

Proponent Testimony of David R. Hill

House Bill 430

Before the Senate Ways and Means Committee

March 21, 2018

Chairman Eklund, Vice Chairman Terhar, Ranking Member Williams and members of the Senate Ways and Means Committee, thank you for the opportunity to offer proponent testimony in support of House Bill 430.

My name is David Hill and I am a Petroleum Geologist and registered oil and gas producer located in Guernsey County, Ohio. I am the immediate Past President of the Ohio Oil and Gas Association. Before that, I was Chairman of the Ohio Oil and Gas Energy Education Program. I am a second generation oil man.

After graduating from Muskingum College in 1980 with a degree in Geology, I immediately registered with the Ohio Department of Natural Resources as an oil and gas producer. By the fall of 1980, I had identified a drilling prospect, raised the necessary capital, and was drilling my first well in Coshocton County, Ohio.

I have drilled hundreds of vertical oil and gas wells in my 38 year career as an oil and gas producer. In 2008, my company, David R. Hill, Inc. drilled more wells than any other company in Ohio. We drilled 55 wells that year. The wells I have drilled range from depths of 400 feet deep in Perry County to the deepest well in the state, located in Belmont County. That well near St. Clairsville, Ohio reached a total depth of 13,727 feet. To this date, it holds the record as the deepest vertical well in Ohio.

In December, 2015, I received a letter from the Ohio Department of Taxation informing me that my company was going to undergo a sales tax audit on its purchases. As you know, since the sales tax law was created, tangible personal property purchased and used to explore for and produce crude oil and natural gas are exempt from sales tax. ORC 5739.02(B)(42)(a). You probably also know that for decades tangible personal property purchased to develop facilities that by law are required to control water pollution from industry are also exempt from sales tax. ORC 5709.19. Everybody knows this. Taxpayers, tax collectors - this is the law that everyone has operated under for decades.

Three people in my office spent over a week compiling the data and purchase documents for the audit. On February 8, 2016, two auditors arrived at my office and spent the next six business days going through my files. Again in May, two auditors spent two more days in my office. They conducted an audit on twenty one of my drilled oil and gas wells and two of my class II brine injection wells.

It was quite obvious from the onset that the auditors were going to take a different position on many issues and deviate from how things have been treated historically for tax purposes. During this time I engaged Tony Ehler with the law firm of Vorys, Sater, Seymour, and Pease LLP.

After the auditors had presented their preliminary assessment, Tony Ehler, his associate, and myself met with the field auditors and presented our reasoning as to why many of the items they were trying to assess sales tax on should be exempt.

In preparation for this meeting I had taken several pictures of one complete production facility and then discussed each piece of equipment and its functionality. This particular production well was one of the wells under audit. The auditors listened to our presentation but ultimately did not change their mind, agree with our reasoning, or adjust my preliminary assessment.

Not only were auditors now expanding sales tax to include more items (e.g., real property and services), but traditional tax exemptions were not being honored. First, a bit of history on the most important exemption for my class II injection wells -the pollution control exemption.

One of the first pieces of legislation I worked on earlier in my career was House Bill 501 in 1985.

Prior to 1985, oil and gas operators could store their brine water (drilling byproduct) in open earthen pits. House Bill 501 changed the law so that oilfield brine had to be disposed of down class II injection wells.

In Ohio, things or devices that prevent or hold industrial water pollution are granted a sales tax exemption. The fact that the only approved method of oilfield brine water disposal is down class II injection wells seems to me as proof positive that class II brine injection wells are designed to prevent pollution to human health, safety and the environment - including protecting Ohio drinking water. In the 1990's, under two different governors and two different tax commissioners, the Ohio Department of Taxation granted sales tax exemption waivers for disposal wells under the pollution control exemption. The rationale was that these wells were devices that prevented pollution into the waters of Ohio.

The Ohio Department of Taxation does not have qualified engineers that can evaluate and determine this type of tax exemption application on their own. So, they turned to the Ohio EPA for the technical advice to make the determination that class II injection wells qualify for the pollution control exemption. And, historically Ohio EPA granted or approved such applications.

Now fast forward to 2016, my company claimed that my class II injection wells were exempt for sales tax because they were pollution control devices. The Ohio Department of Taxation took a different stance. They turned to the Ohio EPA and asked if these were indeed pollution control devices under the

exemption. Ultimately, the Ohio EPA would not render a decision because they said they didn't issue the permit to drill and operate for the class II injection well (ODNR issued the permit). Importantly, ODNR had also issued such permits in previous decades when pollution control tax exemptions were granted. Since no decision was issued on the pollution control device exemption, the Ohio Department of Taxation took the new stance that things associated with my class II injection wells should now be subject to sales tax.

In the 1990s the Ohio EPA could say that class II injection wells prevent industrial pollution. Now they refuse to offer an opinion and I have nowhere else to turn.

As you have heard already, and as I'm sure you will hear from others, the Ohio Department of Taxation is expanding its positions on the ability to assess items. Those positions are completely contrary to how these items had been traditionally treated by Ohio law and in our industry practice.

To put this into context, this "change" all was happening silently, without notice, during a period when the oil and gas industry was suffering one of the worst economic downturns in my 38 year career.

To date, David R. Hill, Inc. has spent \$80,277.10 just in attorney bills to defend myself from this governmental overreach and agency efforts to supersede the rule of law. My three separate tax assessment cases are in varying stages of the tax appeals process. So, my attorney bills will only go up.

Ladies and gentlemen of this Committee, I have three tax assessments from the Ohio Department of Taxation currently on my desk. One is for the assessment of the twenty one producing oil and gas wells I have drilled over the last six years. The other two are for each of the two Class II Injection Wells.

The assessment for the twenty one producing wells totals \$215,627.44. For the Class II brine injection wells, the assessments total nearly \$180,000.

As a taxpayer I hope you can understand and appreciate my frustration in this whole process.

Please understand that if left unchecked the Ohio Department of Taxation will have changed their interpretation of what can and cannot be assessed in the middle of the night without notice, without a corresponding change or edit in statute and then audit all of my transactions by reaching back six years into my life.

I have asked everyone that I have come in contact with on this issue where was David R. Hill, Inc. supposed to go to know that the Ohio Department of Taxation changed the tax exemption rules and then without notice do a six year look back. I can find no prior evidence or announcement that the Ohio Department of Taxation changed their mind or position.

Many of you on this Committee don't know me, but if you inquire you would find that my company has a stellar reputation in the business community throughout Ohio. We pay our bills and we pay our taxes.

I have a excellent reputation as an oil and gas producer at the Ohio Department of Natural Resources.

I'm here to ask for your help. If you can't help me with this administrative tax overreach, my little company located in Byesville, Ohio will owe the Ohio Department of Taxation nearly \$400,000 in additional tax based on the Department's unannounced position shifts. My company - like others being audited - can't take such a financial hit.

Thank you Chairman Eklund and members of the Committee, for allowing me to speak today on House Bill 430. The sooner you consider House Bill 430 and clarify the traditional way the Ohio Department of Taxation applies sales tax on oil and gas production, the sooner that my company and others in the oil and gas industry can rest easy from worrying about unforeseen and shocking audits results.

What I, my company, and my employees have been put through simply isn't fair. Unfortunately, my story is not unlike others currently being audited in the Ohio oil and gas industry. What I and my colleagues have endured for the past 2 1/2 years has been nothing short of taxpayer abuse. We should not be expected to endure the Department's retroactive reinterpretations of the law. I ask you, the members of this Committee, to please bring back clarity, bring back precedent and pass House Bill 430 before businesses like mine are closed and Ohio jobs are lost - all because the Tax Department changed its mind when applying tax law to this industry.