State of Arkansas
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A Bill

Call Item 3
SENATE BILL 1

By: Senators Salmon, Capps, Bisbee, Bookout, Broadway, Brown, Bryles, Crumbly, Glover, Hill, Horn, G. Jeffress, J. Jeffress, Laverty, Luker, Madison, Malone, Miller, T. Smith, Steele, J. Taylor, R. Thompson, Trusty, Whitaker

For An Act To Be Entitled

AN ACT TO INCREASE THE SEVERANCE TAX RATE ON NATURAL GAS; AND FOR OTHER PURPOSES.

Subtitle

AN ACT TO INCREASE THE SEVERANCE TAX RATE ON NATURAL GAS.

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF ARKANSAS:

SECTION 1. Legislative findings and intent.

(a) The General Assembly has determined that the severance tax rate on natural gas should be increased and that there should be different rates of tax for different categories of natural gas.

(b) Amendment 19 of the Arkansas Constitution required this act to be passed by at least three-fourths of the members of the Senate and at least three-fourths of the members of the House of Representatives.

(c) In order to implement the increase in the severance tax rate, the General Assembly has identified the following four categories of natural gas, each as defined in Arkansas Code § 26-58-101:

(1) High-cost gas;

(2) Marginal gas;

(3) New discovery gas; and

(4) All natural gas that is not defined as high-cost gas, marginal gas, or new discovery gas.

(d) To increase the severance tax rate, the General Assembly used the method of levying a specific tax rate on each category so that any future legislative enactment that would have the effect of increasing the rate of severance tax on any of those categories of natural gas as defined by § 26-58-101 will also be subject to the three-fourths vote requirement of Amendment 19 of the Arkansas Constitution.

SECTION 2. Effective January 1, 2009, Arkansas Code § 19-6-201(9), classifying and enumerating general revenues of this State, is amended to read as follows:

(9) Seventy-five percent (75%) of all severance taxes, with the exception of the taxes paid to sever timber and timber products, the severance tax collected on natural gas, and those portions of severance taxes designated as special revenues in § 19-6-301, as enacted by Acts 1947, No. 136, and all laws amendatory thereto, §§ 26-58-101 – 26-58-103, 26-58-106 – 26-58-111, 26-58-114 – 26-58-116, 26-58-118 – 26-58-120, 26-58-123, and 26-58-124;

SECTION 3. Effective January 1, 2009, Arkansas Code § 19-6-201, classifying and enumerating general revenues of this State, is amended to add an additional subdivision to read as follows:

(57) Five percent (5%) of the severance tax collected on natural gas at the rates enacted by § 26-58-111(5).

SECTION 4. Effective January 1, 2009, Arkansas Code § 19-6-301(18), classifying and enumerating special revenues of this State, is amended to read as follows:

(18) Revenue received from saw timber and timber products severance taxes and twenty-five percent (25%) of all other severance taxes, with the exception of the severance tax collected on natural gas, as enacted by Acts 1947, No. 136, and all laws amendatory thereto, §§ 26-58-101 – 26-58-103, 26-58-106 – 26-58-111, 26-58-114 – 26-58-116, 26-58-118 – 26-58-120, 26-58-123, and 26-58-124;

SECTION 5. Effective January 1, 2009, Arkansas Code § 19-6-301, classifying and enumerating special revenues of this State, is amended to add an additional subdivision to read as follows:

(238) Ninety-five percent (95%) of the severance tax collected on natural gas at the rates enacted by § 26-58-111(5).

SECTION 6. Effective January 1, 2009, Arkansas Code § 26-58-101, is amended to add additional subdivisions to read as follows:

26-58-101. Definitions.

As used in this subchapter:

(1) "Acquired", when used in reference to the severance tax on timber, means the time when timber is first weighed or measured by a primary processor after severance;

(2) "Completion" or "completed" means the act of making a well capable of producing gas;

(3) "Conventional gas well" means any gas well that is not classified as a high-cost gas well;

(4) "Date of first production", when used in reference to a particular gas well, means the first day in the month that the gas well produces natural gas for sale;

~~(2)~~(5) "Director" means the Director of the Department of Finance and Administration or any of his or her duly appointed deputies or agents;

(6) "High-cost gas" means natural gas that is:

(A) Produced from any gas well completed within a shale formation, including, but not limited to, the Fayetteville Shale, the Woodford Shale, the Moorefield Shale and the Chattanooga Shale Formations, or their stratigraphic equivalents, as described in published stratigraphic nomenclature recognized by the Arkansas Geological Survey;

(B) Produced from any gas well in which the production is from a completion that is located at a depth of more than 12,500 feet below the surface of the earth, where the term "depth" means the length of the maximum continuous drilling string of drill pipe used between the drill bit face and the drilling rig's kelly bushing;

(C) Produced from a tight gas formation;

(D) Produced from geopressured brine; or

(E) Occluded natural gas produced from coal seams;

(7) "High-cost gas well" means any gas well that is completed as a well capable of producing high-cost gas;

(8)(A) "Marginal gas", when used in reference to a conventional gas well, means all natural gas produced from the conventional gas well beginning on the date the conventional gas well is incapable of producing more than 250 Mcf per day, as determined by the Director of the Arkansas Oil and Gas Commission using the current wellhead deliverability rate methodology utilized by the Oil and Gas Commission, during the calendar month for which the severance tax report is filed.

(B) "Marginal gas", when used in reference to a high-cost gas well, means all natural gas produced from the high-cost gas well beginning on the date the high-cost gas well is incapable of producing more than 100 Mcf per day, as determined by the Director of the Oil and Gas Commission using the current wellhead deliverability rate methodology utilized by the Oil and Gas Commission, during the calendar month for which the severance tax report is filed.

(C) "Marginal gas" shall include production from all zones and multilateral branches at a single well without regard to whether the production is separately metered.

(D) "Marginal gas" shall not include gas produced from:

(i) A high-cost gas well during the thirty-six (36) month period provided in § 26-58-127(b)(1);

(ii) A high-cost gas well during any allowed extension provided in § 26-58-127(b)(2); or

(iii) A new discovery gas well during the twenty-four (24) month period provided in § 26-58-127(a);

(9) "Marginal gas well" means any gas well that produces or is capable of producing marginal gas, as determined by the Director of the Oil and Gas Commission using the current wellhead deliverability rate methodology utilized by the Oil and Gas Commission;

(10) "Market value", when used in reference to the rate of severance tax on natural gas, means the producer's actual cash receipts from the sale of natural gas to the first purchaser less the actual costs to the producer of dehydrating, treating, compressing, and delivering the gas to the purchaser;

~~(3)~~(11) "Natural resources" means all natural products of the soil or water of Arkansas including, but not limited to, asphalt, barite, bauxite, chalk, chert, clay, cinnabar, coal, diamonds, fuller's earth, natural gas, granite, gravel, gypsum, iron, lead ore, lignite, limestone, manganese and manganiferous ores, marble, marl, mussel shells, novaculite, oil, ochre, pearls and other precious stones, phosphate, salt, sand, shale, slate, shells, stone and stone products, sulphur, titanium ore, and zinc ore;

(12) "New discovery gas" means natural gas that is produced from a new discovery gas well;

(13) "New discovery gas well" means any conventional gas well that is completed as a well capable of producing gas;

(14) "Payout" means the date the cumulative working interest revenues from a high-cost gas well equal the sum of:

(A) All drilling and completion costs incurred in connection with the high-cost gas well; and

(B) All operating costs incurred or accrued in connection with the operation of the high-cost gas well during the period of cost recovery;

~~(4)~~(15) "Point of severance" means the place at which transportation of timber or natural resources, excluding natural gas, ~~or timber~~ has been or is about to be commenced for use or processing after being severed;

~~(5)~~(16) "Primary processor" means any person, firm, corporation, or other entity engaged in business as a sawmill, chipper mill, stud mill, square mill, plywood or veneer mill, whole tree chipping mill, post, pole, or piling plant, charcoal plant, processed board mill, bolt working mill, pulp mill, planing or surfacing mill, or other mill or facility where timber first undergoes any processing after harvesting;

~~(6)~~(17) "Producer" means any person, firm, receiver, or other fiduciary, corporation, or association, who or which engages in the business of severing natural resources or timber;

~~(7)~~(18) "Purchaser" means any person, firm, receiver, or other fiduciary, corporation, or association, consignor, agent, or other dealer, by whatever name called, who or which acquires title outright or conditionally to any interest in severed natural resources or timber;

~~(8)(A)~~(19)(A) "Sever", "severed", or "severing" mean natural resources cut, mined, dredged, or otherwise taken or removed for commercial purposes from the soil or water.

(B) However, "sever", "severed", or "severing" as defined in this subdivision ~~(8)~~(19) do not apply to any natural gas returned to any formation, in recycling, repressuring, pressure maintenance operation, or other operation, for the production of oil or any other liquid hydrocarbon.

(C) Further, “sever”, “severed”, or “severing” as defined in this subdivision ~~(8)~~(19) do not apply to any hydrocarbons in gaseous or liquid form which are burned, used, consumed, or otherwise employed in oil and gas operations including but not limited to, secondary recovery operations and fuel for engines in the same leasehold, drilling, or production unit, or unit area of a unitized reservoir from which such hydrocarbons are produced;

(20) “Tight gas formation” means any natural gas bearing formation that:

(A) Has previously been determined by Oil and Gas Commission orders or field rules to be a low permeability formation, including:

(i) Booneville and Chismville-OR# 84-2003-07;

(ii) Gragg-OR# 89-2004-07;

(iii) Waveland-OR# 86-2007-07;

(iv) Rich Mountain-OR# 304-2006-09;

(v) Mansfield-OR# 28-2003-03; and

(vi) Witcherville and Excelsior-OR# 103-2005-07; or

(B) Is determined by the Director of the Oil and Gas Commission to have an estimated in situ permeability of one-tenth milliDarcy (0.1 mD) or less; or

(C) Is determined to be a tight gas formation by field rules, general rules, or orders issued by the Director of the Oil and Gas Commission;

~~(9)~~(21) “Timber” means either softwood or hardwood species of trees suitable for use as sawlogs, pulpwood, veneer bolts or billets, stave bolts or billets, and splits, handle and other bolts or billets including chemical wood, cross ties, posts, poles, piling, chips, charcoal, or any now known or hereafter discovered use of wood or wood pulp;

~~(10)~~(22) “Time of severance” means the date on which transportation of timber or natural resources, excluding natural gas, ~~or timber~~ has been or is about to be commenced for their use or processing after being severed; and

~~(11)~~(23) "Transporter" means any person, firm, receiver, or other fiduciary, corporation, or association, who or which transports severed natural resources or timber ~~from the point of severance, or other~~ to any point within, across, or out of the State of Arkansas.

SECTION 7. Effective January 1, 2009, Arkansas Code § 26-58-111(5), which established the rate of severance tax levied on natural gas extraction, is amended to read as follows:

(5) On natural gas, ~~three-tenths of one cent (0.3¢) per one thousand cubic feet (1,000 cu.ft.)~~ the following percent of the market value of the natural gas severed within the State of Arkansas:

(A) On new discovery gas, as defined in § 26-58-101(12), the severance tax rate shall be one and one-half percent (1.5%) for the time period provided in § 26-58-127(a);

(B) On high-cost gas, as defined in § 26-58-101(6), the severance tax rate shall be one and one-half percent (1.5%) for the time periods provided in § 26-58-127(b);

(C) On marginal gas, as defined in § 26-58-101(8), the severance tax rate shall be one and one-quarter percent (1.25%); and

(D) On all natural gas which is not defined as new discovery gas, high-cost gas, or marginal gas, the severance tax rate shall be five percent (5%);

SECTION 8. Effective January 1, 2009, Arkansas Code § 26-58-124(a), which allocates distribution of the severance tax, is amended to read as follows:

(a) All taxes, penalties, and costs collected by the Director of the Department of Finance and Administration under the provisions of this subchapter, except for the taxes, penalties, and costs collected on natural gas, shall be deposited into the State Treasury to the credit of the State Apportionment Fund.

SECTION 9. Effective January 1, 2009, Arkansas Code § 26-58-124, which allocates distribution of the severance tax, is amended to add an additional subsection to read as follows:

(c) All taxes, penalties, and costs collected by the Director of the

Department of Finance and Administration on natural gas shall be deposited in the State Treasury as follows:

(1) Five percent (5%) of the funds shall be deposited as general revenues; and

(2) Ninety-five percent (95%) of the funds shall be classified as special revenues and shall be distributed as set forth in the Arkansas Highway Revenue Distribution Law, § 27-70-201 et seq.

SECTION 10. Effective January 1, 2009, Arkansas Code Title 26, Chapter 58, Subchapter 1 is amended to add the following new sections to read as follows:

26-58-127. Cost recovery periods for new discovery gas and high-cost gas.

(a)(1) The one and one-half percent (1.5%) severance tax rate on new discovery gas shall apply to the first twenty-four (24) consecutive calendar months beginning on the date of first production from the new discovery gas well, regardless of whether production commenced prior to January 1, 2009; provided, however, that all production attributable to the period prior to January 1, 2009 shall be taxed at the rate in effect prior to January 1, 2009.

(2) At the end of the twenty-four (24) month period, the severance tax rate under § 26-58-111(5)(C) or § 26-58-111(5)(D), as applicable, shall apply.

(b)(1) The one and one-half percent (1.5%) severance tax rate on high-cost gas shall apply to the first thirty-six (36) consecutive calendar months beginning on the date of first production from the high-cost gas well, regardless of whether production commenced prior to January 1, 2009; provided, however, that all production attributable to the period prior to January 1, 2009 shall be taxed at the rate in effect prior to January 1, 2009.

(2) If a high-cost gas well has not achieved payout by the end of the thirty-six (36) month period, the one and one-half percent (1.5%) severance tax rate shall be extended until the earlier to occur of:

(A) Payout of the high-cost gas well; or

(B) Twelve (12) months following the expiration of the original thirty-six (36) month period.

(3) The severance tax rate under § 26-58-111(5)(C) or § 26-58-111(5)(D), as applicable, shall apply to high-cost gas at the later of the expiration of the thirty-six (36) month period or any allowed extension.

26-58-128. Determination of New Discovery Gas, High-Cost Gas or Marginal Gas.

(a) The producer of a proposed or existing gas well may apply, at any time, to the Director of the Oil and Gas Commission for determination that the well qualifies as a new discovery gas well, a high-cost gas well, or a marginal gas well.

(b) The Director of the Oil and Gas Commission may require an applicant to provide any information required to administer this section.

(c) The Director of the Oil and Gas Commission shall make the determination within fifteen (15) calendar days of the application by the producer and the producer shall attach the determination to its severance tax form next due.

26-58-129. Natural gas severance tax payment, apportionment of severance tax between royalty owner and producer, and authority for rulemaking.

(a) The severance tax on natural gas shall be paid in the manner provided in Title 26, Chapter 58.

(b) The portion of the severance tax that is required to be deducted from the royalty owner or other interest shall be calculated in the same manner as the portion of the severance tax borne by the producer.

(c) The Department of Finance and Administration may promulgate the rules necessary to enforce the provisions of this act.

SECTION 11. Effective January 1, 2009, Arkansas Code § 27-70-202(a), classifying and enumerating highway revenues of this State, is amended to add an additional subdivision to read as follows:

(3) Ninety-five percent (95%) of the severance tax levied and collected on natural gas under § 26-58-111(5).

SECTION 12. EMERGENCY CLAUSE. It is found and determined by the General Assembly that state and local roads and highways are in need of substantial expansion, maintenance and repair, and that additional funding is necessary to address this need. It is also found and determined that increasing development and exploitation of natural gas resources in the Fayetteville Shale Play and in other areas of this state has significantly increased the burden and wear and tear on state and local roads and highway, further exacerbating the need for maintenance and repair. It is also found and determined that previous surpluses in state revenue have been largely spent to improve public education and educational facilities in this state, as was required by the Constitution as interpreted by the Arkansas Supreme Court in the Lake View case and additional revenues must be generated from other sources to address the needs of our roads and highways. It is further found and determined that due to recent and dramatic increases in the price of gasoline, and the fact that funds for highways are generated from a flat per-gallon tax, the increasing use of more fuel-efficient vehicles has caused a condition in which revenue for roads and highways has not kept pace with the wear and tear caused by vehicular use. It is further found and determined that immediate enactment of this bill is necessary to provide adequate time for various administrative agencies of state government to prepare the necessary reporting forms and instructions, to educate taxpayers responsible for paying the additional taxes levied herein, and take other steps necessary for the proper implementation and administration of this act. Therefore, the General Assembly hereby finds and declares that an emergency exists, pursuant to Article V, § 38 of the Arkansas Constitution, and this Act, being necessary for the immediate preservation of the public peace, health and safety, shall be in full force and effect from and after January 1, 2009.

APPROVED: 4/2/2008