Testimony For The Record Of the National Association of Royalty Owners, Inc. (NARO)
before the
Senate Committee on Finance
Climate Challenges:
The Tax Code's Role in Creating American Jobs, Achieving Energy Independence, and Providing Consumers with Affordable, Clean Energy
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My name is Jack Fleet, executive director of NARO. I appreciate the opportunity to provide testimony to the committee on this important topic.

This testimony is being provided to present NARO's concerns about legislation which has been proposed in Congress and would remove Percentage Depletion Allowance for oil and gas production. This action will be harmful to millions of middle-income American royalty owners and result in the loss of royalty payments, many of who are retirees living on fixed incomes.

NARO shares concerns of the domestic energy community, in particular oil and natural gas, in the treatment of US government policy regarding stimulation of domestic energy production. To that end, my testimony is focused on the significant negative impact to royalty owners through the modification of removing Percentage Depletion Allowance from our Federal Tax Code. Percentage Depletion Allowance is the only tax deduction that royalty owner takes on their royalty income.

Who is NARO?

The National Association of Royalty Owners is a volunteer led, member based, 501(c)6 and represents the concerns of an estimated 12.6 million royalty owners. Our mission is to support, advocate and educate for the empowerment of mineral and royalty owners. We were founded by Jim Stafford in 1980 to address the concern of Windfall Profit Tax on royalty owners. We have members in all 50 states.

The average NARO member is over 60 years old, widowed and receives less than $500 a month in royalties, which supplements their social security income.

Owners of producing mineral interest (royalty owners) are entitled to their proportionate share of production paid by royalty revenue. NARO hold to the claim the royalty owner's right of equity and fair play in accordance with lease contracts and law. To that end, royalty owners have the right to be heard in matters regarding oil and gas energy policy, proposed legislation or regulatory issues that would positively or adversely affect their interest.

NARO represents many royalty owners who do not have the wealth, time or resources of larger oil and gas or mineral companies and as a result, have a limited ability to make an impact and inform legislators of their concerns.

How many royalty owners are there?

Royalty owners come from all walks of life: ranchers, farmers, barbers, teachers, pharmacist, homemakers, factory workers, carpenters, retirees, widowers and just about every trade or profession in the United States. Our members are your constituents, they are diversified politically and belong to all political parties. Many of them, no doubt, voted for members of this committee and depend on you to represent them.

In 2013, NARO gave testimony to the United States House of Representatives Committee on Ways and Means and estimated nationally there were 8,440,755 royalty owners. Today, that number has grown to an estimated 12,600,000. The number of royalty owners is increasing due to fractionalization of mineral estates from generation to generation. Additionally, there is an increase in citizens buy minerals and royalties for the first time.

Today, we estimate the number of royalty owners in each state to be:

AK	20,400	AL	49,725	AR	382,500	AZ	216,750	CA	765,000
CO	981,750	CT	25,500	DC	25,500	DE	3,825	FL	242,250
GA	127,500	HI	12,495	IA	49,725	ID	53,550	IL	114,750
IN	40,800	KS	221,850	KY	16,575	LA	188,700	MA	45,900
MD	53,500	ME	8,288	MI	66,300	MN	71,400	MO	165,750
MS	58,650	MT	71,400	NC	100,725	ND	36,975	NE	29,325
NH	20,400	NJ	71,400	NM	242,250	NV	66,300	NY	191,250
OH	45,900	OK	2,537,250	OR	76,500	PA	18,500	RI	8,288
SC	33,150	SD	8,288	TN	89,250	TX	4,462,500	UT	58,650
WY	45,900								

These estimates are only those that are currently receiving royalties on producing mineral estates. However, there are many more mineral owners in all states that are not receiving royalties.

Percentage Depletion Allowance:

This tax allowance is not specific to the oil and natural gas Industry. In fact, many natural resource industries are allowed to take depletion allowance, such as Sulphur, Uranium, other rare earth minerals, ores, industrial grade crystals, gold, silver, copper, timber and coal to name a few. It should also be noted that small oil and gas operations that take advantage of percentage depletion allowance are capped at 15 barrels of oil per day per well. Many of these small operators produce 1-5 barrels of oil a day and have 11 employees on average.

Percentage Depletion is Not Cost Depletion:

Depletion represents the decreasing values of a limited reservoir of a non-renewable resource. Just as an assets value depreciates over time and thus the tax liability on that value changes accordingly. The non-renewable resource is diminished over time and the value of that resource depreciates.

Most large companies use cost depletion to calculate the cost/expense involved in extracting or mining of the natural resource and the reserve that remains after the extraction. The alternative to this complicated method is Percentage Depletion Allowance, which is much simpler to apply, especially for the average royalty owner.

The Percentage Depletion Allowance for oil and natural gas is 15%. The flat percentage makes calculating this allowance easy and has limits to benefit the middle-income American royalty owner and has nothing to do with large companies. While Cost Depletion is very costly, complicated and, in most cases, impossible for the small royalty owner to determine. Contracts between the mineral or royalty owner and the operator do not provide for the details necessary for Cost Depletion to be determined.

The proposal to eliminate Percentage Depletion Allowance would not eliminate a "subsidy" to "Big Oil" but would hurt the small royalty owner, most assuredly constituents of the members of this committee. Subsidy is defined as a direct cash payment by the government to a person or business. While leaving Cost Depletion which the large oil and natural gas companies use untouched. Further, people that buy minerals, such as one family member who buys out another family member's interest, likely relied on the continued existence of percentage depletion in agreeing on the price.

Removing Percentage Depletion Allowance would also result in a tax increase for many royalty owners who make less than $400,000 per year. As mentioned earlier, the average NARO member's royalty income is $500 per month and supplements their social security and retirement income. Removing their Percentage Depletion Allowance would raise their annual taxable income and increase their tax burden., counter to President Biden's commitment to protect incomes of those below $400,000 a year.

NARO stands strongly behind keeping Percentage Depletion Allowance and opposes efforts to eliminate it. Removing this allowance will put an added financial burden on the citizens that own these natural resources and hurt those that use their royalty income to supplement their social security and retirement. All of this, just as the economy and our citizens are starting to recover from the COVID pandemic.

<u>Conclusion:</u>

I would like to conclude with an example of the impact royalty income means to a NARO member, Ms. Mosley of North Carolina with mineral and royalty interest in West Virginia.

"The royalty money supplements my small social security allowing me freedom from fear of poverty. And it allows me to donate to charities, including in the county where my minerals are (different from my residence). My cataract surgery with special replacement lenses was possible with the royalty money. President Biden has said that he will not raise taxes on incomes under $400,000. Well, mine is quite a lot less than that, and removal of the depletion deduction would certainly raise my taxes!"

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i "The Need for Percentage Depletion Allowance for Mineral/Royalty Owners: How Tax Policy Can Simultaneously Affect the Equitable Treatment of Royalty Owner, and National Security" by NARO 2013