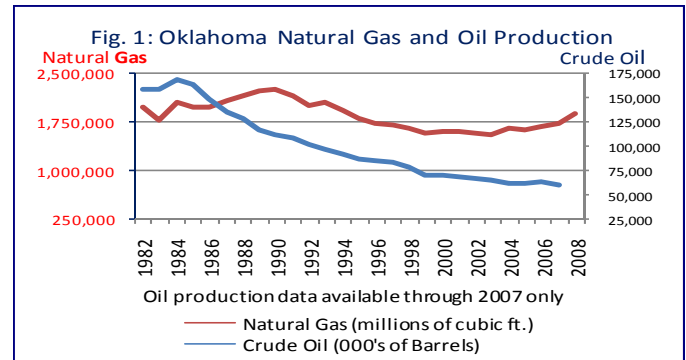


OKLAHOMA'S GROSS PRODUCTION TAXES AND EXEMPTIONS

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

- In 2008, almost 1.9 trillion cubic feet of *natural gas* were produced in Oklahoma. Oklahoma's natural gas output represented 8.8 percent of total U.S. production, trailing only Texas (7.0 trillion cubic feet) and Wyoming (2.3 trillion). Natural gas production fell in the 1990's, but rose almost 19 percent between 2002 and 2008;
- Oklahoma's *crude oil production* in 2007 was 61 million barrels, representing 3.2 percent of total U.S. production. Oklahoma's production falls far below that of Alaska, Texas, and California, and also trails Louisiana. Crude oil production has declined almost every year over the past two decades, falling by a total of almost two-thirds since its peak in the early 1980's.¹



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, since 1999, if prices fall below a floor, 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) or 1 percent (when oil is lower than \$14 per barrel and gas is below \$1.75 per MCF).

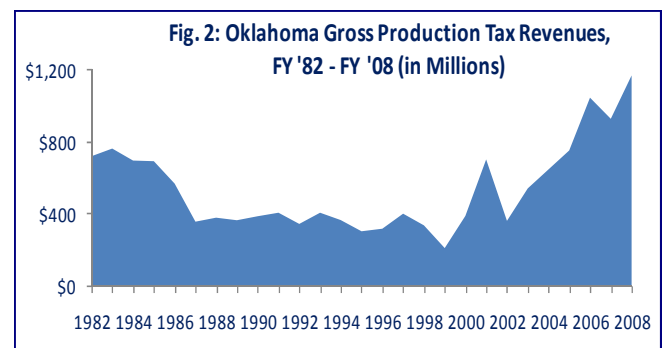
As can be seen from Figure 2, GPT collections have fluctuated greatly over the past decades in conjunction with the rise and fall of energy prices, but have reached historic highs in recent years. Oklahoma collected \$1.168 billion in gross production taxes in FY '08. Of this total, \$808.2 million, or 69.2 percent, was from the gross production tax on natural gas, and \$360.2 million, or 30.8 percent was from the gross production tax on oil. Gross production taxes represented 14 percent of total states taxes in FY '08, ranking behind only the personal income tax (\$2.8 billion, 31 percent) and the sales tax (\$1.8 billion, 22 percent) as a top source of state tax revenues.

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 percentage of total state tax collections.²

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, 4.28 percent dedicated to county roads and bridges, and the remaining 4.28 percent divided between three 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.³



...over

II. Oil and Gas Exemptions

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

- 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. 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 apply only when the average annual index price of oil or gas is below a floor or \$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.
- *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*, where the exemption is for 48 months or until all exploration and developments costs are recovered; *deep wells* below 15,000 feet, where 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*, where 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 is capped at \$25 million per fiscal year as of FY '09. If allowable claims for the exemption are filed in an amount exceeding the cap, the amount of each claim is reduced proportionately. 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 '08, the state paid out \$35.6 million in rebates for horizontally drilled wells. The next most generous credit is for deep wells below 15,000 feet, which is also issued irrespective of price and for a duration of 48 to 60 months. However, the cap on the total amount of credits limits the state's exposure on deep well drilling. In FY '08, credits totaling \$20 million were claimed for deep well drilling, which equaled that year's cap.

Over the five year period from FY '04–FY'08, a total of \$339.3 million in GPT rebates were claimed on all forms of exempted drilling, according to the Oklahoma Tax Commission (Table 1). During this period, the state collected \$4.537 billion in gross production taxes. In FY '08, horizontal and deep wells represented 97.5 percent of the rebates claimed, when exemptions for other forms of drilling were suspended during a time of high prices.⁴

Under current law, all the gross production tax exemptions are scheduled to sunset on June 30, 2009, with the exception of deep wells below 15,000 feet, which remain in effect until June 30, 2011. Two bills introduced in the 2009 legislative session would extend the exemptions as follows:

- SB 313 initially would have extended only the exemption for horizontally drilled wells until 2011. It was amended in a House committee to extend all provisions set to expire on June 30, 2009 until June 30, 2012;
- HB 2062 would extend all provisions set to expire on June 30, 2009 until June 30, 2012.

Table 1: GROSS PRODUCTION TAX REBATES CLAIMED, FY '04 - FY '08

| Claim PERIOD | Horizontally Drilled Wells | Reestablished Production | Production Enhancement | Deep Wells | New Discovery | 3-D Seismic | Economically At-Risk | TOTAL REBATES | Total GPT Taxes |
|-----------------|----------------------------|--------------------------|------------------------|---------------|---------------|--------------|----------------------|---------------|-----------------|
| FY 2008 | \$35,601,260 | \$335,220 | \$186,210 | \$20,000,000 | \$35,925 | \$111,693 | \$733,034 | \$57,003,342 | \$645,764,513 |
| FY 2007 | \$25,834,322 | \$2,313,095 | \$1,979,933 | \$12,883,845 | \$271,289 | \$4,093,132 | \$218,935 | \$47,594,551 | \$751,196,057 |
| 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 | \$1,044,377,673 |
| 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 | \$927,076,329 |
| FY 2004 | \$2,366,979 | \$2,584,677 | \$6,808,032 | \$23,847,903 | \$965,791 | \$2,651,966 | \$356,234 | \$39,581,582 | \$1,168,445,112 |
| Total | | | | | | | | | |
| FY '04 - FY '08 | \$85,988,332 | \$16,219,840 | \$33,440,785 | \$163,047,114 | \$5,409,908 | \$33,755,804 | \$1,446,424 | \$339,308,207 | \$4,536,859,684 |

Table 2: Summary of Oklahoma Gross Production Tax Exemptions, as of FY '09

(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? | 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 7/1/2009 |
| | 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 7/1/2009 |
| Inactive well | 68 OS 1001.F | | Severance or production of oil, gas or oil and gas | 6/7ths | Yes - exemptions apply only if price of oil <\$30.00 per barrel or price of gas <\$5.00 MCF | 28 months from the date upon which production is reestablished | Production is reestablished prior to 7/1/2009 |
| Production enhancement project | 68 OS 1001.G | | Incremental production | 6/7ths | Yes - exemptions apply only if price of oil <\$30.00 per barrel or price of gas <\$5.00 MCF | 28 months from the date of the first sale after project completion | Project beginning date prior to 7/1/2009 |
| Deep well drilling | 68 OS 1001.H.2.a | Depth between 12,500 and 14,999 feet | Production of oil, gas, or oil and gas | 6/7ths. Capped at \$25 million in total exemptions for FY '09 and thereafter | Yes - exemptions apply only if price of oil <\$30.00 per barrel or price of gas <\$5.00 MCF | 28 months from the date of first sales | Wells spudded before 7/1/2009 |
| | 68 OS 1001.H.2.b | Depth between 15,000 and 17,499 feet | | | 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 7/1/2011 |
| | 68 OS 1001.H.2.c | Depth of 17,500 feet and greater | | | 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 | 60 months from the date of first sales | Wells spudded before 7/1/2011 |
| New discovery | 68 OS 1001.I | | Production of oil, gas, or oil and gas | 6/7ths | Yes - exemptions apply only if price of oil <\$30.00 per barrel or price of gas <\$5.00 MCF | 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 - exemptions apply only if price of oil <\$30.00 per barrel or price of gas <\$5.00 MCF | 28 months | Drilling commenced before 7/1/09 |

NOTES

¹ Data on oil and gas production from Energy Information Administration at: <http://www.eia.doe.gov/>² National Conference of State Legislatures at: <http://www.ncsl.org/programs/fiscal/severtax05.htm>³ Oklahoma State Senate, [Overview of State Issues](#), September 2008, pp. 37-41; at: http://www.oksenate.gov/publications/overview_of_state_issues_2008/overview_of_state_issues_2008.pdf⁴ The state paid \$733k in rebates for economically at-risk wells and about \$700k in rebates for all other kinds of wells. This likely represented claims that were filed in FY '08 on production in previous years that was eligible for exemptions.This publication was prepared by David Blatt, Director of Policy, dblatt@okpolicy.org; 918-382-3228

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