



MICHIGAN OIL AND GAS ASSOCIATION

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TESTIMONY OF WILLIAM A. HORN BEFORE THE SENATE FINANCE COMMITTEE

Re: Senate Bill No. 552

December 10, 2013

Good morning.

My name is William Horn. I am a member of the Legal and Legislative Committee of the Michigan Oil and Gas Association.

With me are Frank Mortl, who is the President of the Michigan Oil and Gas Association, and Michael Haines, who is the Chairman of our Legal and Legislative Committee.

MOGA is an association having approximately 1,000 company and individual members who are engaged in *all aspects* of oil and gas exploration and production in Michigan. The members of MOGA include small, independent exploration companies; major oil companies having operations in Michigan; drilling and service companies; individual land owners and royalty owners; utility and pipeline companies; and professionals serving the industry in a variety of ways.

Oil and gas exploration and production in Michigan is a \$4 billion industry and supports nearly 38,000 Michigan jobs. Currently, there are approximately 14,800 operating wells in 64 counties in Michigan. Although Michigan is a net importer of oil and gas products, Michigan production does supply nearly 25% of the natural gas consumed in Michigan's industries, businesses and homes.

MOGA supports Senate Bill 552, which will put into law Michigan's longstanding methodology for valuing and assessing natural gas and oil well personal property. The reason for this legislation and the need for it relate primarily to *casing*, which is the heavy steel pipe installed in an oil or gas well that is expected to produce oil or gas or both. The casing is typically cemented into the ground. The primary function of the casing is to seal off fluids in the well to prevent their getting into other formations than their native formation, thus, for example, protecting groundwater aquifers. Casing will also prevent the hole from caving in.

Most wells that are completed have two strings of cemented casing – the surface casing and the production casing. This is depicted in the figure attached to my testimony – a typical Antrim gas well in Northern Michigan. (In some wells – typically deeper wells – there also is a third string of casing called the intermediate string.) In a producing well, there is also typically a string of tubing set within the casing, and sometimes other downhole equipment.

This legislation will remove uncertainty as to how subsurface casing (and similar in-ground property) is to be valued for personal property tax purposes.

There has never been any doubt that the surface machinery, appliances, tanks and other equipment used in the operation of oil and gas wells, and the pipelines used to transport oil and gas, are taxable personal property. There have been questions, though, about whether the steel casing in the wellbore, which is cemented into the ground and largely un-removable, is taxable as personal property. In the late 1980s, the Department of Treasury took the position that well casing is taxable as personal property. This position has never been ruled upon by a court nor incorporated into any statutory provision.

At the time the Department of Treasury reached the conclusion that casing is taxable as personal property, the Department also concluded that a part of the value to be reported for casing is a reasonable installation cost for placing the casing into the hole and cementing it in. At that time, it was suggested that 75 cents per foot would be an appropriate estimate of the installation cost. The basic concept was that the value to be reported would include only the costs of lowering the casing into ground and cementing it into place. This has been the prevailing understanding since 1989.

Senate Bill 552 would confirm all of these points as a matter of statute. Not only the surface machinery, appliances, tanks and other equipment used in oil and gas well operations, and the pipelines transporting the oil and gas, would be taxable personal property, but also the in-ground casing, tubing and other equipment located in the wells. This language is intended to codify the Department of Treasury's position since 1989. Incidentally, this is also the position set forth in the Assessor's Manual published by the State Tax Commission as a guide for assessors in valuing personal property for taxation purposes.

Senate Bill 552 provides that the drilling, service and other costs associated with the *drilling* of wells is not to be considered in determining the assessed value or taxable value of the casing or other in-ground equipment or used an indicator of assessed or taxable value. This language would reverse the position taken by in State Tax Commission Bulletin 9 of 2012 which, for the first time, required that the entire cost of *drilling* a well be reported as an installation cost for casing. In fact, oil and gas wells are drilled for the purpose of finding whether oil and/or gas are present in economically recoverable quantities at the location and target formation of the well. Not all wells are completed for production. In a well that is being completed for production, some rig time and associated labor are involved in placement or installation of the production casing, tubing and other downhole equipment, but this is a rather small portion of the overall rig time and associated labor on the site. The unprecedented new requirement in Bulletin 9, that *all* drilling, service and other costs associated with drilling wells be reported for personal property assessments has huge implications for oil and gas personal property assessments, and could result in a doubling or even greater increase in the amount of tax to be paid.

If Senate Bill 552 is enacted, it will codify the approach followed by the Department of Treasury since the late 1980s and incorporated into the Assessor's Manual. It will also undo an unprecedented additional tax burden imposed by Bulletin 9.



Well Casing in Typical Antrim Well

