAS

Background

This memorandum presents an overview of the severance taxes and property taxes levied on oil and gas properties in the major
EXTENSIONS OF REMARKS

A severance tax may be either “in lieu of” or an addition to property taxes on oil or gas properties. An “in lieu of” severance tax exempts oil and gas properties from the general property tax. Property taxes on real and personal property have traditionally been a major source of funding for the activities carried on by state and local governments. Applying a property tax to oil and gas properties typically involves determining the value of minerals in the ground and the value of the production equipment. States imposing property taxes have usually chosen one of three methods to value the minerals: value of production; formula valuation; or token assessment.

Annual production assessment applies the property tax levy to the value of production, which might be either gross or net value. Formula valuation attempts to value resources by estimating the average life of a well, rate of discount, and the estimated value of future production. Token assessment would apply the property tax to a minimal amount of value, either per acre of lease or per well.

National Summary

Severance taxes on oil and gas have been enacted in 27 states, including states such as Kansas which have enacted relatively minor severance taxes based on the volume of production for regulatory, rather than revenue, purposes. Seventeen of those 27 states have enacted “significant” severance taxes—a tax at the rate of 2 percent or more of value. Six of the 17 states with significant severance taxes impose their tax in lieu of the property tax.

Kansas

Oil and gas leases, including royalty interests and equipment used in production, are assessed as tangible personal property in Kansas. Guides for assessing oil and gas properties have been prepared by the Director of Property Valuation, Department of Revenue, for use by county appraisers. After appraised values are determined, the properties are assessed at 30 percent of such values and are subject to the total general property tax rate according to the situs of the property.

According to Table 3, prepared by the Department of Revenue, Division of Property Valuation, oil and gas properties paid most of the $76 billion in tax revenues in 1980, up from $60.5 million in 1979.

According to the Kansas Geological Survey, oil and gas production in Kansas for the last two years was as follows:

Thus, using the above oil and gas property tax figures, property taxes statewide averaged 3.1 percent of value and 2.9 percent of value in 1980 and 1979, respectively. Of course, the ratio of property taxes to value varies from lease to lease and county to county.

The biggest factor in the increase in property taxes between 1979 and 1980 was the increase in the price of oil. The calculation of the value of the gross reserves of oil is the most important step in valuing the oil lease. This value is calculated by multiplying the total annualized production for the previous year times a net price figure times a present worth factor. In 1979 Oil and Gas Appraisal Guide, the highest price of stripper oil was $15.10; in 1980, this same oil sold for approximately $38, and the net price figure used in the 1980 Guide was $31.56. These price figures reflect actual selling prices of oil and the worldwide increases in prices. The 1981 net price figures are not yet available.

Equipment values shown in the 1980 Guide were also higher than those in the 1979 Guide. This increase was due to the fact that the equipment values had not been updated for several years and reflected the increase in the value of equipment that has accompanied the increase in the price of oil. The number of gas producers also pay severance taxes, which are paid on January 1 of the assessment year less state and federal wellhead taxes levied on value or volumes produced, and less applicable transportation charges.

The Kansas Geological Survey published a comprehensive summary of the Windfall Profits Tax. An 8 percent severance tax could lower the net price figure per barrel for oil from $31.70 to $29.16, as follows:

Current sales price—1 barrel of oil .................... $38.00
Base price for WPT ........................................... 17.00
Windfall profit for WPT ......................... 21.00
WPT rate for independents on stripper oil ........ 8.00
WPT liability .............................................. 6.30
Current sales price—1 barrel of oil .................... $38.00
WPT liability .............................................. 6.30
Net price with WPT .................................... $31.70
Windfall profit for WPT ......................... 21.00
WPT severance tax adjustment (8%) ........ - 1.68
Net windfall profit ................................. 19.32
WPT rate for independents on stripper oil ........ 8.00
WPT liability .............................................. 5.80
Current sales price—1 barrel of oil .................... $38.00
Salerence tax .............................................. 8.00
Severance tax liability ..................... $3.04
WPT liability .............................................. 5.80
WPT severance tax liability ................. - 2.04
Current sales price—1 barrel of oil .................... $38.00

Severance tax liability ..................... $3.04
At least two opinions of former Kansas Attorneys General have stated that either an "in addition to" or "in lieu of" severance tax could be constitutionally enacted in Kansas. Article 11, Section 1, of the Kansas Constitution specifically authorizes the legislature to classify "mineral products" for purposes of taxation. In an opinion dated September 13, 1954, the Attorney General concluded: "... it is our opinion that a gross production or severance tax would probably be constitutional if levied to the exclusion of property taxes or if levied in addition to property taxes on mineral products. We do not believe that a provision exempting the equipment and other property used in production would constitute an exception.

The above opinion was confirmed in another opinion, dated June 5, 1969: "We have studied the (1964) opinion and agree with his conclusion stated therein. We are unable to find any recent case which would alter that conclusion. However, we would again emphasize that a severance tax act could not exempt the equipment and other property used in the production of oil and gas from ad valorem taxes.

A 1 percent severance tax on oil gas production was enacted on the last day of the 1957 Session. This tax was an "in addition to severance tax. During the first six months after enactment, over $2 million was collected. This tax was held to be invalid by the Kansas Supreme Court, however, in the case State, ex rel. v. Kirchner, 182 Kan. 497 (1958). The Court held that the bill enacting the tax was unconstitutional because the subject of the act was not clearly expressed in its title.
11:30 a.m.
Banking, Housing, and Urban Affairs
To hold hearings on the nomination of Harry J. Bowie, of Mississippi, to be a Member of the Board of Directors of the National Consumer Cooperative Bank; the nomination of Armando Falcon, Jr., of Texas, to be Director of the Office of Federal Housing Enterprise Oversight, Department of Housing and Urban Development; the nomination of Robert Z. Lawrence, of Massachusetts, to be a Member of the Council of Economic Advisers; the nomination of Martin Baily, of Maryland, to be Chairman of the Council Economic Advisors; and the nomination of Dorian Vanessa Weaver, of Arkansas, to be a member of the Board of Directors of the Export-Import Bank.

SD–538

AUGUST 3

9:30 a.m.
Energy and Natural Resources
To hold hearings on S. 1052, to implement further the Act (Public Law 94–241) approving the Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America.

SD–366

Armed Services
To hold hearings on the nomination of Charles A. Blanchard, of Arizona, to be General Counsel of the Department of the Army; and the nomination of Carol DiBattiste, of Florida, to be Under Secretary of the Air Force.

SR–222

10 a.m.
Indian Affairs
To hold hearings on proposed legislation to provide equitable compensation to the Cheyenne River Sioux Tribe.

SR–485

Environment and Public Works
Business meeting to resume markup of S. 1090, to reauthorize and amend the Comprehensive Environmental Response, Liability, and Compensation Act of 1980.

SD–406

EXTENSIONS OF REMARKS

Governmental Affairs
Business meeting to consider pending calendar business.

SD–342

2:30 p.m.
Indian Affairs
To hold hearings on S. 692, to prohibit Internet gambling.

SR–485

AUGUST 4

8:30 a.m.
Judiciary
To hold hearings on the nomination of David W. Ogden, of Virginia, to be an Assistant Attorney General; and the nomination of Robert Raben, of Florida, to be an Assistant Attorney General.

SD–628

9:30 a.m.
Indian Affairs
To hold hearings on S. 299, to elevate the position of Director of the Indian Health Service within the Department of Health and Human Services to Assistant Secretary for Indian Health; and S. 406, to amend the Indian Health Care Improvement Act to make permanent the demonstration program that allows for direct billing of medicare, medicaid, and other third party payors, and to expand the eligibility under such program to other tribes and tribal organizations; followed by a business meeting to consider pending calendar business.

SR–485

10 a.m.
Judiciary
To hold hearings on S. 1172, to provide a patent term restoration review procedure for certain drug products, focusing on proposed remedies for relief, relating to pipeline drugs.

SD–628

10:30 a.m.
Foreign Relations
To hold hearings on S. 693, to assist in the enhancement of the security of Taiwan.

SD–419

Governmental Affairs
Oversight of Government Management, Restructuring and the District of Columbia Subcommittee
To hold hearings on overlap and duplication in the Federal Food Safety System.

SD–342

2 p.m.
Judiciary
Immigration Subcommittee
To hold hearings on annual refugee consultation.

SD–628

2:15 p.m.
Energy and Natural Resources
National Parks, Historic Preservation, and Recreation Subcommittee
To hold oversight hearings to review the performance management process under the requirements of the Government Performance and Results Act, by the National Park Service.

SD–366

Commerce, Science, and Transportation
To hold hearings to examine fraud against seniors.

SR–253

AUGUST 5

9:30 a.m.
Banking, Housing, and Urban Affairs
Housing and Transportation Subcommittee
To hold oversight hearings on activities of the Office of Multifamily Housing Assistance Restructuring of the Department of Housing and Urban Development.

SD–538

10 a.m.
Judiciary
Business meeting to consider pending calendar business.

SD–628

SEPTEMBER 28

9:30 a.m.
Veterans’ Affairs
To hold joint hearings with the House Committee on Veterans’ Affairs to review the legislative recommendations of the American Legion.

345 Cannon Building