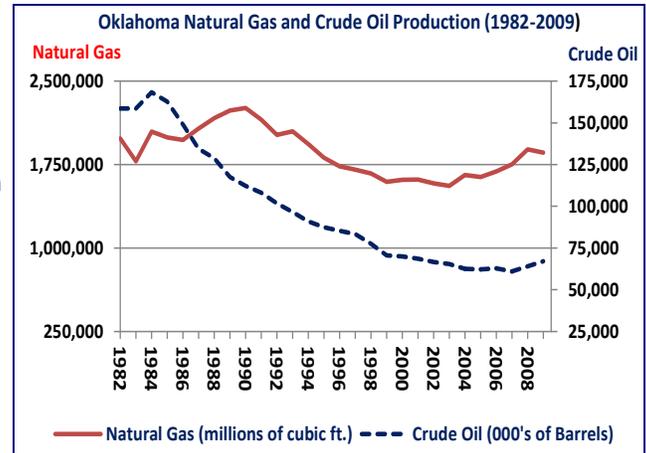


## OKLAHOMA'S GROSS PRODUCTION TAXES AND EXEMPTIONS

Oklahoma is among the nation's largest producers of both natural gas and oil:

- In 2009, almost 1.9 trillion cubic feet of *natural gas* were produced in Oklahoma. Oklahoma's natural gas output represented 8.5 percent of total U.S. production, trailing only Texas (7.7 trillion cubic feet) and Wyoming (2.5 trillion). Natural gas production fell in the 1990's but rose almost 19 percent between 2002 and 2008, before declining modestly in 2009;
- Oklahoma's *crude oil production* in 2009 was 67 million barrels, representing 3.4 percent of total U.S. production. Oklahoma's production is 5th highest in the nation, well below that of Alaska, Texas, and California, and also trailing Louisiana and North Dakota. By the mid-2000's, crude oil production had fallen by almost two-thirds from its early 1980's peak but has risen 10 percent in the last two years.<sup>1</sup>



### I. Gross Production Taxes

Oklahoma assesses a *gross production tax*, or severance tax, on the extraction of oil, natural gas and other minerals. The tax is assessed as a percentage of gross market value based on the average monthly price for each product as determined by the Oklahoma Tax Commission. For oil and natural gas, the basic tax rate is 7 percent; however, the tax rate is lowered to 4 percent when oil is between \$14 and \$17 per barrel and gas is between \$1.75 and \$2.10 per MCF, and to 1 percent when oil is lower than \$14 per barrel and gas is below \$1.75 per MCF. Some production is taxed at a lower rate due to incentives (see pages 2 and 3).

As can be seen from Figure 2, GPT collections have fluctuated greatly over the past decades in conjunction with the rise and fall of energy prices. Total collections from gas and oil reached an historic high of \$1.168 billion in FY '08 but fell to \$732 million in FY '10 with low natural gas prices. In FY '10, oil revenues (\$377 million) surpassed gas revenues (\$355 million) for the first time since collections began to be reported separately in 1991. Gross production taxes represented 10.6 percent of total state taxes in FY '10, ranking behind the personal income tax (\$2.2 billion, 32 percent) and the sales tax (\$1.8 billion, 26 percent) as a top source of state tax revenues. Gross production taxes accounted for 30 percent of state tax revenues in 1982.<sup>2</sup>

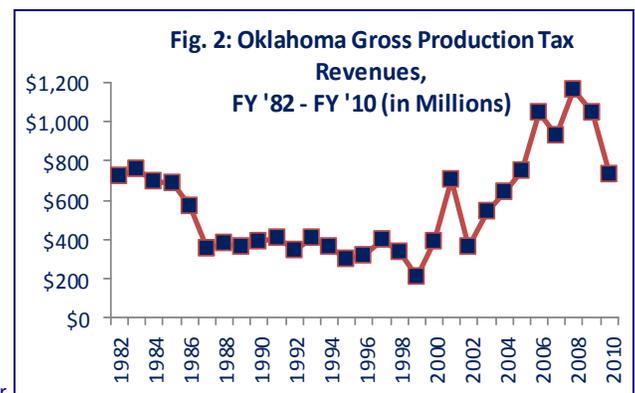
In FY '07, Oklahoma ranked third among the states, behind Alaska and Texas, in total state severance tax collections, and sixth, behind Alaska, Wyoming, North Dakota, New Mexico and Montana in severance taxes as a share of total state tax collections.<sup>3</sup>

GPT revenues for natural gas and for oil are *apportioned* in different manners. If the tax rate is 7 percent, *natural gas revenues* are apportioned as follows:

- 85.72 percent to the General Revenue fund;
- 7.14 percent to county highways; and
- 7.14 percent to school districts.

When the tax rate is 7 percent, *oil revenues* up to the first \$150 million annually are divided in a more complicated fashion, with 77.16 percent divided between three education funds, 14.28 percent divided between county highways and school districts, 3.8 percent dedicated to county roads and bridges, and the remaining 4.8 percent divided between various small funds. Annual oil revenues in excess of \$150 million all go to the General Revenue Fund. Both oil and gas revenues are subject to different apportionment formulas when the tax rate is 4 percent or 1 percent.<sup>4</sup>

...over



## II. Oil and Gas Exemptions

Oklahoma law provides tax exemptions for seven types of oil and gas production:

- Enhanced recovery projects (economically at-risk wells);
- Horizontally drilled wells;
- Inactive wells (reestablished production);
- Production enhancement projects;
- Deep well drilling;
- New discovery wells;
- Three-dimensional seismic shoots;

The exemptions, in most cases, are equal to 6/7ths of the gross production tax, which means that exempt production is taxed at 1 percent. *Beginning July 1, 2011, deep wells below 15,000 feet will be taxed at 4 percent.* Enhanced recovery projects are fully exempt from the gross production tax.

However, these drilling exemptions may be *limited* in three ways:

- *By price* – most drilling exemptions are suspended when the average annual index price of oil or gas is above a floor of \$5.00 per MCF of gas or \$30.00 per barrel of oil. The only exemptions *not subject to a price trigger* are those for enhanced recovery projects, horizontally drilled wells, and deep wells below 15,000 feet spudded after July 1, 2005. *With passage of HB 2432 in 2010, the price floors will rise annually based on the Consumer Price Index.*
- *By duration* – all oil and gas exemptions can be claimed only for a set length of time following a project's initiation or completion. For most drilling, exemptions can be claimed for 28 months from the date of first sales. The exceptions are for:
  - *Horizontal wells*—the exemption is for 48 months or until project payback. HB 2432 passed in 2010 removed the project payback limit for production after July 1, 2011.
  - *Deep wells* - the exemption is for 48 months from the date of first sales for wells between 15,000 and 17,499 feet and 60 months for wells 17,500 feet and deeper; and
  - *Enhanced recovery projects*—the exemption is for five years or termination of the secondary recovery project.
- *By amount* – For deep wells of 15,000 feet and greater, the total amount of exemptions claimed was capped at \$25 million per fiscal year as of FY '09. In 2010, *HB 2432 removed the cap and instead set the tax on all deep wells below 15,000 feet at 4 percent effective July 1, 2011.* No other exemptions are capped as to their total amount.

*Overall, the most generous exemption is for horizontally drilled wells, which can be claimed in an unlimited amount regardless of the price of oil and gas and for a duration of 48 months. In FY '10, the state paid out \$83.3 million in rebates for horizontally drilled wells. The next most generous credits are for deep wells below 15,000 feet, which are also issued irrespective of price and for a duration of 48 to 60 months. However, until July 1, 2011 deep well credits are capped at \$25 million annually. Beginning in FY '12, the cap will be lifted but production will be taxed at 4 percent.*

Until July 1, 2011, all oil and gas exemptions are paid out as rebates on claims filed after the end of the fiscal year in which production occurred. In 2010, HB 2432 deferred payments on rebates for horizontal and deep well drilling production during FY '10 and FY '11. Deferred payments for production in FY '10 and FY '11 will be paid out over 36 months beginning in July 2012 (FY '13); the state will be charged 9 percent interest on any late payments. Beginning in FY '13, exemptions for horizontal and deep well drilling will be claimed as front-end credits rather than as rebates.

Over the seven year period from FY '04–FY'10, a total of \$517 million in GPT rebates were claimed on all forms of exempted drilling, according to data from the Oklahoma Tax Commission (Table 1, page 3). In FY '10, as total rebates reached a new high of \$112.8 million, horizontal and deep wells represented 96.4 percent of the rebates claimed.

Under current law, all the gross production tax exemptions are scheduled to sunset. HB 1488 (Rep. Brumbaugh) would extend all exemptions set to expire on June 30, 2012 until June 30, 2015 (see Table 1). Exemptions on deep wells and horizontal wells are in effect until 2015; HB 2121 (Rep. Hickman) and SB 885 (Sen. Branam) are intended to clarify language on eligibility for deep well and horizontal well credits that was enacted in HB 2432 in 2010.

TABLE 2 ON THE NEXT PAGE SUMMARIZES THE MAIN PROVISIONS OF THE EXEMPTIONS FOR EACH KIND OF DRILLING

**Table 1: GROSS PRODUCTION TAX REBATES CLAIMED, FY '04 - FY '10**

Claim PERIOD	Horizontally Drilled Wells	Reestablished Production	Production Enhancement	Deep Wells	New Discovery	3-D Seismic	Economically At-Risk	TOTAL REBATES
FY 2010	\$83,383,000	\$127,000	\$2,388,000	\$25,376,000	\$6,000	\$76,000	\$1,421,000	\$112,777,000
FY 2009*								\$65,300,000
FY 2008	\$35,601,260	\$335,220	\$186,210	\$20,000,000	\$35,925	\$111,693	\$733,034	\$57,003,342
FY 2007	\$25,834,322	\$2,313,095	\$1,979,933	\$12,883,845	\$271,289	\$4,093,132	\$218,935	\$47,594,551
FY 2006	\$17,813,629	\$8,161,496	\$13,066,852	\$46,759,454	\$2,590,112	\$17,242,747	\$84,575	\$105,718,865
FY 2005	\$4,372,142	\$2,825,352	\$11,399,758	\$59,555,912	\$1,546,791	\$9,656,266	\$53,646	\$89,409,867
FY 2004	\$2,366,979	\$2,584,677	\$6,808,032	\$23,847,903	\$965,791	\$2,651,966	\$356,234	\$39,581,582

**Table 2: Summary of Oklahoma Gross Production Tax Exemptions, as of FY '11**

(boxes in yellow represent exceptions to general rules)

Kind of drilling	Statutory Section	Kind of well	Exemption applicable to	Amount of exemption	Subject to price? (1)	Length of exemption	Allowable production date
Enhanced Recovery Projects	68 OS 1001.D3	Secondary recovery projects	Incremental production attributable to the working interest owners	Full	No	5 years or termination of the secondary recovery project	Project beginning date prior to 7/1/2012
	68 OS 1001.D4	Tertiary recovery projects				10 years or until project payback is achieved	
Horizontally drilled wells	68 OS 1001.E	Well producing after 7/1/94	Production of oil, gas, or oil and gas	6/7ths	No	48 months or until project payback is achieved	Producing prior to 7/1/2011
						48 months from the month of initial production	Producing on or after July 1, 2011 and prior to July 1, 2015
Inactive well	68 OS 1001.F		Severance or production of oil, gas or oil and gas	6/7ths	Yes	28 months from the date upon which production is reestablished	Production is reestablished prior to 7/1/2012
Production enhancement project	68 OS 1001.G		Incremental production	6/7ths	Yes	28 months from the date of the first sale after project completion	Project beginning date prior to 7/1/2012
Deep Wells	68 OS 1001.H.2.a	Depth between 12,500 and 14,999 feet	Production of oil, gas, or oil and gas	6/7ths	Yes	28 months from the date of first sales	Wells spudded before 7/1/2009
Ultra-Deep Wells	68 OS 1001.H.2.b	Depth between 15,000 and 17,499 feet	Production of oil, gas, or oil and gas	6/7ths. Capped at \$25 million in total exemptions through FY '11; After July 1, 2011: Taxed at 4%, amount uncapped	Partially - exemptions apply only if price of oil <\$30.00 per barrel or price of gas < \$5.00 MCF for wells spudded before 7/1/2005. For newer wells, exemptions apply regardless of price	48 months from the date of first sales	Wells spudded before 7/1/2015
	68 OS 1001.H.2.c	Depth of 17,500 feet and greater				60 months from the date of first sales	Wells spudded or reentered before 7/1/09
New discovery	68 OS 1001.I		Production of oil, gas, or oil and gas	6/7ths	Yes	28 months from the date of first sales	Wells spudded or reentered before 7/1/09
Three-dimensional seismic shoot	68 OS 1001.J		Production of oil, gas, or oil and gas	6/7ths	Yes	28 months from the date of first sales	Drilling commenced before 7/1/09

(1) Exemptions subject to price apply only if price of oil &lt;\$30.00 per barrel or price of gas &lt;\$5.00 MCF adjusted annually for inflation

## NOTES

<sup>1</sup> Data on oil and gas production from Energy Information Administration at: <http://www.eia.doe.gov/><sup>2</sup> Tax collections from Oklahoma Annual Executive Budgets, Historical Documents, Appendix D<sup>3</sup> National Conference of State Legislatures at: <http://www.ncsl.org/IssuesResearch/BudgetTax/StateEnergyRevenuesUpdate/tabid/12674/Default.aspx><sup>4</sup> Oklahoma State Senate, [Overview of State Issues](#), October 2010, pp. 39-42 (unavailable online)This publication was prepared by David Blatt, Director, [dblatt@okpolicy.org](mailto:dblatt@okpolicy.org); 918-859-8747

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