10-3-1980

Report on Dedicates Oil, Natural Gas Taxes to Common School Fund (State Measure No. 03)

City Club of Portland (Portland, Or.)
REPORT ON
DEDICATES OIL, NATURAL GAS TAXES TO COMMON SCHOOL FUND
(STATE MEASURE NO. 3)

Purpose: "Proposed constitutional amendment provides that any taxes on production, storage, use, sale, ownership, etc. of oil or natural gas, except for administrative cost and refunds or credits, shall become a part of the Common School Fund. No such tax shall be higher than six percent of the market value of the oil or natural gas. The measure does not apply to taxes on the retail sale of motor vehicle fuel."

To the Board of Governors,
The City Club of Portland:

I. INTRODUCTION

State Measure 3 (HJR 6) was passed and referred to the people by the 1979 session of the Oregon legislature. The purpose of the Measure is to dedicate oil and natural gas taxes (excluding motor vehicle fuel taxes) to the Common School Fund (see text of Measure in Appendix C). Measure 3 proposes an amendment to Section 2, Article VIII of the Oregon Constitution, which defines the revenue sources of the Common School Fund, and purportedly would make the following changes:

A) All receipts (less administrative costs) from a tax on oil and/or natural gas would be dedicated to the Common School Fund.

B) The constitutional limit on new taxes imposed on oil and/or natural gas would be 6 percent of the market value of the oil and natural gas.

No tax will be imposed by passage of Measure 3. Voter approval of this Measure would bind the Legislature, should it choose to enact such a tax in the future, to a 6 percent maximum tax with the proceeds dedicated to the Common School Fund.

The Common School Fund is a mechanism by which current revenues from certain state lands are distributed to each county for educational expenditures based on the number of children between the ages of 4 and 20.

As provided by ORS 307.010, all mineral resources (not otherwise exempt) are subject to ad valorem (property) taxation in Oregon. Due to the speculative nature of estimating quantities of the resource, assessment is not an easy task. Currently, little of the value of minerals and other natural resources is being assessed for purposes of property taxation.

Severance taxation is an alternative to property taxation of these resources. The concept of taxing mineral deposits is based on the premise that when a natural resource is removed, the value of that resource to the state is lost forever. Hence, the state is justified in seeking compensation for the lost value. In addition, there may be a wider range of other environmental and aesthetic costs associated with the removal of natural resources.
II. HISTORY

In 1846 Michigan was the first state to impose a severance tax on minerals. Twenty-eight states currently have some form of severance tax on minerals. The table below shows states which have a severance tax that provides a significant portion of their overall tax revenues.

<table>
<thead>
<tr>
<th>State</th>
<th>$ Yield 1978-79 (FY)</th>
<th>% of Total Tax Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alaska</td>
<td>107,700,000</td>
<td>19.10</td>
</tr>
<tr>
<td>Louisiana</td>
<td>476,000,000</td>
<td>24.09</td>
</tr>
<tr>
<td>New Mexico</td>
<td>145,823,000</td>
<td>19.16</td>
</tr>
<tr>
<td>Oklahoma</td>
<td>230,368,000</td>
<td>17.51</td>
</tr>
<tr>
<td>Texas</td>
<td>957,703,000</td>
<td>17.81</td>
</tr>
<tr>
<td>Wyoming</td>
<td>66,021,000</td>
<td>22.81</td>
</tr>
</tbody>
</table>

(Source: Oregon Legislative Revenue Office)

In the last 89 years, there have been 225 exploration projects within Oregon for oil and natural gas. The recent well-publicized discovery of natural gas at Mist, in Columbia County, is the only significant find of which the Committee is aware. While the potential for future natural gas finds is believed good, there is little indication of any oil reserves. Accordingly, there is no way to predict the extent of future production or the tax revenue which could be derived from it. Because the tax rates and methods of computation in other states vary considerably, it is also impossible to intelligently predict the impact of the Measure in Oregon.

Two measures were introduced in the 1979 legislative session dealing with mineral (oil/gas) severance taxes. House Joint Resolution 6 (HJR 6) and House Bill 2574 (HB 2574) were introduced by Representative Curt Wolfer as companion measures. The latter bill would have imposed a five percent severance tax on the production or mining of oil and gas, with all proceeds dedicated to the Common School Fund.

HB 2574 was referred to the House Revenue Committee which reported it out Do-Pass (with amendments). The House passed the bill 49-2 and referred it to the Ways and Means Committee on the Senate side where it died in committee upon adjournment.

III. ARGUMENTS ADVANCED IN FAVOR OF THE MEASURE

The following arguments were advanced in favor of Measure 3 in testimony before your Committee:

The Measure would:
1. Provide a new source of tax revenue;
2. Provide a potentially substantial new permanent funding source for the Common School Fund;
3. Provide a method of compensating the State of Oregon for the non-renewable resources being extracted from within its borders;
4. Provide certainty to private industry of the maximum tax exposure in the State of Oregon on oil and natural gas resource development;
5. Establish a beneficial public use for tax revenues from oil and natural gas and protect these funds from being diverted to other uses prior to any major discoveries;
6. Place the management of the funds into an established program.
IV. ARGUMENTS ADVANCED AGAINST THE MEASURE

Your Committee was unable to find any opposition to the Measure, organized or otherwise. During interviews with witnesses and during Committee discussion, the following points were raised as possible objections:

1. The Common School Fund is not necessarily more deserving than several other publicly beneficial uses of these potential tax revenues.
2. The Measure amends the Constitution and could only be changed by a vote of the people. It therefore lacks the flexibility needed in a tax program.
3. The Measure is ambiguous and vague. The legislature, courts, governmental agencies and the public would have difficulty interpreting and applying it.
4. Terms like "fair market value" are not defined and the Measure is unclear about whether the limitation applies to single or multiple points of distribution from producer to consumer.
5. An essentially permanent "6 percent limit" is imposed on the total amount of new tax revenue on oil and natural gas.
6. The 6 percent limitation is not clearly limited in its application to a severance tax as imposed successfully by other states, but is so broad as to be applicable to all aggregate taxes on oil and natural gas other than motor vehicle fuel.
7. The Measure singles out oil and natural gas and ignores other non-renewable resources produced in the state.
8. Establishment of a tax limitation before imposition of the tax itself is unwise public policy.

V. DISCUSSION

The general thrust of the Measure is to dedicate any future oil or natural gas taxes to the Common School Fund, in order to establish an additional, potentially large, source of revenue for the public schools. Some witnesses said that it was wise public policy to constitutionally dedicate these potential funds to the schools at this time, in order to prevent the legislature from diverting them for other uses.

Under close scrutiny the wording of the Measure is ambiguous; for example:

"SECTION 3a. Any tax or excise levied on, with respect to or measured by the extraction, production, storage, use, sale, distribution or receipt of oil or natural gas, or the ownership thereof, shall not be levied at a rate that is greater than six percent of the market value of all oil and natural gas produced or salvaged from the earth or waters of this state as and when owned or produced. This section does not apply to [the State motor vehicle fuel tax]."

In this section, it is unclear whether the Measure allows only one 6 percent tax (i.e., production or sale) or whether it would allow a maximum 6 percent tax on each level of production and distribution. Further, it is unclear whether the 6 percent maximum is based on the market value of all oil and natural gas sold or handled in Oregon, or whether the tax is limited to "...six percent of the market value of all
oil and natural gas produced or salvaged from ...this State."

Only a very small fraction of the gas and oil sold in Oregon is produced here. If the Measure applies to all oil and natural gas present in the state, including oil and gas originating elsewhere, and if the Measure limits all taxes on all oil and gas to 6 percent of the value of Oregon's small production, then this Measure would create a constitutional tax shield for the oil and natural gas industry.

The "market value" foundation of the limitation also is vague since there are currently several "market values" quoted ranging from $2.50/cu. ft. for domestically produced natural gas to $4.50 for imported Canadian gas. The "market value" of both oil and natural gas appears to fluctuate with time and vary with source.

Therefore, the maximum amount of tax collectible could be determined only after price and production levels for the tax year are known. The Measure produces both legislative and administrative problems primarily because it fails to provide specific instructions for assessing the fair market value of oil and gas production levels.

Still unanswered after the Committee's review is the question of why the framework for a "severance" tax is being established by constitutional amendment rather than by legislation. Other states have dedicated and limited "severance" taxes by statute rather than by constitutional amendment. Their choice of legislation was made, apparently, with an eye towards the need for flexibility to alter the taxes as production or economic conditions change. This flexibility does not exist where the use of tax funds is regulated by the Constitution. Furthermore, the Committee is not certain why a constitutional tax limitation should be established before enactment of the tax itself.

These questions remain unresolved because there is no detailed legislative record available to illuminate the intent of the Measure, nor are there available individual legislators' positions for or against the Measure.

The Committee was unable to interview the draftsman of the "market value" limitation, an oil industry lobbyist who declined to be interviewed. Your Committee was also unable to interview the sponsor and chief architect of the Measure, State Representative Curt Wolfer, who was out of state.

VI. CONCLUSIONS

The vagueness of the Amendment and the uncertainty of its effects lead your Committee to conclude that Measure 3 is undesirable. Setting aside the wisdom of a severance tax and how it should be used, your Committee believes the Measure should not be adopted because:

1. The application of the 6 percent limitation is ambiguous;

2. The meaning of "market value" is unclear; and

3. There is no convincing argument that the dedication of future oil and natural gas taxes, or any limitation on such taxes, should be established by constitutional amendment rather than by legislation.
VII. RECOMMENDATION

Your Committee recommends a "NO" vote on State Measure No. 3 at the November 4, 1980 general election.

Respectfully submitted,

William P. Buren  
Carl Cottingham  
Douglas M. Crow  
Marilyn Jenkinson  
Carolyn Ryan  
Sylvia Takeuchi  
Diarmuid F. O'Scannlain, Chairman

Approved for publication by the Research Board on August 28, 1980 and authorized by the Board of Governors for distribution to the membership for discussion and action on Friday, October 3, 1980.

APPENDIX A
PERSONS INTERVIEWED

Frank J. Barich, Public Affairs Area Manager, Chevron, U.S.A., Inc.  
David Cargo, Portland attorney and former Governor of New Mexico  
William Cox, Executive Director, Oregon State Land Board  
Terry Drake, Legislative Revenue Office  
Paul Howe, Senior Vice President of Operations, Northwest Natural Gas Company

APPENDIX B
BIBLIOGRAPHY


Senate Committee on Agriculture and Natural Resources. Minutes of meetings of May 23, 1979 and June 6, 1979, and Exhibits A, B, and C.

House Committee on Revenue. Minutes of meetings of March 27 and 28, 1979.

Text of HJR 6, HJR 6 A-Engrossed, and HJR 6 B-Engrossed. 1979 Regular Session.
Be It Resolved by the Legislative Assembly of the State of Oregon:

Paragraph 1. Section 2, Article VIII of the Constitution of the State of Oregon, is amended, and the Constitution of the State of Oregon is amended by creating a new section 3a to be added to and made a part of Article IX, such sections to read:

Sec. 2.(1) The sources of the Common School Fund are:
(a) The proceeds of all lands granted to this state for educational purposes, except the lands granted to aid in the establishment of institutions of higher education under the Acts of February 14, 1859 (11 Stat. 383) and July 2, 1862 (12 Stat. 503).
(b) All the moneys and clear proceeds of all property which may accrue to the state by escheat or forfeiture.
(c) The proceeds of all gifts, devises and bequests, made by any person to the state for common school purposes.
(d) The proceeds of all property granted to the state, when the purposes of such grant shall not be stated.
(e) The proceeds of the five hundred thousand acres of land to which this state is entitled under the Act of September 4, 1841 (5 Stat. 455).
(f) The five percent of the net proceeds of the sales of public lands to which this state became entitled on her admission into the union.
(g) After providing for the cost of administration and any refunds or credits authorized by law, the proceeds from any tax or excise levied on, with respect to or measured by the extraction, production, storage, use, sale, distribution or receipt of oil or natural gas and the proceeds from any tax or excise levied on the ownership of oil or natural gas. However, the rate of such taxes shall not be greater than six percent of the market value of all oil and natural gas produced or salvaged from the earth or waters of this state as and when owned or produced. This paragraph does not include proceeds from any tax or excise as described in section 3, Article IX of this Constitution.

(2) All revenues derived from the sources mentioned in subsection (1) of this section shall become a part of the Common School Fund. The State Land Board may expend moneys in the Common School Fund to carry out its powers and duties under subsection (2) of section 5 of this Article. Unexpended moneys in the Common School Fund shall be invested as the Legislative Assembly shall provide by law. Interest derived from the investment of the Common School Fund shall be applied to the support of primary and secondary education as provided under section 4 of this Article.

SECTION 3a. Any tax or excise levied on, with respect to or measured by the extraction, production, storage, use, sale, distribution or receipt of oil or natural gas, or the ownership thereof, shall not be levied at a rate that is greater than six percent of the market value of all oil and natural gas produced or salvaged from the earth or waters of this state as and when owned or produced. This section does not apply to any tax or excise the proceeds of which are dedicated as described in section 3 of this Article.

Paragraph 2. The amendment proposed by this resolution shall be submitted to the people for their approval or rejection at the next regular general election held throughout this state.

NOTE: Matter underlined in an amended section is new; complete new sections begin with SECTION.