Approved March 27, 1986
Date

MINUTES OF THE Senate COMMITTEE ON Assessment and Taxation.

The meeting was called to order by Senator Fred A. Kerr at
Chairperson

11:00 a.m./p.m. on Wednesday, March 26, 1986 in room 519-S of the Capitol.

All members were present except:

Committee staff present:
Tom Severn, Research Department
Melinda Hanson, Research Department
Don Hayward, Revisor's Office
LaVonne Mumert, Secretary to the Committee

Conferees appearing before the committee:
David R. Collins, Kansas Geological Survey
Donald P. Schnacke, Kansas Independent Oil and Gas Association
L. O. Tenk, Eastern Kansas Oil and Gas Association
Steven R. Gustison, Eastern Kansas Oil and Gas Association
John Bower, McLouth

S.B. 743 - Exemption from severance tax on certain oil production

Chairman Kerr explained that S.B. 743 is a result of a number of meetings in an attempt to offer some relief to the problems being experienced by the oil industry. Input was received from the Department of Revenue, Kansas Geological Survey, some Committee members and House members. The bill is specifically directed to those small wells which are the first to be shut in. S.B. 743, as drafted, bases the exemption criteria on the dollar production. Chairman Kerr advised that since the publication of the bill it has become apparent that the dollar exemption concept is administratively very difficult. He suggested that should the Committee decide to pursue the issue that an increase in the per barrel exemption would be more acceptable. He provided a copy of a newspaper article concerning the oil problem (Attachment 1).

David R. Collins explained the current production rate exemptions and the provisions for exemptions contained in S.B. 743 (Attachment 2). Dr. Collins explained the different effect exemptions based on production rates or on gross value have with regard to tax exposure and tax relief. He estimates the fiscal impact of the bill to be a loss of approximately $6 million, based on an oil price of $15 per barrel. He advised that the bill, in its current form, would provide a small relief to production depths of less than 1000 feet and between 2000 and 2500 feet when the market is down but would very significantly increase the tax exposure when the market is up. He suggested modifying the provisions of the bill (see Attachment 2) and adding an inflation index. Answering questions from Committee members, Dr. Collins said that, under existing market conditions, no one that is currently exempt would lose that exemption under the bill and that the bill does not change the new pool exemption.

Donald P. Schnacke discussed the problems being experienced in the industry (Attachment 3). He talked about the impact of decreasing oil prices on stripper wells and noted that 90% of the production in Kansas is stripper wells. He discussed the lost jobs and loss in tax revenues projected by the Interstate Oil Compact Commission. He suggested that the bill be amended to increase the exemption only on the deeper production and to eliminate the gross value basis for exemption. Mr. Schnacke thinks this would decrease severance tax revenues by about $5 million. He pointed out that once a well is plugged, that production is usually lost forever. In response to Senator Allen's question, Mr. Schnacke said that there is a 90-day rule where production can cease; after the 90 days, temporary abandonment status must be applied for or the well must be plugged if production is not started.

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

L. O. Tenk said he opposes S.B. 743 in its current form (Attachment 4). He feels it is essential to keep exemptions on a per barrel basis. Mr. Tenk discussed the importance of keeping wells in production as long as possible.

Steven R. Gustison opposes the bill in its current form (Attachment 5). He said that the average daily production in eastern Kansas is one-third of a barrel per day. He said his organization recognizes the problem of western Kansas producers and feels they need some support. He mentioned concerns that S.B. 743, in its current form, could change the responsibility for filing the renewal application to the pipeline companies rather than the operator. Mr. Gustison feels it is important that the applications continue to be filed by the operators.

John Bower requested an interim study of the property tax structure on oil and gas wells (Attachment 6).

Meeting adjourned.

ASSESSMENT AND TAXATION

OBSERVERS
(PLEASE PRINT)

DATE	NAME	ADDRESS	REPRESENTING
3/26/86	David R. Collins	1930 Constant Ave Lawrence, KS 66044	Kansas Geological Survey
3/26	Ross Martin	Topeka	KPC
	Ken Peterson	"	"
	Robert C. [illegible]	Ottawa	[illegible]
	Ronald R. Hein	Topeka	Mesa
	Steve Gustison	Ottawa	SELF
	Don Schnacke	Topeka	KIOGA
	John Bower	Mitchell	Royalty Owner
	Chip Wheelen	Topeka	KLPG

THE WICHITA EAGLE-BEACON Sunday, March 23, 1986

Stripper Oil Wells In Peril

By Forrest S. Gossett
Staff Writer

Across Kansas' wheat fields, pastures and prairie, 56,000 oil wells — with their giant horse-head shaped pumps moving up and down — are producing 200,000 barrels of crude oil daily despite a three-month slide in oil prices.

But up to a third of those wells — low-production stripper wells — could disappear from the Kansas landscape this year as the industry adjusts to a tailspin that has seen crude oil prices fall from $28 to $14 a barrel over the past three months.

A study released last month by the Interstate Oil Compact Commission predicted that Kansas operators might plug and abandon up to 18,000 wells over the next 12 months, costing the industry up to $244,000 million.

THE STRIPPER wells, which produce less than 10 barrels a day, are the ones most in danger of being abandoned because at current prices the cost of getting the oil out of the ground frequently exceeds the profit that can be made on a barrel.

In Kansas, an estimated 45,000 stripper wells produce an average of three barrels each a day — nearly 75 percent of the state's daily output of 200,000 barrels.

With most of its stripper wells operating, the state already stands to lose more than $1 billion in revenues if oil prices don't recover. And the state treasury could lose about $32 million in sever-

Stripper Wells In Kansas

Total as of Jan. 1: 45,749
Average production: 2.91 barrels a day
Number of wells abandoned at:

Price	Wells lost	Dollars lost to state over first year
$20	4,589	$81.7 million
$18	7,114	$121.3 million
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Source: RAM Group Ltd. and Interstate Oil Compact Commission

he said, will keep pumping until they run dry.

"We look at our own lifting costs and realize that," Smith said. "We've plugged some wells, but I just don't think the state will lose that many wells. Even if you can make a dollar a barrel, you're going to keep a well open."

Attachment 1
Senate Tax Comm. - 3/26/86

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Revenue losses, though, could even be greater as producers are forced to plug and abandon stripper wells, because if prices should recover, the barrels produced by the stripper wells would be lost.

"TAKEN EACH by themselves, stripper wells have no impact," said Wichita oilman A. Scott Ritchie, president of the Kansas Independent Oil and Gas Association this year. "But taken in total, their production is substantial and important to the state. And after you plug a well, it's gone. It will take a substantial reinvestment to make up the difference."

Farmers who lease their property to oil producers will lose, too. Farmers generally receive one-eighth of the total take from oil produced on their leases.

For instance, a farmer who has five stripper wells on his property that combine to produce 20 barrels of oil a day will receive $12,740 in royalties income this year, only half his 1985 level. If a producer is forced to plug that stripper well, the farmer would lose all his oil royalty income.

Nationally, the 36-state commission predicted that if oil prices remain in the $14 to $15 range the nation could lose 23 percent of its 452,543 "stripper" wells.

NOT EVERYONE in the oil industry agrees with the compact commission's gloomy forecast.

Dick Smith, president and owner of Range Oil Co. in Wichita, says that he thinks the compact commission's report is much too negative. Most Kansas stripper wells can make money, though not much, at $14 a barrel, Smith said.

Many wells cost less than $10 a barrel to produce, and those wells, would lose 18,600 barrels and $244.6 million a year in revenues.

"That's really bad news for the industry," said Donald Hultgren, an oil analyst for Eppler Guerin & Turner Inc., a Dallas brokerage. "Clearly the stripper wells are vital to the independents. There are just a lot of small companies in the industry who have made their livelihoods on the small stripper wells. This is just an indication of howtough things are going to get in the oil patch."

Exactly when a stripper well is abandoned depends in large part on when it first started production, what its future reserves may be and on whether it is producing large amounts of water.

Mandigo says that the biggest factor in Kansas is water. Some wells produce a hundred barrels of water for every barrel of oil. Generally, the water is pumped back into formations through disposal wells.

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"We look at our own lifting costs and realize that," Smith said. "We've plugged some wells, but I just don't think the state will lose that many wells. Even if you can make a dollar a barrel, you're going to keep a well open."

NONETHELESS, SMITH admitted that Kansas is in danger of losing "several thousand" stripper wells.

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The wells collectively produced 127 barrels of oil a day and 10,500 barrels of water a day, said Mandigo, meaning that $14 a barrel made the wells unprofitable to produce.

"Those wells, at least many of those wells, were cash losers at current prices," Mandigo said. "There is generally a high water cut here in Kansas, and it can be expensive to operate those wells."

ACCORDING TO the commission study, Kansas could lose 10,300 of its 56,000 active oil wells if prices remain at current levels. Of the state's active wells, 45,749 are classified as stripper wells.

Losing that many wells would cost the state about 29,000 barrels of production a day — $160 million over the course of a year.

Texas and Oklahoma would be hit much harder.

A prolonged period of $15 oil prices could cost Texas more than $500 million a year, while in Oklahoma, where strippers account for 60 percent of the state's total production, producers would lose about $307 million.

FOR EACH state, the lower the price of oil, the more wells lost. For instance, at $10 a barrel, the commission predicts that Kansas

AND THAT, he said, can cost plenty.

"Energy costs can really hurt you in that type of well," Mandigo said. "You start losing money at these levels."

But even wells that are not producing large amounts of water are in danger. Oil well pumping units, like any other machinery, require periodic maintenance, which can range from $200 or $300 to several thousand dollars depending upon what is needed.

Phillips Petroleum Co., the Bartlesville, Okla., company that took on $2 billion in debt last year to thwart a T. Boone Pickens takeover, said recently that it was reviewing stripper wells on a case-by-case basis.

ALREADY, THE company has shut-in several wells in the huge Permian Basin of Texas, and more wells may be shut in.

Testimony regarding Senate Bill No. 743
March 26, 1986

by

David R. Collins, Ph.D
Advanced Projects Section
Kansas Geological Survey

Senate Bill No. 743 proposes an alternative approach to the present method of determining low production exemptions from the severance tax on crude oil. I will first address the merits of the proposed gross value exemption as it relates to the intended purpose of the low production exemptions in the severance tax law. I will then comment on certain problems which relate to adoption of the proposed exemption structure.

In the present severance tax law, crude oil exemptions are specified in terms of average daily production rates. The level of exempted production is based on depth of production and whether or not production results from a water flood process (See Table 1).

Table 1: Production rate exemptions for crude oil

	Normal Primary or Secondary Production	Production from a Water flood Process
less than 2000 ft.	2 BOPD	3 BOPD
greater than 2000 ft.	3 BOPD	4 BOPD

These production rate exemptions were included in the current law as an attempt to provide increased net revenue for production from wells in catagories which include a significant proportion of the industry's economically marginal operations. Increased net revenue obtained through tax relief should extend the economic life of a well. These production rate exemptions were defined in relation to the market

conditions which existed at the time, with crude oil priced at more than #30 per barrel.

With a production rate exemption, the extent to which marginal producing wells are exempted varies widely with market conditions. As crude oil prices drop, an increasing proportioin of wells which qualify for the exemption become non-economic and are plugged while wells with higher production rates become marginal without qualifying for any exemption. Conversely, higher crude oil prices result in application of the exemption to increasingly profitable opertions.

In Senate Bill No. 743, crude oil exemptions for single well production are specified in terms of gross value of average daily production. The value of exempted production is based on depth of production and whether or not production results from a water flood process (See Table 2).

Table 2: Gross value exemptions for crude oil

	Normal Primary or Secondary Production	Production from a Water flood Process
less than 1000 ft.	$ 40/day	$ 70/day
1000-2500 ft.	$ 60/day	$ 95/day
2500-4500 ft.	$ 80/day	$120/day
greater than 4500 ft.	$100/day	$145/day

In the face of declining market prices the gross value exemption extends to wells with higher production rates as their gross revenue falls and they approach economically marginal conditions.

With rising market prices the gross value exemption is restricted to wells with lower production rates. As gross revenues increase and wells become more profitable they eventually fail to qualify for the exemption.

If a production rate exemption were provided at 3 bopd, the maximum value of exempted production would change from $75/day to $45/day with a change in price from $25/barrel to $15/barrel. With a gross value exemption of $75/day, the same decline in price would result in the maximum exempted production result in the rates increasing from 3 bopd to 5 bopd.

A widely accepted principle of equity in taxation is that the incidence of the tax should be related to ability to pay. By this criterion neither form of exemption is perfect, but the gross value exemption is clearly superior to a production rate exemption.

For a given distribution of production in Kansas, production rate exemptions would result in tax relief maintaining a fixed proportion of gross (zero exemption) tax with changing oil prices (see Figure 1).

For the same statewide distribution of production, gross value exemptions result in tax relief increasing as a proportion of gross with decreases in oil prices (see Figure 2).

When changing from a production rate exemption system to a gross value exemption system, the result involves added tax exposure for the oil industry at high oil prices and added tax relief for the industry at lower oil prices (see Figure 3). For the Department of Revenue this

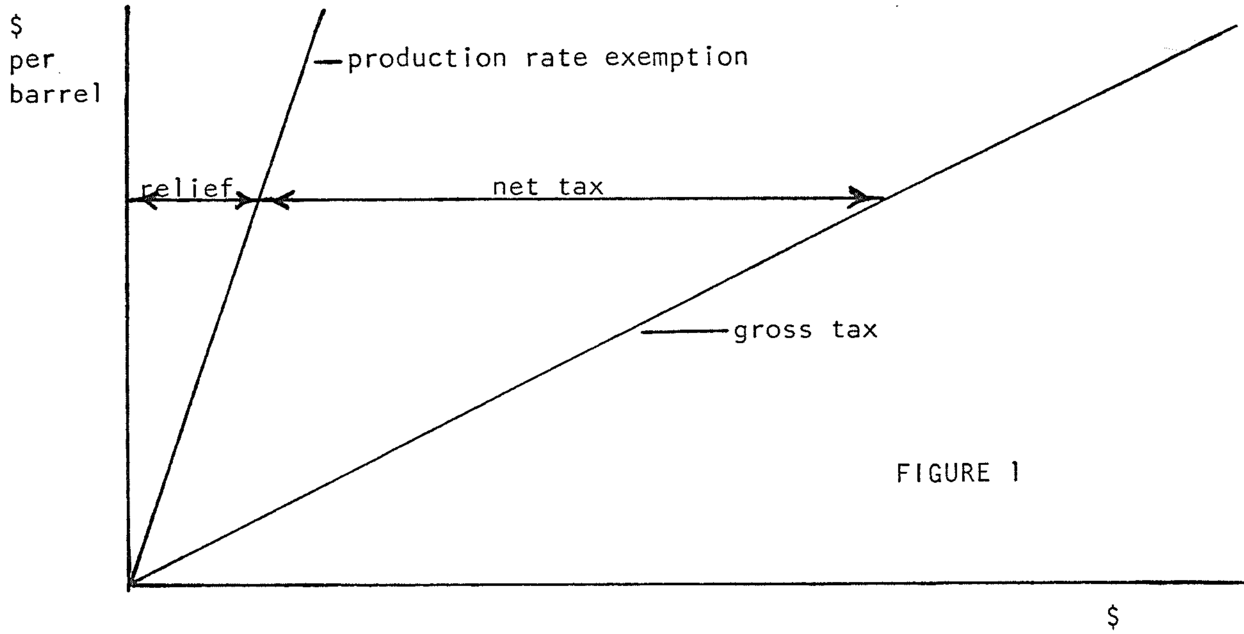

FIGURE 1

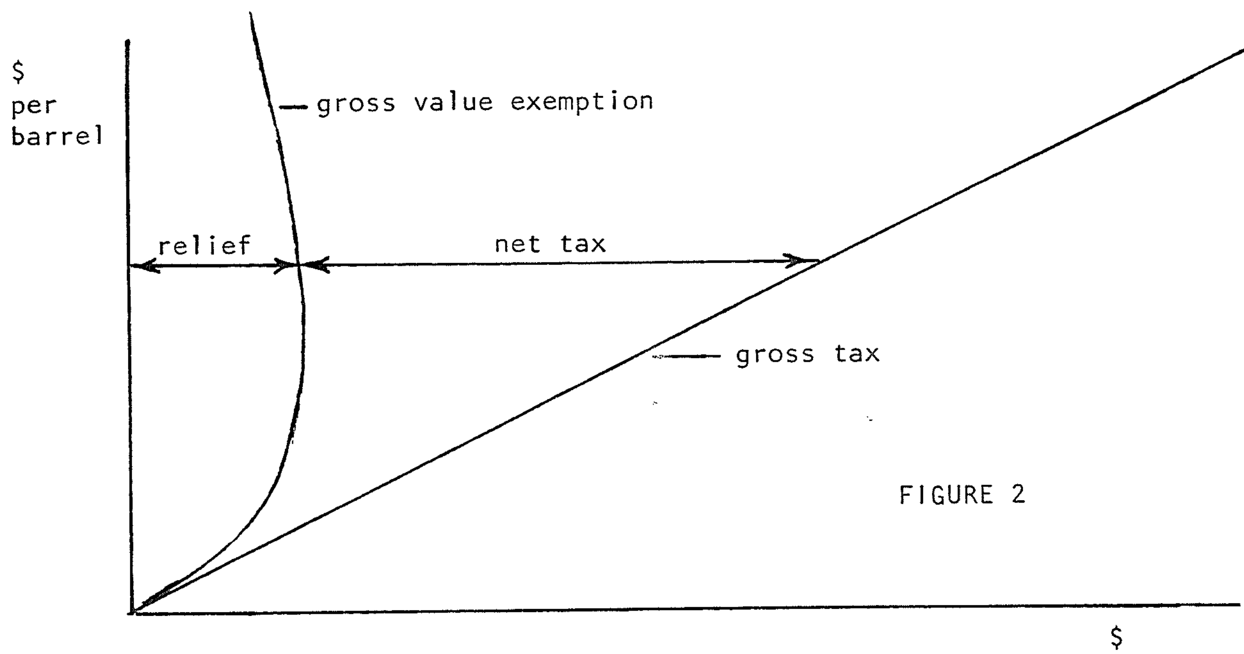

FIGURE 2

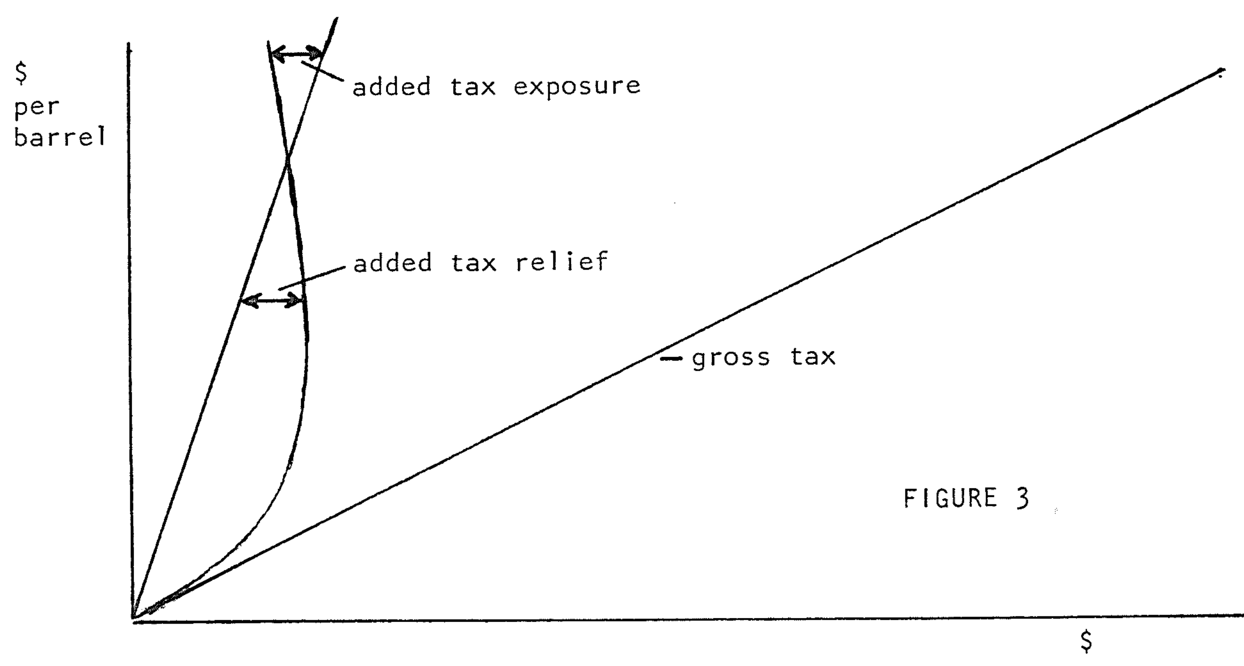

FIGURE 3

would mean a fiscal note with increased tax revenue at higher prices and loss of revenue at lower prices. Based on production data available to the Kansas Geological Survey I have estimated that, for the entire State, added tax relief (or loss of revenue) at an oil price of $15 per barrel would be approximately $6 million. This would decrease to zero at a price near $26 per barrel, with increased tax revenue at higher prices.

The advantages of the proposed structure of gross value exemptions to an individual producer depends upon their current exemption status and the price at which they would be exposed to new taxes. Because of differences in the depth intervals proposed in Senate Bill No. 743 and in the current law, there are two regions of Kansas in which the new exemption structure would expose currently exempt production to a potentially significant tax. Where production occurs at depths of less than 1000 feet the first two tiers of counties in eastern Kansas) current exempt production would begin to be exposed to the tax at oil prices above $20 per barrel. At $15 per barrel the region would receive add relief of less than $200,000 but at #30 per barrel would be exposed to almost $500,000 in added taxes. A similar situation exists for production at depths between 2000 and 2500 feet. The opposition to Senate Bill No. 743 from producers in these areas comes from a recognition of the relatively small advantages of the proposed structure on the down side of the market and the very significant tax exposure on the up side. The appeal of gross value exemptions would be greatly improved at relatively modest additional loss of tax revenue by adopting the following structure (see Table 3).

(6)

	Normal Primary or Secondary Production	Production from a Water Flood Prcess
less than 2000 ft.	$ 60/day	$ 95/day
2000 - 4500 ft.	$ 80/day	$120/day
greater than 4500 ft.	$100/day	$145/day

Because the exposure to additional taxes increases rapidly above the critical price I also feel that it is important to add an inflation index to Senate Bill No. 743 which would adjust the gross value exemptions by an amount equal to changes in operating costs.

It is my understanding that the oil producers may propose an alternative modification to the current law based on production rate exemptions. While I agree that any form of relief would be an improvement, I feel that Senate Bill No. 743 with the modifications I have suggested would be more advantageous to the industry and the State in both the short and long term.

KANSAS INDEPENDENT OIL & GAS ASSOCIATION
500 BROADWAY PLAZA • WICHITA, KANSAS 67202 • (316) 263-7297

March 26, 1986

TO: Senate Committee on Assessment & Taxation

RE: SB 743

We are very appreciative to have the opportunity to address SB 743 and suggest a much simpler approach that would help prevent the loss of production and plugging of marginal wells in Kansas.

I don't need to remind you that our industry is in trouble. The price of oil dropped from $27 to $14 since the first of the year. Oil production checks this month are running about one-third of those last month. Because of OPEC's failure to agree on international pricing, the future market continues to drop. We expect still lower prices in Kansas. Drilling has slowed dramatically. Lay-offs are being reported throughout the state. The industry is in very bad financial shape. (See Exhibit A, dated March 23, 1986.)

The counties took $131 million in ad valorem taxes in 1985 from producing properties - an all time high in Kansas. We are very concerned how we are going to pay this year's ad valorem taxes to the counties.

IOCC has studied the impact of the loss of production and reserves in Kansas due to the decline in prices. (See Exhibit B.) They have also projected the loss of jobs and general taxes as a result of declining oil prices. (See Exhibit C.)

We know that the loss of oil revenue can be projected into a loss of the Kansas severance tax. I estimated at $14, Kansas has lost $35 million of the $70 million plus in oil severance tax collections due simply to the drop in the price of oil.

We don't want to overlook the opportunity to explain to you what $14 posted for 40° gravity oil in Kansas typically means. The typical producer immediately is impacted with a $2.60 deduct for royalty and override interests; transportation is 75¢; severance tax is 65¢; gravity differential (30°) is $1.50; and ad valorem taxes are $1.05. The net to the producer is $7.45 to pay all bills, for lifting water, separation of oil, electricity and expenses on the lease. On January 1, 1986, a producer could make out at a price of $27/bbl, on a 3BOD well. Today it takes a 6BOD well to keep from shutting in the production.

The dramatic drop in the price of crude oil is having its effects on natural gas production in Kansas. We are producing at about 50% of natural gas production capacity in Kansas at the present time. Conversions to No. 6 fuel oil are taking its toll on the natural gas market in Kansas.

SB 743 was designed primarily by the Kansas Geological Survey to address the problem of more realistically applying the severance tax to fluctuating oil prices. It would have a revenue impact of about $5 million less in severance tax collections. We are very appreciative of the KGS working on a solution to protect what wells we have left in Kansas.

Attachment 3
Senate Tax Comm. - 3/26/86

From what we have heard, it would be difficult to administer. After careful study, it does not have the acceptance of the industry and it is not enthusiastically acceptable to the Revenue Department due to the complexity of the bill from an auditing point of view. Kansas production is 90% stripper and the average is around 3 BOD. The Kansas severance tax law does attempt to protect marginal production and production that has high lifting costs.

We have had three years of experience with the severance tax. The 3 and 4 BOD exemption below 2,000' has not been effective in protecting marginal deep production. From the very beginning, there have been complaints about that provision in the law for straight production and water flood production below 2,000'.

You will recall how the Congress exempted stripper wells (10 BOD or less) from the federal Windfall Profits Tax. It's in that spirit that we suggest you increase the exemption only on the deeper production in Kansas.

The below 2,000' production is what is now paying what oil severance tax is now coming into the general fund and we think SB 743 should simply be amended to address that problem, which has been a problen since 1983, and still is.

We suggest you abandon the KGS gross value plan as defined in SB 743 and simply amend the bill as follows:

Line 0084 - restore 2,000' and strike all proposed new language;

Line 0085 - replace "three barrels or less" with "five barrels or less";

Line 0111 - restore 2,000 feet;

Line 0113 - replace "four barrels or less" with "six barrels or less";

Strike out all new proposals and restore the bill to the original language of KSA 79-4217, or as an alternative, you could authorize a substitute bill amending KSA 79-4217. This amendment would address the subject of protecting marginal wells below 2,000" as follows:

KSA 79-4217	Proposed Amendment
Straight Production:	
2,000' or less = 2 BOD	Leave alone
2,000' or more = 3 BOD	5 BOD
Water Flood Production:	
2,000' or less = 3 BOD	Leave alone
2,000' or more = 4 BOD	6 BOD

Following the IOCC material, we would recommend this be a temporary measure and when the price goes to $25/bbl in the future, the original 3 and 4 barrel exemptions would be restored.

This has the general support of our industry. We cannot guarantee this plan will save these deep wells from being shut in. Earlier this week the oil future market dropped to $11 and if that trend continues, there is very little the Legislature can do to help us. The fiscal impact of the alternative proposal is about that as SB 743. We estimate the potential loss of revenue to be $6 million. It would have the effect of postponing abandonment and plugging of marginal wells in Kansas so they will be around to produce in the future.

Donald P. Schnacke

DPS:pp
Attachments (3)

Stripper Oil Wells In Peril

By Forrest S. Gossett
Staff Writer

Across Kansas' wheat fields, pastures and prairie, 56,000 oil wells — with their giant horse-head shaped pumps moving up and down — are producing 200,000 barrels of crude oil daily despite a three-month slide in oil prices.

But up to a third of those wells — low-production stripper wells — could disappear from the Kansas landscape this year as the industry adjusts to a tailspin that has seen crude oil prices fall from $28 to $14 a barrel over the past three months.

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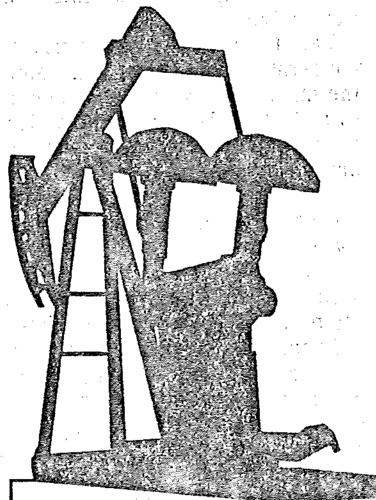

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Texas and Oklahoma would be hit much harder.

A prolonged period of $15 oil prices could cost Texas more than $500 million a year, while in Oklahoma, where strippers account for 60 percent of the state's total production, producers would lose about $307 million.

FOR EACH state, the lower the price of oil, the more wells lost. For instance, at $10 a barrel, the commission predicts that Kansas

● WELLS, 2C, Col. 1

EXHIBIT A

The Wichita Eagle-Beacon

March 23, 1986

Oil Price Slide May Cost State Thousands of Wells

● WELLS, From 1C

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ALREADY, THE company ha[illegible] shut-in several wells in the h[illegible] Permian Basin of Texas, and more wells may be shut in.

The RAM Group, Ltd.

EXHIBIT B

TABLE 4

KANSAS
IMPACT OF DECREASING CRUDE OIL PRICES
ON STRIPPER WELLS

OIL PRICE	PERCENTAGE OF STRIPPER WELLS ABANDONED	NUMBER OF STRIPPER WELLS ABANDONED	PRODUCTION LOST FIRST YEAR (BPD)	VALUE OF PRODUCTION LOST FIRST YEAR ($ MILLION)	TOTAL RESERVES LOST (MM BBLS)
$10	40.8%	18,656	67,036	$244.682	274.311
$15	22.5%	10,307	29,112	$159.390	77.098
$18	15.6%	7,114	18,465	$121.313	29.259
$20	10.0%	4,589	11,198	$81.748	9.748
$23	5.0%	2,269	5,228	$42.931	1.772
$25	0.0%	0	0	$0.000	0.000

NOTE:

STRIPPER WELLS AS OF 1/1/85	45,749	WELLS
AVERAGE STRIPPER WELL PRODUCTION	2.91	BPD

EXHIBIT C

Interstate Oil Compact Commission
Impact of $1.00 Decrease in Crude Oil Price, Selected States

nterstate Oil Compact Commiss
Decrease in Crude Oil Price,

	Crude Oil	NG Liquids	Total	%of U.S.	Jobs	GSP	Taxes
Arkansas	17,618	909	18,527	0.49	390.49	46,858,995	1,561,966
Kansas	75,723	20,928	96,651	2.54	2,037.10	244,452,351	8,148,412
Louisiana	449,545	155,194	604,739	15.92	12,746.02	1,529,522,406	50,984,080
Mississippi	31,879	1,666	33,545	0.88	707.02	84,842,931	2,828,098
New Mexico	75,532	54,534	130,066	3.42	2,741.39	328,966,482	10,965,549
North Dakota	52,654	6,028	58,682	1.54	1,236.83	148,420,118	4,947,337
Oklahoma	153,250	54,262	207,512	5.46	4,373.71	524,845,022	17,494,834
Texas	856,085	330,048	1,186,133	31.22	25,000.00	3,000,000,000	100,000,000
Wyoming	127,763	15,657	143,420	3.77	3,022.85	362,741,784	12,091,393

Senate Bill #743

Testimony of L. O. Tenk, President of Eastern Kansas Oil and Gas Association.

I am testifying today on behalf of Eastern Kansas Oil & Gas Association. Our headquarters are located in Chanute, KS.

When the severance tax became law in 1983, EKOGA fought for and obtained certain exemptions which recognized the unique problems present in the shallow producing areas of Eastern Kansas. These exemptions were based on a barrels per day basis. All records, past and present including the Federal Windfall Profits Tax, well records, pipeline runs, proration allowable, etc., are reported on a per barrel basis.

We oppose that part of the bill referring to a dollar value per well. We do recognize the problems facing the operators of marginal wells in the deeper producing horizons of Western Kansas. When the lifting cost exceeds the per barrel value, the well is plugged. When a producing well is plugged it is gone forever. Regardless of the so called oil glut, the State of Kansas and the U.S. can ill afford the loss of even one barrel of domestic crude.

EKOGA supports additional exemptions on marginal wells below the 2000' level.

Attachment 4
Senate Tax Comm. - 3/26/86

Testimony of Steven R. Gustison, Independent Oil Operator and a Director of Eastern Kansas Oil and Gas Association (EKOGA), Relating to Senate Bill 743.

I'm an Independent Oil Operator and a board member of the Eastern Kansas Oil & Gas Association (EKOGA), whose membership totals close to 1100 and is composed of operators, royalty owners and suppliers located in Eastern Kansas.

Now that the oil price has plummented below $13/bbl and with the bottom still not established, it is necessary to make some adjustments to the severance tax exemptions in order to minimize the premature plugging of wells in Kansas. Our Association recognizes the fact that Senate Bill 743 is trying to achieve this end by upping the amount of money on a per well per day basis that would be exempted from paying any severance tax. Our Association is by no means opposed to added economic incentives but it is opposed to this bill because it so severely alters the way that the current exemptions are administered. We believe that with only a slight adjustment you could greatly benefit the portion of our industry that needs the help the most and still minimize the negative effect to the State of Kansas.

Attachment 5
Senate Tax Comm. - 3/26/86

We think that the current system of crude oil exemptions based on an average daily production rate is the best system to use because it is easiest to understand by an operator and simplest to administer. The Crude Oil Exemption Renewal Application is a very easy form for operators to fill out. It also allows an operator to know on a yearly basis the status of his lease. Presently, the exemptions are classified by depth of production with the break over point at two thousand feet (2,000'). Since it is the producers with production below 2000' that are being denied the needed exemptions under these market conditions, our association would be in favor of raising the daily exemption for that classification and leaving the exemptions for production above 2000' as are currently established. We believe that exemptions based on the price of oil would be a very complicated system to understand and costly to both the operator and the State of Kansas to administer.

IMPORTANT — OPERATORS

The enclosed Crude Oil Exemption Renewal Application must be completed and returned to the Department of Revenue promptly to prevent disruption in your exempt status.

If you are no longer the operator of this lease, please return the application listing the name of the current operator (if available).

The white copy is to be returned to the Department of Revenue and the blue copy is to be retained as a part of your records.

A new Certificate of Exemption will be issued upon receipt of proper documentation which indicates that the lease qualifies for continuing exempt status.

PLEASE NOTE: IF THE LEASE DOES NOT QUALIFY AT THIS TIME - RETURN THE APPLICATION INDICATING -- DOES NOT QUALIFY.

Requests for assistance may be directed by calling 913/296-7713.

MT/07b
(Rev. 3/85)

NOTICE OPERATORS

Renewal Applications must be received prior to the expiration date in order for the Certificate of Exemption to be in effect continously.

If there is a time lapse between the expiration date and receipt of the renewal, the Certificate of Exemption will be granted with an effective date of the first day of the month in which the renewal application was received.

No refund will be made for the intervening period.

Application for a Certificate of Exemption will not be processed without a valid operators license to operate in the State of Kansas.

A refund of the tax paid during the qualifying period of a new Exemption Certificate will be made only for those months for which you maintain a valid license to operate in the State of Kansas.

KANSAS DEPARTMENT OF REVENUE
DIVISION OF TAXATION
MINERAL TAX BUREAU
STATE OFFICE BUILDING
TOPEKA, KANSAS 66625

CRUDE OIL EXEMPTION RENEWAL APPLICATION

G.O.C., INCORPORATED
1302 S MAIN, STE A, PO BOX 391
OTTAWA , KS 66067

OFFICE USE ONLY
Effective
Termination

The JOHN E BURKDOLL Lease Certificate of Exemption is scheduled to expire at 12:00 midnight on MAY 1, 1986. Therefore, it is essential that this renewal application be given immediate attention. In an effort to expedite the renewal of your Certificate of Exemption, the Department has completed the items below under the heading "Lease Information" based upon your previous application. Please review these entries and make corrections by crossing out incorrect items and entering corrected information. Should this lease continue to qualify for an exemption, please complete this application and return to the address above along with a copy of the most recent Kansas Property Valuation form PV-PP-25 "Oil Assessment Rendition" form on file with the county(s) in which production is located. To ensure that your exemption remains in effect, please submit these documents at least 21 days prior to the scheduled expiration date.

LEASE INFORMATION

Operator I.D. No. 6419 Exemption Certificate No. A00

Reason for Exemption: Minimum Production ☐ Waterflood ☒ XX Tertiary ☐

Legal Description: Section 13 Township 18S Range 20E

County I.D. No. 30 Number of Producing Wells 8

Average Well Depth 680 KCC Waterflood or Tertiary Project No. 11839

A listing of your most recent 12 month production history must be reported to verify the reason for exemption.

MONTH	PRODUCTION	NUMBER OF PRODUCING WELLS	NUMBER OF OPERATING DAYS
APR - 85			
MAY - 85			
JUN - 85			
JUL - 85			
AUG - 85			
SEP - 85			
OCT - 85			
NOV - 85			
DEC - 85			
JAN - 86			
FEB - 86			
MAR - 86			
TOTALS	1.		2.

Average Daily Production [3.] bbls. per day.

Divide Box 1 by Box 2 and enter the number of barrels in Box 3.

X ____________________
Signature of Authorized Officer or Agent

____
NAME OF PURCHASER

I hereby declare to the best of my knowledge that this application is correct.

MT/07a
(12/83)

DEPARTMENT OF REVENUE COPY

STATEMENT OF JOHN BOWER ON SENATE BILL NO. 743

Before the Senate Committee on Assessment and Taxation

March 26, 1986

MR. CHAIRMAN: My name is John D. Bower. I am a farmer, "semi-retired," living at RR 1, Box 261, McLouth, Kansas 66054, and a former member of the House of Representatives from Jefferson County.

I am a royalty owner.

I have no comment on the merits of Senate Bill 743, since it does not speak to my situation.

However, I urge you to consider seriously the disaster which has hit Kansas' oil industry and royalty owners, part of it brought on by Kansas tax policies. My concerns are primarily about the local property tax on oil and gas, and are set out in the accompanying statement, which I have asked be distributed.

I MAKE THE FOLLOWING PROPOSALS

1. Make a thorough study of the tax on oil and gas wells, which is basically unchanged since 1923.

2. Base any tax on oil and gas for the support of local government on a percentage of sales. This would at least be uniform and equal, based on a known quantity instead of guesswork.

3. Reduce or repeal the severance tax.

IF YOU WANT TO ENCOURAGE INDUSTRIAL DEVELOPMENT IN KANSAS, CHANGE TAX POLICIES WHICH MAKE IT HARD FOR KANSAS BUSINESS TO COMPETE.

Thank you.

Attachment 6
Senate Tax Comm. - 3/26/86

March 25, 1986

SUBJECT:OIL TAXATION IN KANSAS, A PROTEST

MR. CHAIRMAN: My name is John D. Bower. I am a "semi-retired" farmer, living at RR 1, Box 261, McLouth, Kansas 66054, and a former member of the House of Representatives from Jefferson County. I am a royalty owner.

My purpose is to review how oil is taxed in Kansas, and to show how un-uniform and unequal and unfair the result can be, and to propose changes to bring greater fairness and equity.

First, let me give you a horrible example.

The McLouth oil pool, abandoned at the end of World War II because of low prices and the cost of developing underground injection of brines, was reopened in 1981. Two wells were drilled on our farm, but production did not begin until April of 1983 because of problems with gas leaking into the formation from the overlying gas storage field. Two more wells were drilled in 1983 and two in 1985, making six in all. The following is a summary of production, taxes and royalties, 1981 through 1985.

[NOTE: Property tax paid in 1982 ($636.56) was refunded on appeal to the Board of Tax Appeals. An appeal of a portion of the 1985 tax is pending.]

YEAR	BBL	ROYALTY	FED TAX	KAN TAX	PROPERTY TX	NET	% OF ROYALTY
1981							
1982	531.17	1690.96		4.52	[636.56]	1049.88	37.91%
1983	15285.00	48822.21	330.32	2112.12		46379.57	4.33%
1984	29131.78	93737.01	14.52	4133.73	4456.04	85132.72	9.16%
1985	22941.76	67830.75		2952.90	7595.50	57282.35	15.55%
TOTAL	67889.71	212080.93	345.04	9203.27	12051.54	190481.08	10.02%

PERCENT OF GROSS ROYALTIES, STATE TAX---> 4.34 4.34% LOCAL TAX-->5.68%

PROPERTY TAX IS 7.46 PERCENT OF 1984 AND 1985 ROYALTIES

State and local taxes took more than ten percent of royalties! In two years we have paid $12,051 in local property taxes, making us one of the largest taxpayers in the school district, though we are far having the most wealth or income.

Furthermore, since oil property assessment is based on the previous year's production, we can expect to be taxed at least $2,500 in 1986, based on the 22942 barrels pumped in 1985, even though January 1986 production was only 457 barrels, and who knows what the price will be?

WHY ARE WE BEING ROBBED?

Oil and gas property is assessed and taxed as personal property [K.S.A 79-329; K.S.A. 79-33Ø; and K.S.A. 79-331 (see appendix, page 4)]. Appraised valuation is an estimate of the present market value of recoverable reserves, based on production history and the rate of decline in production.

The appraiser must make a value judgment of the worth of the remaining portion of an unseen resource, based on what the producer has been able to recover in the past. It is not an easy task. The appraiser has for guidance the OIL AND GAS APPRAISAL GUIDE, prepared by the Division of Property Valuation of the Kansas Department of Revenue, based on general experience in producing oil and gas in Kansas.

The following formula is used to estimate value: [Number of barrels produced (or sold) in previous year (or part of year annualized)] X [price per barrel on January 1] X [present worth factor (from GUIDE, based on rate of decline)] X [decimal interest of owner] = [appraised valuation] X [3Ø%] = assessed valuation.

Now, let's look at an example. These are adjoining leases. Together they constitute the entire McLouth Pool.

NOTE-Columns 1, 2 and 3 are the actual appraisal; columns 4 and 5 show what our tax would have been with the same decline rate as McLeod and Willits, respectively. This shows the effect of change in the assumed rate of decline and the associated present worth factor. A small error by the assessor can take a large bite out of the taxpayer. [Table was generated by computer; some figures may vary slightly from official records.]

McLOUTH OIL POOL--McLEOD, WILLITS AND BOWER LEASES, VALUE OF OIL PRODUCTION, 1984, AND PROPERTY TAX VALUATIONS MADE AND TAXES LEVIED, 1985

DESCRIPTION	McLEOD 1	WILLITS 2	BOWER-Ø% 3	BOWER-26% 4	BOWER-33% 5
Decline rate used	.26	.33	.ØØ	.26	.33
1984 actual	7416Ø.ØØ	32225.ØØ	3Ø872.ØØ	3Ø872.ØØ	3Ø872.ØØ
1984 annualized		369Ø8.ØØ	32869.ØØ	32869.ØØ	32869.ØØ
Price, January 1	21.86	21.86	21.86	21.86	21.86
Gross income stream	1621137.6Ø	8Ø68Ø8.88	718516.34	718516.34	718516.34
Present worth factor	1.646	1.337	2.528	1.646	1.337
Est reserve value	2668392.49	1Ø787Ø3.49	18164Ø9.31	1182677.9Ø	96Ø656.35
Decimal interest	.125	.125	.125	.125	.125
Appraised value	333549.Ø6	134837.93	227Ø51.16	147834.74	12ØØ82.Ø4
Assessed value [3Ø%]	1ØØØ64.72	4Ø451.38	68115.35	4435Ø.42	36Ø24.61
Tax [111.273 mills]	11134.5Ø	45Ø1.15	7595.5Ø	4935.ØØ	4ØØ8.57
Value 1984 sales	2Ø2642.2Ø	1ØØ851.11	89814.54	89814.54	89814.54
85 tax, percent	.Ø55	.Ø45	.Ø85	.Ø55	.Ø45

The most irrational and unfair tax of all is the one on wells which have never produced oil or gas. To comply with this requirement, the OIL AND GAS APPRAISAL GUIDE sets an arbitrary value. A well from 1,ØØØ to 2,ØØØ feet deep is appraised at $1Ø,ØØØ to the royalty interest and $5Ø,ØØØ to the working interest. That might be an average value, but when applied to a particular well it is as silly as saying that every fish on the line but not landed weighs 1Ø pounds! That can't be "uniform and equal," but it is the law.

SUMMARY

Agnes and I have been unfairly taxed in each of the three years we have paid oil property taxes. The total over charge is more than $5ØØØ, or 44%. The Board of Tax appeals agreed on 1982, and I am confident they will agree on 1985. [I don't know if I can reopen 1984.] But I resent having to appeal my taxes every year to receive some semblance of justice.

I do not blame the County Appraiser, nor the Division of Property Valuation. They do their best in an impossible situation. I blame the Legislature, which gave them the task of estimating the value of something nobody can see, and on that guess, levies a tax on something which may never be sold.

Taxes are not paid from property, they are paid from income. Yet oil property, a declining resource, is taxed at 3Ø% of value, while other property, much of it non-depreciating, is taxed at far less. The current push for classification is simply a move to perpetuate the present unfairness.

People who have an interest in oil and gas production, most of them little people, have become second class citizens, painted by the media as rich and greedy S.O.B.'s, while government strips us of our property in proportions the general public would never tolerate for themselves. An employee of the Division of Property Valuation told me he considered the oil industry the most over-taxed business in the state.

The severance tax, imposed amid rosy dreams of financing the state on $38 oil before OPEC fell apart, is now crushing a major Kansas industry, and thousands of small royalty owners and producers.

If you really want to encourage industry in Kansas, forget about trying to bribe or coax outsiders to come here, and reduce the taxes which are making it impossible for Kansas business to survive and compete.

PROPOSALS

1. The tax on oil and gas wells is basically unchanged since 1923. Make a thorough study, with a view to revision or repeal.

2. Base any tax on oil and gas for the support of local government on a percentage of sales. Such a tax would at least be uniform and equal, based on a known quantity instead of on guesswork.

3. Repeal or reduce the severance tax.

Appendix

KANSAS STATUTES ON TAXATION OF OIL AND GAS

K.S.A. 79-329. Oil and gas property as personality. That for the purpose of valuation and taxation, all oil and gas leases and all oil and gas wells, producing or capable of producing oil and gas in paying quantities, together with all casing, tubing or other material therein, and all other equipment and material used on operating the oil and gas wells are hereby declared to be personal property and shall be assessed and taxed as such.

K.S.A. 79-33Ø. Same; valuation. That in valuing for taxation, oil or gas properties consisting of one or more leases and oil or gas wells, there shall, in addition to the value of all oil- or gas-well material in or upon the leasehold properties, be made such valuation of the oil or gas wells as would make a reasonable and fair value of the whole property: provided, That such portion of the valuation of the oil or gas wells as represents the lessor's interest, or royalty interest, therein shall be assessed to the owner thereof and the remaining portion or working interest therein shall be assessed to the owner of the lease, together with the other property assessed in connection therewith.

K.S.A. 79-331. Oil and gas property; determination of value; changes in determination of value of production. That in determining the value of oil and gas wells and properties the assessor shall take into consideration the age of the wells, the quality of oil or gas being produced therefrom, the nearness of the wells to market, the cost of operation, the character, extent and permanency of the market, the probable life of the wells, the quantity of oil or gas produced from the wells, the number of wells being operated, and such other facts as may be known by the assessor to affect the value of the property.

Whenever a county board of equalization or the state board of equalization shall make a change in any of the factors or figures used in determining the eight/eights (8/8ths) valuation of the production for any oil or gas well or lease, such change shall apply to the working interest, royalty interest, overriding royalty interest and production payments.

[Other statutes-K.S.A. 79-5Ø1; K.S.A. 79-1439; K.S.A. 79-75-51Ø5a; K.S.A 79-312]

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I would welcome comments, information or questions at the following address:

John D. Bower
RR 2, Box 261
McLouth, Kansas 66Ø54
Telephone 913 796 6768