

OIL AND GAS CONSERVATION COMMISSION
1624 West Adams - Suite 202
Phoenix, Arizona 85007

Minutes of Meeting
April 15, 1970

Present:

Mr. Ralph W. Bilby, Chairman
Mr. Kenneth G. Bentson, Vice Chairman
Mr. Lucien B. Owens, Member
Mr. Frank E. Moore, Member
Mr. Robert A. Bledsoe, Member
Mr. John Bannister, Executive Secretary
Mr. James R. Scurlock, Geologist
Dr. Willard Pye, University of Arizona
Mr. John M. Hazelett, Member Tax Commission
Mr. Robert F. Houk, Research, Tax Commission
Mr. Neal G. Trasente, Director Sales & Use Tax
Division, Tax Commission

Minutes of meeting of March 18, 1970 were approved as written.

Reports of the Executive Secretary and Geologist were accepted.

Executive Secretary reported that as a direct result of Senate Bill 186, signed by Governor Williams on April 9, 1970, which removed a 15,360 acre limit on oil and gas leases that may be held in the State by an individual, Mr. E. R. "Mike" Richardson of Albuquerque, New Mexico has paid to the State of Arizona \$213,000 for one year's rental fee on 854,000 acres of State land and paid \$105,000 to the Bureau of Reclamation for annual rental for 209,000 acres of Federal land. This is more than the total amount of State leases issued in 1968 and 1969 and covers leases in Yuma, Maricopa, Pima, Pinal and Santa Cruz Counties. In addition, five brokers have been engaged to secure fee leases.

Mr. Owens reported that he had contacted Mr. Walter Carpenter, Town Manager of Holbrook, regarding holding the regular May meeting of the Commission in Holbrook. Mr. Carpenter's response was enthusiastic and he has extended a written invitation to the Commission. Executive Secretary was instructed to make arrangements for the meeting with a trip to view Aritex Development Corporation's salt storage project near Holbrook.

Executive Secretary reported that audit report for the period ending June 30, 1969 has been received from the Auditor General. All books and records were reported in good order with no exceptions noted.

Meeting was turned over to Mr. John Hazelett, Member of the State Tax Commission. Mr. Hazelett introduced Mr. Robert Houk and Mr. Neal G. Trasente. Copies of "Outline of Oil and Gas Lease and Production Revenue Accruing to the State of Arizona, Where Such Revenue is Being Missed, How These Revenue Gaps Might be Closed and Other Comments", prepared by the Tax Commission, were distributed and outline was discussed by Mr. Hazelett. Outline is affixed hereto and made a part hereof.

Meeting adjourned at 10:00 a.m., to be followed by hearing of Case No. 40.

APPROVED May 20, 1970



Ralph W. Bilby, Chairman

Outline Of Oil And Gas Lease And Production Revenue Accruing
To The State of Arizona, Where Such Revenue is Being Missed,
How These Revenue Gaps Might Be Closed And Other Comments

I Revenue now accruing to the state from the production of oil and gas in Arizona:

A. Income from sub-surface leasing of oil and gas rights as paid to the State Land Department (see their report):

1. For the year 1966-67	\$ 188,314.27
2. For the year 1967-68	207,720.75
3. For the year 1968-69	285,020.44

B. That portion of the leasing fees and/or royalties paid to the U. S. Government returnable to the state under the Mineral Leasing Act of February 25, 1920 - 37½% (this includes all types of minerals as well as oil and gas lease fees - breakdown not located - see report of State Land Commissioner):

1. For the year 1966-67	\$ 88,817.87
2. For the year 1967-68	64,313.50
3. For the year 1969-70	69,038.59

C. Land royalties from state land leases as paid to the State Land Department (see their report):

1. Year ended 6-30-67	\$163,081.37
2. Year ended 6-30-68	1,249.26 (suit pending)
3. Year ended 6-30-69	83,525.18 (helium only)

D. Sales tax from the sale of oil and gas produced in Arizona as collected by the State Tax Commission.

1. All information confidential (ARS 42-1307)

E. Income tax on oil and gas production and/or royalties as paid to the State Tax Commission.

1. All information confidential (ARS 43-145)

F. Ad valorem taxes based upon valuations placed upon the well (in contrast to the value of the surrounding property or property improvements) by the Property Tax Department, Assessed by County Assessors and paid to County Treasurers at the official state, county or school district tax rate for any given year. Recent assessed valuation totals are as follows:

1. Valuation as of January 1, 1967 and used for fiscal year 1967-68 tax assessment purposes (last year tax assessment was made by the State Tax Commission and included in November 1967 report to the Governor) - \$929,453.
2. Valuation as of January 1, 1968 as determined by new Property Valuation Department - Break out of oil and gas valuations not made in Assessor's abstract.
3. Valuation as of January 1, 1969 as determined by Property Valuation Department and used for 1969-70 tax assessment purposes (see 1969 abstract of Assessment Roll) - \$8,947,297. This assessment was appealed by producers to allow for a trucking allowance of 25¢ per barrel. Arizona Board of Property Tax Appeals allow a deduction of \$715,000 producing a net assessed valuation of \$8,232,297. All of this was reported to be in Apache County. (Average total ad valorem tax rate was approximately \$6.50 per \$100 valuation.

II Revenue state is not now receiving:

- A. State lease fees - Probably nil.
- B. Federal lease fees and/or royalties - 62½% retained by Washington.
- C-1. State land royalties - This now being battled in court (?).
- C-2. Indian land royalties - State not entitled to any of this. (Current argument between Hopi and Navajo Indians on who is to get lease fees and royalties on disputed reservation land is becoming serious. This may have to be settled by Congress.)
- D. Sales tax on flared gas, gas and oil consumed by the gas and oil production industry and transportation costs.
- E. Income tax on development costs which are expensed as incurred, cost and percentage depletion allowances, royalties paid to the Indians and U. S. Bureaus and possibly accounting manipulations by interstate operators applying out-of-state losses against in-state profits.

- F. Ad valorem taxes on royalties paid to the state, Indian tribes, Federal bureaus and possibly individual owners; flared gas; gas and oil consumed by the gas and oil industry; and transportation costs.
- G. There is a possibility that some royalties paid by producers to individual land owners are escaping income taxation.

III What can be done about closing these revenue gaps?

- A. State lease fees - 100% now going to the state.
- B. Federal lease fees and/or royalties - 37½% now being returned to the State. Public Land Law Review Commission report now due to be made to Congress by June 30, 1970 may recommend the increasing of these fees as well as the percentage due to our state.
 - C-1. State land royalties - win case!
 - C-2. Indian land royalties - no change contemplated.
- D. Sales tax - Stop all unreasonable flaring of gas; have legislature tighten laws on allowing deductions for gas or oil used for producing purposes and for transportation costs; and recommend closer auditing of sales tax returns by State Tax Commission.
- E. Income tax - Recommend closer auditing of income tax returns by State Tax Commission.
- F. Ad valorem tax - Oil and Gas Commission should have their own audit procedure to compare individual well reports with assessed valuations placed on these wells by Property Valuation Department.

IV Other Comments:

- A. Possible reduction in state lease fees and royalties that may be required by Congress.
 - 1. There is a strong feeling in Congress that ownership of all minerals as well as oil and gas in the ground should be held by the U. S. Government and that there should be a sharing of lease and royalty fees between the state and federal governments. This is now being discussed by the Public Land Law Review Commission. With Congress now being controlled on a one-man-one vote basis and with relatively few votes in Arizona compared to

the rest of the country, Arizona could come out on the short end of this dispute.

- B. Imposition of severance tax on extraction of oil, gas, minerals and timber rather than continuing to follow the present basis of imposing a "Privilege sales tax" of 2% on mining, oil and gas production and 1½% on timbering.

1. All discussion centering around an "Interstate Taxation Act" or the recently proposed "Interstate Sales and Use Tax Act" seem to be zeroing in on the imposition of sales taxes on a "destination" rather than an "origination" basis of any shipment. With the bulk of Arizona copper and gas and oil leaving our state while title still rests in the original producer, a great source of our state sales tax income could be immediately cut off with the passage of such an "Interstate Taxation Act". The State Tax Commission has been recommending to our legislature that this tax be taken out of the sales tax field and made the subject of a strict severance tax. It still urges this change. The confidential nature of our sales tax reports, now being applied to mining and oil and gas production, could be eliminated from such a severance tax statute so that an easy check could be made to assure maximum severance tax collections.

- C. Possibility of errors in this outline.

1. The Oil and Gas Commission has requested this information of the undersigned due to its apparent lack of source material. Because of a hurried preparation in fields not strictly limited to Tax Commission obligations, this outline may contain errors or data that may be misconstrued. However, in the interest of helping the Oil and Gas Commission reach responsible conclusions in their field of operation, we are glad to submit this outline as the best information we can put together in the time allowed.

D. See also the Tax Briefs attached which were prepared on the following subjects:

1. Oil and Gas Commission - Duties and Responsibilities.
2. Transaction Privilege Tax - Oil and Gas Industry.
3. Property Valuation Department, Oil and Gas Industry.

Prepared by John M. Hazelett, Member and Robert F. Houk, Research Director,
Arizona State Tax Commission

April 15, 1970.

STATE TAX COMMISSION OF ARIZONA
ANALYSIS OF SALES AND USE TAX COLLECTIONS
FOR THE YEAR 1968-1969

TAXABLE ACTIVITIES AND BUSINESS CLASSIFICATIONS	TOTAL TAX COLLECTED	PRIVILEGE SALES TAX		EDUCATION EXCISE TAX		SPECIAL EXCISE TAX FOR EDUCATION		USE TAX		
		RATE	AMOUNT	RATE	AMOUNT	RATE	AMOUNT	RATE	AMOUNT	
Retail	\$ 80,703,415.59	2%	\$ 53,802,277.06	1%	\$ 26,901,138.53			2%	Breakdown not determined	
Mining-Oil & Gas Production	14,348,761.21	1%	7,174,380.61	½%	3,587,190.30	½%	\$ 3,587,190.30	2%	"	
Contracting	13,531,011.66	1%	5,036,659.21	½%	2,518,329.61	1½%	5,976,022.84	2%	"	
Utilities	8,909,146.14	1%	2,969,715.38	½%	1,484,857.69	1½%	4,454,573.07	2%	"	
Rentals	8,749,289.22	2%	5,832,859.48	1%	2,916,429.74			2%	"	
Restaurants-Bars	8,413,541.15	2%	5,609,027.43	1%	2,804,513.72			2%	"	
Communications	3,172,514.16	1%	1,057,504.72	½%	528,752.36	1½%	1,586,257.08	2%	"	
Job Printing-Advertising	1,838,668.08	1%	612,889.36	½%	306,444.68	1½%	919,334.04	2%	"	
Publishing	1,525,014.18	1%	508,338.06	½%	254,169.03	1½%	762,507.09	2%	"	
Amusements	1,161,869.87	2%	774,579.91	1%	387,289.96			2%	"	
Timbering	685,435.99	1%	456,957.33	½%	228,478.66			2%	"	
Meat Packing	384,449.89	1/4 of 1%	256,299.93	1/8 of 1%	128,149.96			2%	"	
Railroads & Aircraft	260,404.20	1%	86,801.40	½%	43,400.70	1½%	130,202.10	2%	"	
Feed-Wholesale	259,834.20	1/4 of 1%	173,222.80	1/8 of 1%	86,611.40			2%	"	
Transportation and Towing	91,028.76	1%	30,342.92	½%	15,171.46	1½%	45,514.38	2%	"	
Private Car-Pipelines	2,167.32	1%	722.44	½%	361.22	1½%	1,083.66	2%	"	
Unclassified (See Note)	3,447,118.85				1,212,889.67				2,234,229.18	
Total (Net of all refunds)	\$ 147,483,670.47		\$ 84,382,578.04		\$ 43,404,178.69		\$ 17,462,684.56		\$ 2,234,229.18	
Penalties	224,547.56		224,547.56							
License Fees	17,149.00		17,149.00							
TOTAL (Net of all refunds)	\$ 147,725,367.03		\$ 84,624,274.60							
Distribution:	Overall Percent									
Cities	14.32	\$ 21,158,269.60	25.0%	\$ 21,158,269.60						
Counties	19.25	28,432,435.67	33.6%	28,432,435.67						
State General Fund	66.43	98,134,661.76	41.4%	35,033,569.33	100%	\$ 43,404,179.69	100%	\$ 17,462,684.56	100%	\$ 2,234,229.18
TOTAL	100.00%	\$ 147,725,367.03	100%	\$ 84,624,274.60	100%	\$ 43,404,179.69	100%	\$ 17,462,684.56	100%	\$ 2,234,229.18

NOTE: It is to be noticed that use tax, penalties, license fees and a portion of the education excise tax are not classified by business types. Such a breakdown would require considerable additional accounting effort not obtainable with the reporting forms now being used.

TAX BRIEF

SUBJECT: Oil and Gas Commission - Duties & Responsibilities.

FACTS: The Oil and Gas Commission requested the State Tax Commission to inform them of just what tax laws are now in effect concerning oil and gas producers and whether these tax laws are being properly enforced.

**QUESTIONS
PRESENTED:**

1. What are the duties and responsibilities of the Oil and Gas Commission?
2. Is their request in line with these duties?

**LAW AND
REGULATION:**

In setting up the Oil and Gas Commission the legislature made a declaration of policy which is contained in Sec. 27-502 A.R.S. and provides:

- "A. It is the public policy of the state to:
- "1. Conserve the natural resources of oil and gas and products thereof.
 - "2. Prevent waste of oil and gas resources.
 - "3. Provide for protection and adjustment of correlative rights of owners of land wherein the natural resources lie and of owners and producers of oil and gas resources and products thereof, and of others interested therein.
 - "4. Encourage development of natural resources of oil and gas and their products.
 - "5. Encourage continuous and economic supply thereof and demand therefor.
 - "6. Safeguard the health, property and public welfare of citizens of the state and other interested persons.
 - "7. Promote all purposes indicated by the provisions of this article."

To go along with this policy the legislature provided in Sec. 27-515 as follows:

- "A. The commission shall have jurisdiction and authority over all persons and property deemed

necessary to administer and enforce the provisions of this article and other laws relating to conservation of oil and gas. The commissioner or his representative or employee may, at any time, enter upon property and inspect wells drilled for oil or gas, and well records, and shall control property, machinery and appliances necessary to gauge the wells.

"B. The commission may, with the approval of the governor, employ personnel necessary to enforce this article, and for their compensation. He may:

"1. Administer oaths to a witness in any hearing, investigation or proceeding held under this article or other law relating to conservation of oil and gas.

"2. Issue subpoenas requiring attendance and testimony of witnesses and production of books, papers and records deemed material or necessary, and direct service of subpoenas by a sheriff or other officer authorized by laws to serve process.

"3. Prescribe rules and regulations and do all acts necessary or advisable to carry out the provisions of this article."

The statute covering rules and regulations is Sec. 27-516 A.R.S. which provides:

"A. The commission shall make rules and amend them from time to time as deemed necessary for the proper administration and enforcement of this article, including the following rules, regulations and orders:

"1. Requiring the drilling, casing and plugging of wells in a manner to prevent:

"(a) Escape of oil and gas from one stratum to another.

"(b) Intrusion of water into an oil or gas stratum from a separate stratum.

"(c) Pollution of fresh water supplies by oil, gas or salt water.

"(d) Waste.

"2. Requiring reports showing the location of oil and gas wells, and requiring filing of logs and drilling records within ninety days from the completion of a well drilled for oil or gas.

"3. Requiring a reasonable bond with good and sufficient surety conditioned on the performance of the duties prescribed in subdivision 1 and 2 of this subsection including the obligation to plug each dry or abandoned well.

"4. Preventing drowning by water of any stratum or part thereof capable of producing oil or gas in paying quantities, and preventing the premature and irregular encroachment of water which reduces or tends to reduce the total ultimate recovery of oil or gas from any pool.

"5. Requiring the operation of wells with efficient gas-oil ratio and fixing the limits of such ratios.

"6. Preventing blow-outs, caving and seepage.

"7. Preventing creation of unnecessary fire hazards.

"8. Required identification of ownership of oil and gas wells, producing leases, refineries, tanks, plants, structures, and storage and transportation equipment and facilities.

"9. Regulating shooting, perforating and chemical treatment of wells.

"10. Regulating gas cycling operations.

"11. Regulating secondary recovery methods, including introduction of gas, air, water or other substance into producing formations.

"12. Regulating spacing of wells and establishing drilling units.

"13. Limiting, allocating and apportioning production of oil and gas from a pool or field for prevention of waste, and allocating production between tracts of land under separate ownership in a pool on a fair and equitable basis so that each tract will be permitted to produce not more than its just and equitable share from such pool.

"14. Preventing, so far as practicable, reasonably avoidable drainage from each developed unit, not equalized by counterdrainage.

"15. Requiring a producer of oil or gas to submit for each oil or gas well operated, on a form prescribed by the commission, a monthly report of actual production from each oil or gas well.

"16. Requiring persons making settlement with the owner of oil or gas interests to render statements to the owner showing the quantity and gravity purchased and the price per barrel of oil or the price per one thousand cubic feet of gas.

"17. Requiring, either generally or in a particular area, a certificate of clearance for transportation or delivery of oil, gas or any product thereof.

"18. Requiring the applicant for a drilling permit in cases where the surface of the land is owned by another not in a contractual relationship with the applicant, to post bond in a reasonable sum with good and sufficient surety conditioned on payment of just compensation to the landowner for actual damages to the surface of the land or improvements thereon caused by the drilling permittee's operations.

"B. No rule, regulation or order, or change, renewal or extension thereof, except as otherwise provided by this article, shall, in the absence of an emergency, be made by the commission under the provisions of this article except after a public hearing of which not less than ten days' notice has been given.---

"C. In the event an emergency is found by the commission to exist, which in its judgment requires making, changing, renewing or extending a rule, regulation or order without first having a hearing,

the emergency rule, regulation or order shall have the same validity as if a hearing had been held after due notice. The emergency rule, regulation, or order shall remain in force not to exceed thirty days from its effective date, but in any event shall expire when a rule, regulation or order with respect to the subject matter of the emergency rule, regulation, or order becomes effective after due notice and hearing."

APPLICATION
OF LAW AND
REGULATIONS
TO FACTS:

As will be noted all laws (and the same holds for the regulations) refer to oil and gas wells, oil and gas equipment and machinery, and oil and gas production. The only comment on money is paragraph 16 Sec 27-516 ARS and there the requirement is that the person making settlement with the owner of a gas or oil interest show the per barrel or price per thousand cubic feet. From this position it can be assumed that the legislature had in mind the Oil and Gas Commission to confine itself to the field of management and production.

Yet in opposition to the above assumption the policy of the Oil and Gas Commission is stated to be - to "conserve the nature resources"; "prevent waste"; "provide for protection and adjustment of correlative rights"; encourage development of natural resources"; "encourage continuous and economic supply and demand"; safeguard the health, property and public welfare"; and finally to "promote all purposes indicated by the provisions of this article."

CONCLUSION:

In a nutshell the duties and responsibilities of the Oil and Gas Commission is to promote the oil and gas industry in the State of Arizona while at the same time preventing waste of our resources and safeguarding our rights and welfare. This can not be accomplished without a general or working knowledge of the economics of the oil and gas industry, the taxes they have to pay, the current prices in the field and the contractual relationship between owners, operators, transporters and refiners.

The State Tax Commission collects the Arizona Privilege Transaction Tax (Sales) and the Arizona corporate and individual income tax as applies to oil and gas producers. The information obtained for both of these taxes is

confidential in nature and cannot be disclosed to any outsider as provided by statute (A.R.S. 42-1307 and 43-145).

The ad valorem tax is imposed by the Property Valuation Department and subject to taxpayer appeal through the Property Tax Appeals Board. It is our understanding that there is no statute on the books that requires that this information be kept confidential (as is the case of our sales and income tax laws) and yet this is the attitude now being maintained by the Property Valuation Department.

Royalty payments on gas and oil producers operating under state leases are required to be paid to the State Land Department. Payments on Federal land are required to be made to the Federal Department involved and on Indian lands to the Department of Interior. It is believed that royalty payment records made on state and federal land is readily available but that information concerning Indian leases are confidential and cannot be obtained.

Three years ago, when this matter came up, it was found out that some oil and gas producers had failed to file proper Arizona Privilege Sales and Use Tax Transaction forms. It is believed that some of them are now under reporting these tax obligations again. It is the intention of the Tax Commission to insist that these taxpayers constantly be required to pay their fair share of State sales and income tax obligations.

Prepared by Robert F. Houk
and John M. Hazelett
April 8, 1970