Excise Tax Division
North Carolina Department of Revenue
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IMPORTANT NOTICE: TAX ON SEVERANCE OF ENERGY MINERALS EFFECTIVE JULY 1, 2015

This notice includes law changes enacted in Session Law 2014-4 by the 2013-2014 of the General Assembly on the severance of energy minerals as it relates to its taxation administered by the Excise Tax Division.

An excise tax is levied on the privilege of engaging in the severance of energy minerals from the soil or water of this State. The purpose of the tax is to provide revenue to administer and enforce the provisions of Chapter 105, Article 5I of the North Carolina General Statutes, to administer the State's natural gas and oil reclamation regulatory program, to meet the environmental and resource management needs of this State, and to reclaim land affected by exploration for, drilling for, and production of natural gas and oil. The severance tax is imposed upon all energy minerals severed when sold.

Part I reflects information regarding the Taxation and On-Site Use Exemption. Part II includes information for Return Requirements, as well as those for a Bond or Irrevocable Letter of Credit.

PART I: TAXATION AND ON-SITE USE EXEMPTION

Effective July 1, 2015

Severance Tax – N.C. Gen. Stat. § 105-187.77(c), (d), and (e) impose an excise tax upon all energy minerals severed when sold. The amount of severance tax is calculated using the applicable percentage rates as follows:

- Oil – Two percent (2%) of the gross price paid (N.C.G.S 105-187.77(c)).
- Condensates – Two percent (2%) of the gross price paid (N.C.G.S 105-187.77(c)).
- Gas – Nine-tenths of one percent (0.9%) of the market value (N.C.G.S 105-187.77(e)) as determined in N.C. Gen. Stat. § 105-187.78.

NOTE: "Marginal Gas Rate" – N.C. Gen. Stat. § 105-187.77(d) states the producer of a proposed or existing gas well may apply to the Mining and Energy Commission for a determination that the well qualifies as a marginal gas well. The producer may elect to have the gas taxed at the marginal gas rate or the gas rate. For severance of gas from a marginal gas well, the percentage rate is four-tenths of one percent (0.4%).

N.C. Gen. Stat. § 105-187.76(8) defines “Marginal Gas Well” as a well incapable of producing more than 100 MCF (one thousand cubic feet of natural gas) per day, as determined by the Mining and Energy Commission using the current wellhead deliverability rate methodology utilized by the Commission, during the calendar month for which the severance tax report is filed.

N.C. Gen. Stat. § 105-187.78(a) defines the market value of natural gas as the total gross cash receipts from the sale of the natural gas adjusted by subtracting the producer’s actual costs to deliver the gas to the market.

In order to be eligible to subtract the actual costs to deliver the gas to the market, the producer shall maintain any records the Secretary considers necessary to determine and verify the amount of the costs to deliver the gas to the market the producer is eligible to subtract. The burden of proving eligibility for subtracting the costs to deliver the gas to the market and the amount of the costs to deliver the gas to the market to be subtracted shall rest upon the producer, and no subtraction of costs shall be allowed to a producer that fails to maintain adequate records or to make them available for inspection (N.C.G.S 105-187.78(b)).

N.C. Gen. Stat. § 105-187.78(c) defines "Costs to deliver the gas to the market" as the actual and reasonable costs incurred by the producer to get the gas from the mouth of the well to the first purchaser, except costs incurred in normal lease separation of the oil or condensate from the gas, and costs associated with insurance premiums on a facility used to deliver the gas to market. Costs to deliver the gas to the market include ONLY the following:

(1) Costs for compressing the gas sold.
(2) Costs for dehydrating the gas sold.
(3) Costs for sweetening and treating the gas sold.
(4) Costs for delivering the gas to the purchaser.
(5) Reasonable charges for depreciation of the facility used to deliver the gas to market being used, provided that, if the facility is rented, the actual rental fee is added.
(6) Costs of direct or allocated labor associated with the facility used to deliver the gas to market.
(7) Costs of materials, supplies, maintenance, repairs, and fuel associated with the facility used to deliver the gas to market.
(8) Property taxes paid on the facility used to deliver the gas to market.
(9) Charges for fees paid by the producer to any provider of dehydration, treating, compression, and delivery services.

On-Site Use Exemption – N.C. Gen. Stat. § 105-187.79 gives an exemption for on-site use of energy minerals. The exemption is given for the use of energy minerals that are severed from the land or water, owned legally or beneficially by the producer, and used on the land from which they are taken by the producer as part of the improvement of or use in the producer's homestead. This exemption amount is limited to a cumulative yearly delivered to market value maximum of one thousand two hundred dollars ($1,200). When severed energy minerals so used exceed a cumulative delivered to market value of one thousand two hundred dollars ($1,200) during any year, the further severance of energy minerals shall be subject to the severance tax.

For additional information regarding the taxation of severance minerals, as well as the on-site use exemption, see the Department's website, www.dornc.com/taxes/excise/index.html.

PART II: RETURN REQUIREMENTS AND BOND OR IRREVOCABLE LETTER OF CREDIT

Return Requirements – N.C. Gen. Stat. § 105-187.80 sets out that a return is due quarterly or monthly and must be filed by the producer of the energy minerals. A producer of energy minerals shall pay the tax for all owners of the energy minerals.

> Quarterly Filing - A taxpayer who is consistently liable for less than one thousand dollars($1,000) a month in severance taxes must file a return and pay the taxes due on a quarterly basis. A quarterly return covers a calendar quarter and is due by the 25th day of the second month following the end of the quarter.
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> Monthly Filing - A taxpayer who is consistently liable for at least one thousand dollars ($1,000) a month in severance taxes must file a return and pay the taxes due on a monthly basis. A monthly return is due by the 25th day of the second month following the calendar month covered by the return.

The tax is the primary liability of the producer, except as provided in this section. A first purchaser may not take delivery of energy minerals from a producer unless the producer furnishes the purchaser with a taxpayer identification number assigned by the Secretary. A first purchaser failing to secure the producer's taxpayer number, either from the producer or the Secretary, will be liable for any tax, penalty, and interest due on the energy minerals purchased from the producer (N.C.G.S 105-187.82).

The amount of tax due and any other information required by the Secretary must be included on the return. The return must contain the following information concerning energy minerals produced during the month being reported:

(1) The gross amount of energy minerals produced that are subject to the tax imposed by this Article.
(2) The leases from which the energy minerals were produced.
(3) The names and addresses of the first purchasers of the energy minerals.
(4) To claim an exemption for on-site use, the producer or taxpayer of a proposed or existing gas well shall apply to the Secretary for determination of eligibility. The Secretary may require an applicant to provide any information required to administer this provision. The Secretary shall make the determination within 15 calendar days of the receipt of all information

required, and the producer or taxpayer shall attach the determination of eligibility to its severance tax form next due, as applicable.

(5) Commission Determination. - To claim the marginal gas rate, the producer or taxpayer of a proposed or existing gas well shall provide to the Secretary proof that the Mining and Energy Commission has determined the well qualifies as a marginal gas well.

Bond or Irrevocable Letter of Credit – N.C. Gen. Stat. § 105-187.81 sets out that the Secretary requires a producer to furnish a bond or irrevocable letter of credit if the producer fails to file a required return. A bond or an irrevocable letter of credit must be conditioned on compliance with the requirements of this Article, payable to the State, and be in the form required by the Secretary. The bond or irrevocable letter of credit amount is two times the applicant's average expected monthly tax liability under this Article, as determined by the Secretary. When notified to do so by the Secretary, a person who is required to file a bond or an irrevocable letter of credit must file it within 30 days after receiving the notification.

For additional information regarding the return requirements, bond, or irrevocable letter of credit, see the Department's website, www.dornc.com/taxes/excise/index.html.

If you have questions about the information in this document or about excise tax, please contact the Department either toll free at 1-877-308-9092 or local at (919) 707-7500. If a written response would require the Department to interpret the law in a manner not specifically addressed in a statute, regulation, or Departmental or IRS publication, the person requesting the written response must follow the procedure (and pay the required fee) for requesting a private letter ruling available on the Department's website at the following address: www.dornc.com/practitioner/plr_policy.pdf.