

BACKGROUND REPORT ON THE PROPERTY TAXATION OF NATURAL GAS PIPELINE PROPERTY IN MONTANA

Prepared for the Revenue and Transportation Interim Committee

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INTRODUCTION

On December 2, 2008, the Montana Supreme Court decided an appeal by Omimex Canada, Ltd., from the judgment of the First Judicial District Court, Lewis and Clark County, "declaring that the Montana Department of Revenue may centrally assess Omimex's property and classify it under 15-6-141, MCA, as class nine property" rather than as class eight personal property under 15-6-138, MCA.¹ The Supreme Court reversed the District Court decision regarding the classification of Omimex's property. The decision resulted in a refund of protested property taxes and payment of interest to Omimex for tax years 2004 and 2005. The decision also had implications for the taxation of other natural gas pipeline companies.

This report provides a summary of Omimex's property tax dispute (including ongoing disputes) with the Montana Department of Revenue, a brief overview of the Supreme Court decision affecting the taxation of Omimex's property, and a tabulation of refunds to Omimex for tax year 2005. The report also describes how the 2009 Montana Legislature responded to the Supreme Court decision with the enactment of Senate Bill No. 489. Finally, it shows how the legislation affected the classification of natural gas pipeline companies.

BACKGROUND

Omimex is an independent oil and natural gas production company. The company's corporate headquarters are located in Fort Worth, Texas, and it has Montana offices in Butte and Cut Bank. Omimex owns property in Blaine, Glacier, Hill, Liberty, Phillips, Toole, and Valley Counties consisting of natural gas pipelines and production wells. One pipeline crosses the county line between Glacier and Toole Counties, and another natural gas pipeline crosses the border between Montana and Alberta, Canada. A third pipeline runs from Hill County through Liberty County into Toole County.² Omimex transports in its pipelines its own natural gas, third-party gas, and gas of which it owns a working interest. Omimex has a single gas marketing agreement with Wisconsin Public Services.³

In tax year 2004, Omimex reported its personal property for local assessment to the various

¹Omimex Canada, Ltd., v. Montana Department of Revenue, 347 Mont. 176, 201 P.3d 3 (2008).

²Omimex Canada, Ltd., v. Department of Revenue (No. BDV-2004-288, First Judicial District, Lewis and Clark County), January 17, 2006.

³See Jeff Martin, "Don't Mess with Taxes: HJR 44 Study of the Taxation of Certain Oil and Natural Gas Property and Other Topics Considered by the Revenue and Transportation Interim Committee", (Montana Legislative Service Division, December 2006), Chapter Three.

counties in which it operates.⁴ The Montana Department of Revenue determined that the property should be centrally assessed and taxed at the class nine property tax rate of 12% rather than at the class eight personal property tax rate of 3%. In April 2004, Omimex filed a complaint for declaratory judgment in the District Court in Helena. The complaint contended that Omimex's property consists of unregulated gathering lines and related property that transmits natural gas from various wellhead connections to various interconnections with transmission lines in which Omimex has no ownership interest. The complaint stated that similarly situated taxpayers with comparable property operating in more than one county are locally assessed and are taxed at 3% of market value.

Omimex paid its property taxes under protest for tax years 2004 through 2008. Omimex did not dispute the Department's valuation of its property for tax years 2004 and 2005 but did so for tax years 2006 through 2008.

In the decision of December 2, 2008,⁵ the Supreme Court stated:

The fundamental question in this case is whether Omimex's property should be taxed at a rate of 12% under §15-6-141, MCA, or at a rate of 3% under §15-6-138, MCA. (at ¶ 17) Regardless of whether Omimex's property is centrally or locally assessed, its tax rate class is determined by the application of the physical attributes of Omimex's Montana properties to the terms of the property classification statutes, §§15-6-138 and -141, MCA. (at ¶ 18)

Before the enactment of Senate Bill No. 489, 15-6-141, MCA, provided that, with respect to natural gas property,

(1) class nine property includes:

(b) allocations for centrally assessed natural gas companies having a major distribution system in this state; . . .

The Court concluded that Omimex's property is designed:

"not to distribute, but rather to accumulate natural gas from hundreds of individual wells to central points where the gas is commingled and delivered to a single buyer. . . . Therefore, Omimex's properties, regardless of whether they are centrally or locally assessed, should be classified as . . . class eight property subject to a 3% tax rate." (at ¶ 26)

⁴The Montana Power Company sold its natural gas exploration, production, and marketing assets to PanCanadian Petroleum. In 2003, Omimex purchased certain gathering facilities in Montana from EnCana Oil and Gas, a successor company to PanCanadian Petroleum.

⁵For a detailed analysis of the Supreme Court's decision, see Lee Heiman's December 15, 2008, memo to the Revenue and Transportation Interim Committee. The cite of that memo is on p. 7 of this report.

Omimex paid 75% of its taxes under protest for tax years 2004 and 2005 (the difference between the class nine property tax rate and the class eight property tax rate). Section 15-1-402, MCA, requires that property taxes paid under protest plus interest must be refunded to the taxpayer in an action finally determined adversely to the governmental entity levying the tax. Interest is paid at the interest rate earned by the pooled investment fund as provided in 17-6-203, MCA.

For tax years 2004 and 2005, the Montana Department of Revenue (Department) calculated the amount of refund and interest for the 95-mill school equalization levies, the 6-mill university levy, and the estimated refunds for each county in which Omimex owns property. Those amounts are shown in the table below.

Property Tax and Interest Refunds to Omimex, Ltd., Tax Years 2004-2005						
Tax Year 2004						
County Name	State Refund	State Interest on Refund	County Estimated Refund (Does not include fees)	County Interest on Estimated Refund	Total Estimated Refund	Total Estimated Interest
Phillips	\$59,273	\$8,782	\$132,284	\$76,438	\$191,557	\$85,220
Valley	238	35	545.07	80.76	783	116
Toole	8,971	1,329	25,114	3,721	34,085	5,050
Blaine	18,303	2,712	68,661	10,173	86,964	12,885
Glacier	49,359	7,313	219,578	32,534	268,938	39,847
Liberty	14,738	2,184	55,697	8,252	70,435	10,436
Total	150,882	22,355	501,879	131,199	652,761	153,554
Grand Total		173,238		633,078		806,315
Tax Year 2005						
County Name	State Refund	State Interest on Refund	County Estimated Refund (Does not include fees)	County Interest on Estimated Refund	Total Estimated Refund	Total Estimated Interest
Silver Bow	\$1,791	\$189	\$9,466	\$1,083	\$11,257	\$1,272
Phillips	31,526	3,607	72,949	8,346	104,476	11,952
Hill	84	10	355	41	438	50
Valley	184	21	373	43	558	64
Toole	9,463	1,083	25,368	2,902	34,831	3,985
Blaine	21,727	2,486	80,485	9,208	102,212	11,693
Glacier	79,196	9,060	368,608	42,170	447,804	51,230
Liberty	23,582	2,698	85,902	9,828	109,484	12,525
Total	167,553	19,153	643,506	73,619	811,058	92,773
Grand Total		186,706		717,125		903,831
Total refund: 2004-2005	\$318,435	\$41,509	\$1,145,385	\$204,818	\$1,463,820	\$246,327

Source: Montana Department of Revenue spreadsheet, unpublished. The 2005 county estimated refund figures including interest were revised for Glacier County by Legislative Services Division staff based on the actual amount of protested taxes paid by Omimex in that tax year.

The total estimated amount of property taxes and interest paid to Omimex is \$1.71 million. The largest refunds are in Glacier County.

During the 2005-2006 legislative interim, the Revenue and Transportation Interim Committee conducted a study of the taxation of oil and natural gas property. It reviewed a proposal (LC8000) that would have required the local assessment of "legal entities that are primarily oil or gas producers even if their production facilities include flow lines, gathering lines, or injection lines that cross a county or state line."⁶ Under the proposal, these companies would have been locally assessed and taxed at 3% of market value. At the time of the study, the proposal would have applied to EnCana Energy Resources, Inc.; Fidelity Exploration and Production Company; and Omimex Canada, Ltd.

The study evaluated the fiscal impact of the proposal on the state and local taxing jurisdictions in which the companies operated. Using the information from that report, the tables below show the amount of state refunds and the estimated refunds in each of the counties and school districts (except for Hill, Silver Bow, and Valley Counties) in which Omimex owns property. The term "Other County School Levies" in the tables refers to county transportation mill levies, elementary school retirement levies, and high school retirement levies. The column headed by "% Reduction in Property Taxes" is intended to indicate the degree of accuracy of the estimated taxes in the 2005-2006 study compared with the estimated refunds by county.

Blaine County

In 2005, the property of Omimex accounted for less than 2.4% of the property tax base in the county and in the Zurich elementary school district and for other county school levies, but accounted for 7.48% of the tax base in the Chinook elementary school district and a little over 3.95% in the Chinook high school district.

Estimated Refunds: Blaine County	2005 Mill Levy	2005 Estimated Taxes	Taxes Refunded	Interest Due	Total Refunded	% Reduction in Property Taxes
University Levy	6	\$1,721	\$1,291	\$148	\$1,439	-75%
School Equalization	95	27,249	20,436	2,338	22,774	-75%
Total State	101	28,970	21,727	2,486	24,213	-75%
County	168.77	48,480	35,660	4,080	39,740	-74%
Other County School Levies	42.66	12,236	9,000	1,030	10,030	-74%
Chinook Elementary	141.11	38,539	28,348	3,243	31,591	-74%
Zurich Elementary	21.03	288	212	24	236	-74%
Chinook High School	34.43	9,875	7,264	831	8,095	-74%
Total County	NA	109,419	80,485	9,208	89,693	-74%

Montana Department of Revenue spreadsheets, unpublished. Montana Tax Foundation, Montana Property Tax Mill Levies, 2005-2006.

⁶ "Don't Mess with Taxes: HJR 44 Study of the Taxation of Certain Oil and Natural Gas Property and Other Topics Considered by the Revenue and Transportation Interim Committee", *op. cit.*, Appendix C.

Glacier County

In tax year 2005, the property owned by Omimex accounted for 5.9% of the property tax base in Glacier County and ranged from 5.6% of the property tax base in the Cut Bank high school district to 8.3% in the Browning elementary school district.

Estimated Refunds: Glacier County	2005 Mill Levy	2005 Estimated Taxes	Taxes Refunded	Interest Due	Total Refunded	% Reduction in Property Taxes
University Levy	6	\$6,273	\$4,705	\$538	\$5,243	-75%
School Equalization	95	99,321	74,491	8,522	83,013	-75%
Total State	101	105,594	79,196	9,060	88,256	-75%
County	172.01	179,834	136,193	15,581	151,774	-76%
Other County School Levies	59.67	62,384	47,245	5,405	52,650	-76%
Browning Elementary	209.46	92,406	69,981	8,006	77,987	-76%
Browning High School	85.06	37,525	28,419	3,251	31,670	-76%
Cut Bank Elementary	109.1	65,932	49,932	5,712	55,644	-76%
Cut Bank High School	80.49	48,642	36,838	4,214	41,052	-76%
Total County	NA	486,723	368,608	42,170	410,778	-76%

Montana Department of Revenue spreadsheets, unpublished. Montana Tax Foundation, Montana Property Tax Mill Levies, 2005-2006.

Liberty County

In 2005, the property owned by Omimex accounted for 4.54% of the property tax base in Liberty County and not quite 4% of the property tax base in the Chester joint elementary district and high school district. The tax base for the Chester school districts includes property in Hill County.

Estimated Refunds: Liberty County	2005 Mill Levy	2005 Estimated Taxes	Taxes Refunded	Interest Due	Total Refunded	% Reduction in Property Taxes
University Levy	6	\$ 1,868	\$1,401	\$160	\$1,561	-75%
School Equalization	95	29,574	22,181	2,538	24,719	-75%
Total State	101	31,442	23,582	2,698	26,280	-75%
County	211.8	65,935	49,362	5,648	55,010	-75%
Other County School Levies	28.37	8,832	6,612	756	7,368	-75%
Chester-Joplin-Inverness Elem	78.93	24,572	18,396	2,105	20,500	-75%
Chester-Joplin-Inverness High School	49.48	15,404	11,532	1,319	12,851	-75%
Total County	463.58	114,742	85,902	9,828	95,730	-75%

Montana Department of Revenue spreadsheets, unpublished. Montana Tax Foundation, Montana Property Tax Mill Levies, 2005-2006.

Phillips County

In tax year 2005, the property owned by Omimex accounted for less than 1% of the property tax base in the Saco school district, 3.03% in the county, and 10.87 % in the Whitewater K-12 school district.

Estimated Refunds: Phillips County	2005 Mill Levy	2005 Estimated Taxes	Taxes Refunded	Interest Due	Total Refunded	% Reduction in Property Taxes
University Levy	6	\$2,497	\$1,873	\$214	\$2,087	-75%
School Equalization	95	39,538	29,653	3,393	33,046	-75%
Total	101	42,035	31,526	3,607	35,133	-75%
County	77.52	32,263	24,506	2,804	27,310	-76%
Other County School Levies	41	17,064	12,962	1,483	14,444	-76%
Whitewater K-12	118.69	45,594	34,632	3,962	38,595	-76%
Saco Elementary	18.18	583	443	51	493	-76%
Saco High School	16.68	535	406	46	452	-76%
Total County	NA	96,038	72,949	8,346	81,295	-76%

Montana Department of Revenue spreadsheets, unpublished. Montana Tax Foundation, Montana Property Tax Mill Levies, 2005-2006.

Toole County

In tax year 2005, property owned by Omimex was relatively unimportant in the taxing jurisdictions in the county. Omimex property accounted for 2.34% of the tax base in the Galata elementary school district and around 1% or less in the other taxing jurisdictions, including the county.

Estimated Refunds: Toole County	2005 Mill Levy	2005 Estimated Taxes	Taxes Refunded	Interest Due	Total Refunded	% Reduction in Property Taxes
University Levy	6	\$750	\$562	\$64	\$626	-75%
School Equalization	95	11,868	8,901	1,019	9,920	-75%
Total State	101	12,617	9,463	1,083	10,546	-75%
County	145.38	18,161	13,336	1,526	14,861	-73%
Other County School Levies	38.33	4,788	3,516	402	3,918	-73%
Sunburst K-12	97.55	5,591	4,105	470	4,575	-73%
Shelby Elementary	168.58	1,308	960	110	1,070	-73%
Galata Elementary	3.97	238	174	20	194	-73%
Shelby High School	66	4,462	3,277	375	3,651	-73%
Total County	NA	34,547	25,368	2,902	28,270	-73%

Montana Department of Revenue spreadsheets, unpublished. Montana Tax Foundation, Montana Property Tax Mill Levies, 2005-2006.

Section 15-1-402, MCA, provides that property taxes paid under protest must be deposited in a designated protest fund. Property taxes levied by the state against centrally assessed property under 15-23-101, MCA, must be remitted by the county treasurer to the Department of Revenue for deposit in various funds. Refunds are paid from these funds.

ONGOING MATTERS

Omimex's property tax protest is settled for tax years 2004 and 2005. However, the company has disputed the valuation of its property for tax years 2006 through 2008. The Department of Revenue has centrally assessed (using the unitary valuation method) Omimex's property since tax year 2004. Omimex has challenged the Department of Revenue's authority to centrally assess its class eight property. Omimex has protested 81%, 82%, and 84% of its property taxes for tax years 2006, 2007, and 2008, respectively.

On October 20, 2009, the State Tax Appeal Board issued an order stating that class eight property may be centrally assessed.⁷ The order also stated that the board will determine whether Omimex's property is properly centrally assessed. The Board will conduct a hearing related to the matter December 14-17, 2009. Refunds of Omimex's protested property taxes for tax years 2006 through 2008 will be delayed until the valuation method dispute is resolved. According to a spreadsheet prepared by the Department of Revenue, the total amount of Omimex's protested taxes for those tax years is \$3.1 million, exclusive of interest. The state's share of the protested amount is \$668,578 and the local share is \$2.47 million.

SENATE BILL NO. 489

The effect of the Supreme Court decision was not confined to Omimex, but would apply to other natural gas pipelines that did not have a major natural gas distribution system in the state.⁸ In a memo last interim to the Revenue and Transportation Interim Committee analyzing the decision, Lee Heiman noted that the "decision may have serious financial consequences . . . if it is applied to similar properties."⁹ Heiman also said that because the decision was based on statutory construction and not on constitutional principles, the Legislature could revise how this property is taxed.

Senate Bill No. 489 (Chapter 487, Laws 2009), introduced by Sen. Jeff Essmann, dealt with the Supreme Court Omimex decision by revising the laws related the taxation of oil and natural gas pipelines. The legislation:

- clarified that regulated natural gas and oil pipelines and common carrier pipelines are taxed as class nine property under 15-6-141, MCA; and
- clarified oil and gas production property, including flow lines and gathering lines, is taxed as class eight property under 15-6-138, MCA.

⁷Omimex Canada, Ltd., v. Montana Department of Revenue, Docket No.: CT-200606.

⁸The pipeline companies that would have been affected by the Supreme Court decision included Energy West Development, Colorado Interstate Pipeline, Havre Pipeline, Northern Border Pipeline, Omimex Pipeline, Liscom Creek Pipeline, Devon Energy Production Company, and Fidelity Exploration.

⁹Memo from Lee Heiman, Legislative Services Division Attorney, to members of the Revenue and Transportation Interim Committee, "Omimex Supreme Court Decision", December 15, 2008, p. 3. The memo is available on the Revenue and Transportation Interim Committee webpage at http://leg.mt.gov/css/Committees/Interim/2007_2008/rev_trans/default.asp under "Publications".

The legislation specifically included flow lines and gathering lines in the description of oil and gas production equipment in 15-6-138(1)(c)(iii). Flow lines and gathering lines are defined as "pipelines used to transport all or part of the oil or gas production from an oil or gas well to an interconnection with a common carrier pipeline as defined in 69-13-101, a pipeline carrier as defined in 49 U.S.C. 15102(2), or a rate-regulated natural gas transmission or oil transmission pipeline regulated by the public service commission or the federal energy regulatory commission." (See 15-6-138(2)(c), MCA.)

Under the provisions of the legislation, natural gas gathering lines do not include gas gathering facilities of a stand-alone gas gathering company providing gas gathering services to third parties on a contractual basis, owning more than 500 miles of gas gathering lines in Montana, and centrally assessed in tax years prior to 2009. This property is considered natural gas transmission pipeline property subject to central assessment under 15-23-101, MCA (see 15-6-138(5), MCA).

The legislation also revised the description of centrally assessed property under 15-6-141(1)(b), MCA, by removing the phrase "companies having a major distribution system in this state" and inserting the following italicized language:

allocations for centrally assessed natural gas distribution utilities, rate-regulated natural gas transmission or oil transmission pipelines regulated by either the public service commission or the federal energy regulatory commission, a common carrier pipeline as defined in 69-13-101, a pipeline carrier as defined in 49 U.S.C. 15102(2), or the gas gathering facilities specified in 15-6-138(5).

Finally, the legislation revised the description of the companies subject to central assessment under 15-23-101, MCA, to correspond with the description of natural gas property classified under 15-6-141, MCA.

Two companies have been reclassified from class nine property to class eight property as a result of the legislation.

Liscom Creek Station is a small natural gas company that operates in Powder River and Custer Counties. In tax year 2008, the total market value of property owned by Liscom was \$199,000 (\$168,619 in Custer County and \$30,381 in Powder River County) and taxable value was \$23,880 (\$20,234 in Custer County and \$3,646 in Powder River County). In tax year 2009, its total market value was \$176,000 (\$149,133 in Custer County and \$26,867 in Powder River County) and its taxable value was \$5,280 (\$4,474 in Custer County and \$806 in Powder River County).

Fidelity Exploration and Production Company is a direct wholly owned subsidiary of WBI Holdings, Inc.; it is an MDU Resources Group, Inc., company, operating in several states. In Montana, Fidelity owns property in Big Horn, Carbon, Dawson, Fallon, Phillips, and Valley Counties.

In tax year 2008, the total statewide market value of Fidelity's property in Montana was \$49,417,793 with a taxable value of \$5,930,134. Most of its property is in Big Horn County (\$23,271,775 market value and \$2,792,613 taxable value) and Fallon County (\$22,741,684 market value and \$2,729,001 taxable value).

In tax year 2009, Fidelity's total statewide market value is \$43,076,201 (\$20,285,400 in Big Horn County and \$19,823,333 in Fallon County) and its total taxable value is \$1,292,286 (\$608,562 in Big Horn County and \$594,700 in Fallon County).

From tax year 2005 to tax year 2008, the taxable value of Fidelity's property increased from \$84,320 to \$357,207 in Phillips County. In tax year 2009, the taxable value of Fidelity's property in the county is \$77,842.

In June 2009, the Montana Department of Revenue informed Omimex that the Department had classified Omimex's property as class nine property and had valued the property as centrally assessed, or unit valued, property.¹⁰ The reason for the classification is that third-party gas "is transported through Omimex pipelines . . .". Section 15-6-141(1)(b) includes in the description of class nine property "**a common carrier pipeline as defined in 69-13-101, a pipeline carrier as defined in 49 U.S.C. 15102(2), or the gas gathering facilities specified in 15-6-138(5).**" (emphasis added by the Department of Revenue)

Attached to this report is a spreadsheet prepared by the Montana Department of Revenue that shows tax years 2008 and 2009 classification and the statewide market value and taxable value of oil and natural gas pipelines operating in Montana.

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¹⁰Memo from Lee Baerlocher, Bureau Chief, Montana Department of Revenue, to Clark P. Storms, Omimex Canada, Ltd., June 16, 2009.