# Legislative Analysis

Phone: (517) 373-8080
http://www.house.mi.gov/hfa

Analysis available at
http://www.legislature.mi.gov

**QUALIFYING EXPENSES RELATED TO OIL AND GAS PRODUCTION**

**House Bill 6485 as enrolled**
**Sponsor: Rep. Triston Cole**
**House Committee: Commerce and Trade**
**Senate Committee: Finance**
**Complete to 2-4-19**

***(Vetoed by the Governor 12-28-18)***

**SUMMARY:**

House Bill 6485 would amend the Income Tax Act to exclude certain costs and allowances related to oil and gas production from exemption from certain categories of taxable income and from the corporate income tax. The bill would expand the deduction related to oil and gas production that was eliminated in Public Act 38 of 2011.[1]

The bill states that is intended to clarify the original intent of the legislature for expenses related to oil and gas, and is accordingly retroactive and effective for all tax years beginning after December 31, 2011. (Retroactivity would also apply to the sections amended by the Senate substitute, as described below).

Allowable deductions for the following three categories would be clarified under the bill:

- Taxable income for a person other than a corporation, estate, or trust.
- Taxable income for a resident estate or trust.
- Corporate income tax on every taxpayer with business activities in Michigan or ownership interest or beneficial interest in permitted flow-through entities with business activities in Michigan.

For each of those categories, the bill would provide that, for the purposes of determining which expenses are not allowed as deductions, "expenses of producing oil and gas" would <u>not</u> include any of the following:

- Costs incurred to purchase, lease, or otherwise acquire an oil and gas property, whether proved or unproved.
- Costs incurred for exploration of an oil and gas property, whether producing or nonproducing.
- Costs incurred for processing, transportation, or marketing of the oil and gas that has been produced from an oil and gas property.
- Costs incurred for plugging and abandonment of an oil and gas property.
- Allowances for depletion that do not reduce the adjusted basis of the oil and gas property.

[1] House Fiscal Agency analysis of PA 38 of 2011 (HB 4361) http://www.legislature.mi.gov/documents/2011-2012/billanalysis/House/pdf/2011-HLA-4361-6.pdf

As passed by the Senate (and concurred in and enrolled by the House), the bill would also include the following adjustments:

- Allowing an additional deduction under the First-Time Home Buyer Savings Program introduced in Senate Bills 511 and 512.[2] Those bills passed both houses, but were vetoed by the governor on December 21, 2018.
- Allowing a deduction, to the extent included in adjusted gross income, of the compensation received under the Wrongful Imprisonment Compensation Act.[3]
- Accounting for PA 589 of 2018 (HB 4522), which allowed a taxpayer to claim an exemption for a stillbirth occurring in that tax year.[4]
- Adjusting the allowable deduction for retirement income for a surviving spouse.

MCL 206.30, 206.36, and 206.523

**BRIEF DISCUSSION:**

There was considerable disagreement in the House committee as to the effect of the bill. Proponents argued that the recent Revenue Administrative Bulletin (RAB)[5] issued by the Department of Treasury would sharply limit the costs that could be deducted under the severance tax, and that the bill is intended to clarify what would and would not fall under the deduction. They stated that the deduction was formed as part of a compromise, and that the resulting provisions of Public Act 38 of 2011 were designed to protect court decisions[6] allowing the deductions. As indicated in the bill language, they held that the bill clarifies the original intent of the language as enacted in 2011.

Opponents replied that the legislature's changes to the Income Tax Act in 2011 were intentionally made to prevent "double dipping" by oil and gas companies—that is, taking a double deduction for production costs. They argued that if those costs are deducted at the federal level, they should be added back in at the state level. Further, they questioned what the tax policy basis would be for allowing deductions for the same costs at both the federal and state levels.

**FISCAL IMPACT:**

As written, the bill would reduce income tax revenue by a projected $4.0 million to $5.0 million per year. Because the bill is retroactive back to tax year 2012, there would be an additional one-time revenue loss of approximately $10.0 million in the first tax year after the changes took effect.

---

[2] House Fiscal Agency analysis of SBs 511 and 512: http://www.legislature.mi.gov/documents/2017-2018/billanalysis/House/pdf/2017-HLA-0511-04AF4B1B.pdf

[3] House Fiscal Agency analysis of PA 343 of 2016 (SB 291): http://www.legislature.mi.gov/documents/2015-2016/billanalysis/House/pdf/2015-HLA-5815-8F5DDF42.pdf

[4] House Fiscal Agency analysis of PA 589 of 2018 (HB 4522): http://www.legislature.mi.gov/documents/2017-2018/billanalysis/House/pdf/2017-HLA-4522-FC490394.pdf

[5] https://www.michigan.gov/documents/treasury/RAB_2018-8_-_Oil_and_Gas_620525_7.pdf

[6] *Bauer v Dep't of Treasury*, 203 Mich App 97 (1993) and *Elenbaas v Dep't of Treasury*, 231 Mich App 801 (1998)

***Vetoed 12-28-18:***

In his veto message, Governor Snyder wrote that the tax reforms he worked on with the legislature in 2011 "sought to eliminate tax deductions or loopholes that resulted in unfair benefit for some taxpayers. This bill would run contrary to that objective."

Further, he wrote that because the bill would narrow the expenses required to be added back after they had been deducted at the federal level, it would "result in some expenses being deducted twice at the state level."

Legislative Analyst: Jenny McInerney
Fiscal Analyst: Jim Stansell

■ This analysis was prepared by nonpartisan House Fiscal Agency staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.