RURAL MUNICIPALITIES of ALBERTA

March 2023

UNPAID OIL & GAS TAX SURVEY SUMMARY

In early 2023, the RMA requested that all members complete a survey providing an update on their unpaid oil and gas tax burden as of December 31, 2022. The survey builds on previous member input on this issue from 2022, 2021, 2020, and 2019.

This briefing provides an overview of survey results, and what these trends mean for rural municipalities using the most up to date data provided by all RMA members. The data collected is accurate as of December 31, 2022.

Survey Response Rate

All of the RMA's 69 member municipalities responded to the survey. This **100% response rate** speaks to the importance of this issue across the province and the accuracy of the final data collected.

Survey Results

- Rural municipalities are currently facing an overall unpaid oil and gas property tax burden of **$268.5 million**.
- This represents a **6.1% increase** from the overall amount in the RMA's 2022 member survey, a **9.6% increase** from the RMA's 2021 member survey, a **55.2% increase** from the RMA's 2020 member survey, and a **231.5% increase** from the RMA's 2019 member survey.
- The average RMA member is facing an unpaid tax burden of **$3,891,285** from the oil and gas industry.
- Seven municipalities have unpaid tax burdens **above $10** million from the oil and gas industry.
- Two municipalities have no unpaid tax burden from the oil and gas industry, and an additional seven municipalities have an unpaid tax burden **below $100,000**.
- Municipalities have written off nearly **$132 million in unpaid taxes** since 2015**.** This means that municipalities consider these taxes uncollectible, and they will never recover this lost revenue.
- Still-operating companies are responsible for **41% of unpaid taxes** from the oil and gas industry.
- RMA members have tax repayment agreements in place with industry for an **additional $45 million in unpaid taxes.** This amount **is not** reflected in the $268.5 million overall unpaid property tax burden.

Key Analysis

- The problem is **getting worse**: 2022 saw the highest single year rate of current unpaid taxes.
- The problem is **province-wide**: Every RMA district is facing at least $21 million in unpaid taxes.
- The problem is **driven by choice, not desperation**: As the oil and gas industry booms and new well drilling rates skyrocket, some companies continue to ignore their tax responsibilities and government continues to ignore enforcement options.
- The problem is **solvable**: 41% of unpaid taxes are owed by companies that continue to operate and simply choose not to pay taxes. Government could take action to compel these companies to pay taxes but has chosen not to do so.

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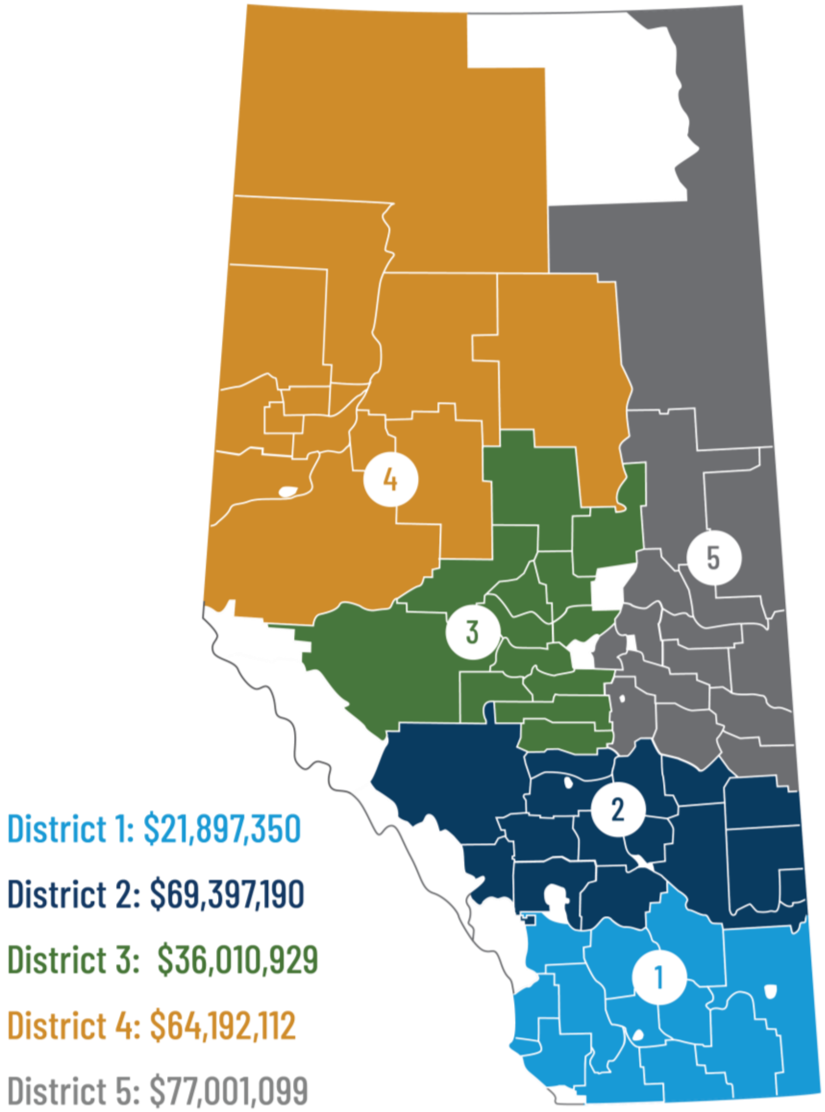
Unpaid Oil and Gas Property Taxes by District

Unlike some issues, which only impact municipalities in some regions of the province, the issue of unpaid taxes from the oil and gas industry is truly provincewide, as shown below:

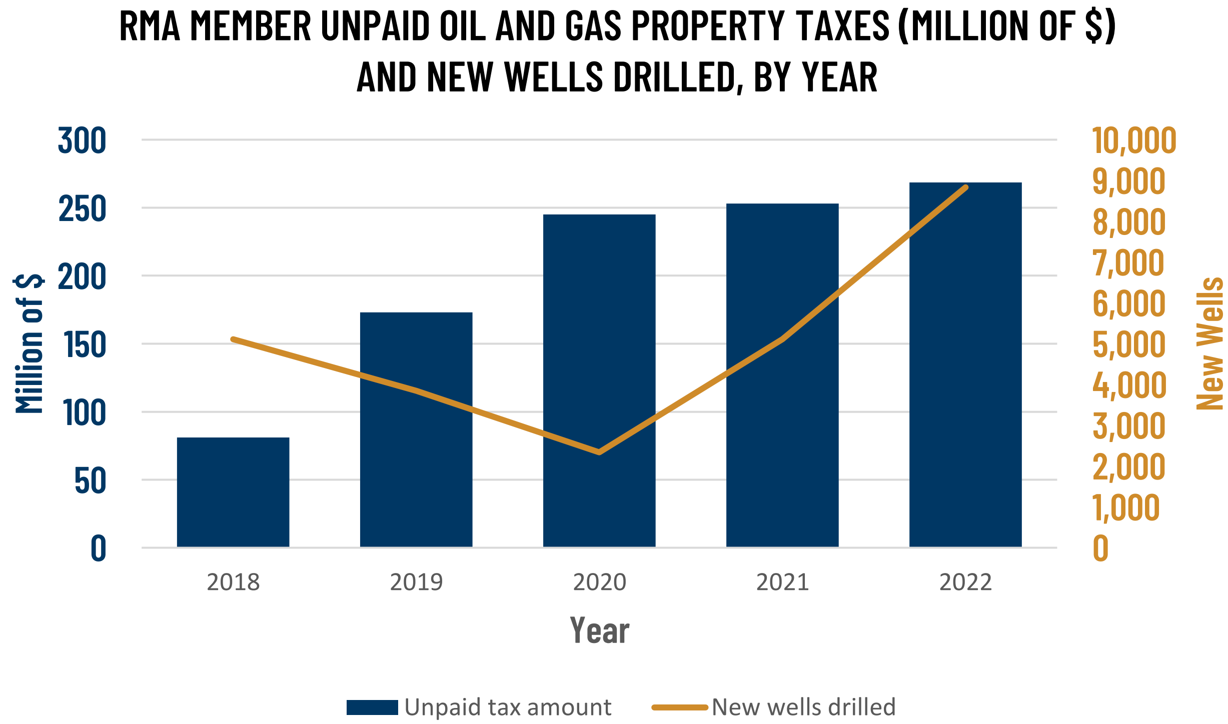


Unpaid Oil and Gas Property Taxes by the Numbers

While the overall amount of $268.5 million in outstanding oil and gas property taxes is alarming on its own, digging into the survey data is even more compelling. The data below tells some other important stories about this ongoing crisis for rural municipalities and the lack of effort on the part of industry and the Government of Alberta to address it.

As the industry continues to experience a boom period, the tax payment problem is ignored

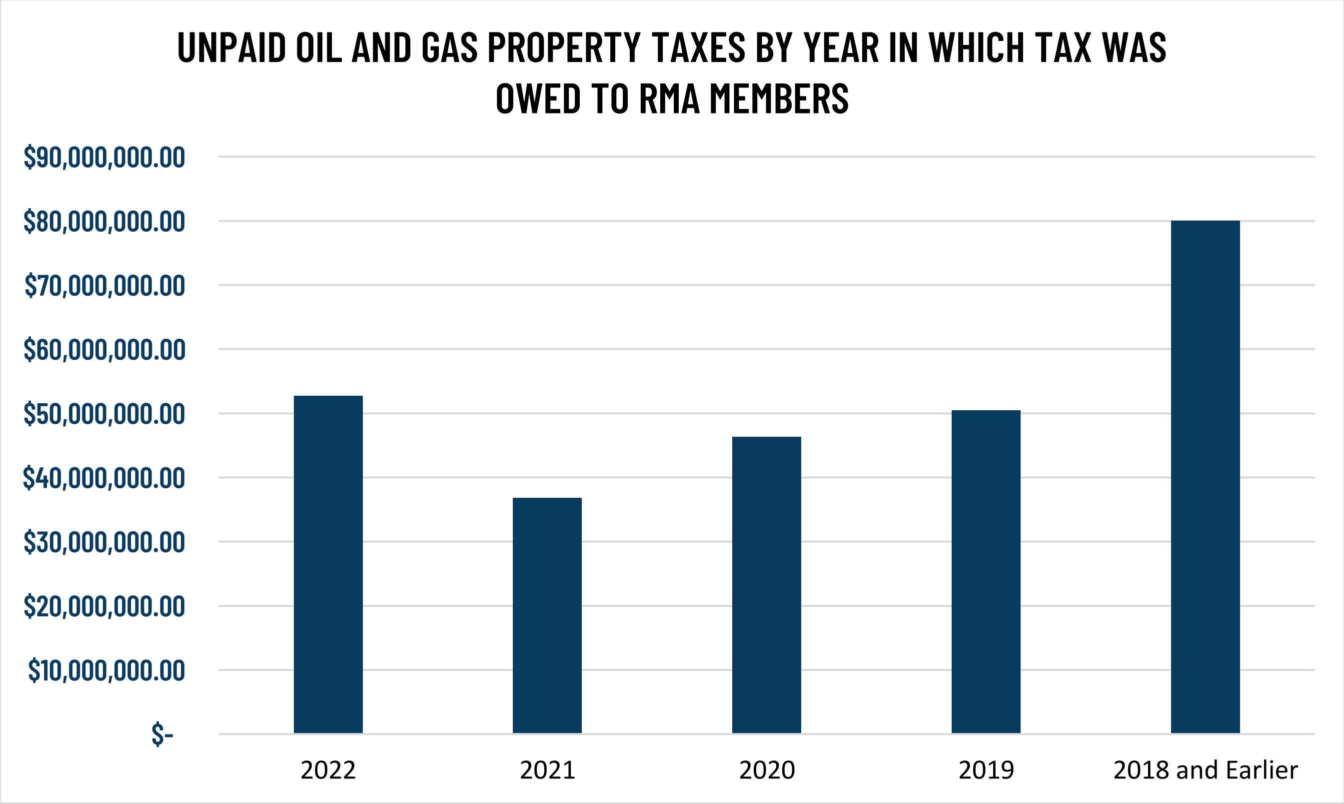
While the increase in unpaid taxes from 2021 to 2022 and again from 2022 to 2023 was more modest than growth in previous years, comparing that to broader growth in the industry tells a different story, as the chart below shows:



From 2018 to 2020, the rate of unpaid taxes tended to grow at an inverse rate to the number of new wells drilled in the province; as unpaid taxes increased, new wells decreased. This suggested that perhaps the unpaid tax issue was linked to the industry's general struggles. However, this connection has disappeared. Even as new well drills increased by 277.8% from 2020 to 2022, unpaid taxes continue to increase. **Clearly industry and government are prioritizing continued industry growth without the matching accountability**.

The oil and gas industry continues to pile new mountains of unpaid taxes onto the backs of rural municipalities

Industry and government have argued that, while the issue of unpaid taxes is concerning, most of the tax debts are several years old and the actions taken by the province have solved the issue moving forward. The RMA's member survey data shows a very different reality, one in which **oil and gas companies continue to ignore their obligations**. The chart below shows the current unpaid tax amounts incurred by municipalities each year:

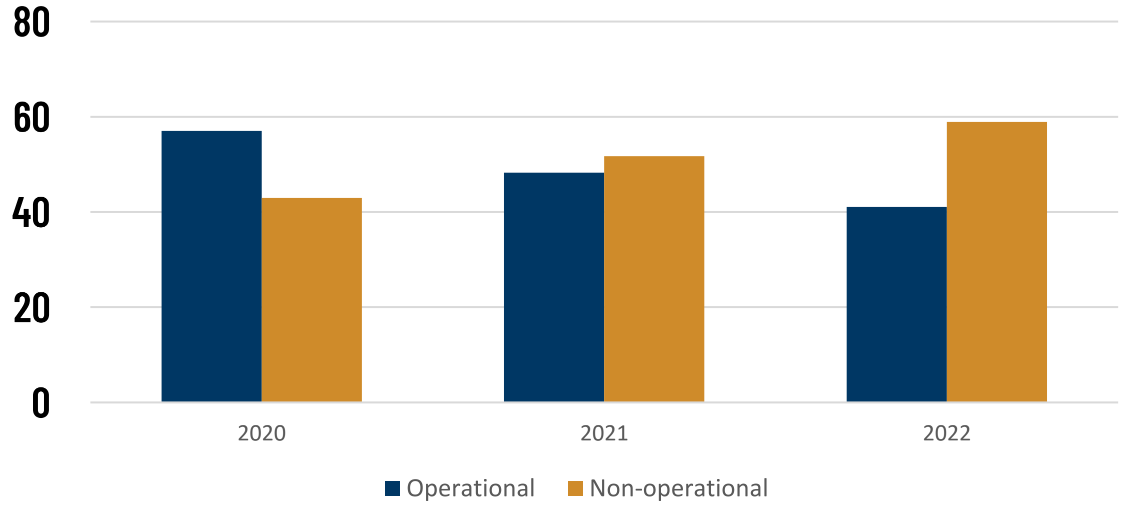


Despite the industry's economic success in 2022, the Government of Alberta's introduction of the special lien, and the ability of the AER to consider unpaid taxes in its risk assessments, unpaid tax numbers continue to rise, suggesting that this is an active issue and not only linked to legacy or written-off taxes from several years ago. Some companies continue to operate while they are either unwilling or unable to pay taxes.

As new unpaid taxes are being incurred at a higher rate, the portion of taxes owed by non-operational companies is also gradually increasing

The RMA's survey asked members to indicate the portion of unpaid taxes owed by companies that continue to operate and those that are now non-operational, usually due to insolvency. These results also show an interesting trend:

PORTION OF UNPAID TAXES OWED BY OPERATIONAL AND NON-OPERATIONAL COMPANIES, 2020 to 2022 TAX YEARS



The table above shows the portion of unpaid taxes owed by companies that are currently operational and non-operational. The number of non-operational companies that owe property taxes continues to rise. Due to recent legal decisions, and in particular the *Redwater* decision, municipalities face major challenges recovering taxes owed from non-operational companies. **While non-operational does not mean taxes are unrecoverable, it does reduce the range of tools available and likelihood of success**. It is imperative that the government act quickly in better enforcing tax payments from operational companies while these companies still have the means to address their growing unpaid property tax debt.

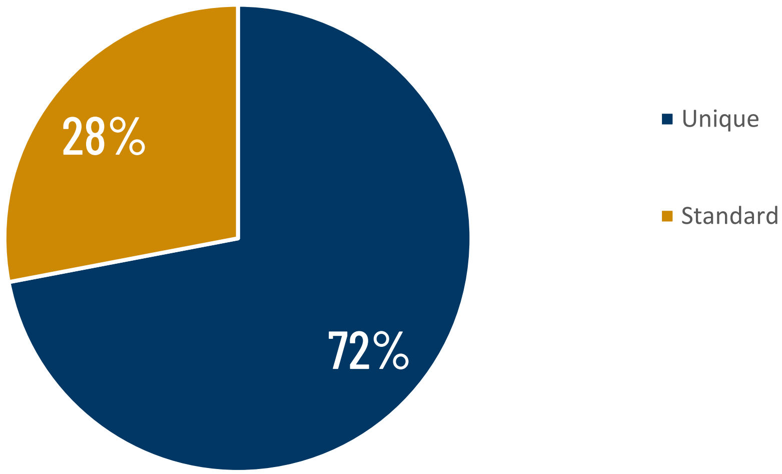
Have Repayment Agreements Been Effective?

In December 2022, Municipal Affairs expressed interest to the RMA in learning more about tax repayment agreements in place between oil and gas companies and municipalities, including how they are implemented, enforced, and their effectiveness in actually collecting on tax arrears. To address these questions, the RMA distributed a second survey with the assistance of the Alberta Rural Municipal Administrators Association (ARMAA) to gather more detailed information on how agreements were structured and to what extent they helped recover unpaid oil and gas taxes. RMA also asked a general question about repayment agreements in the main member survey.

The member survey results indicated that 16 municipalities have agreements in place and 53 do not. It was made clear in the survey that the agreements do not ensure repayment once in place as there are limited enforcement mechanisms available.

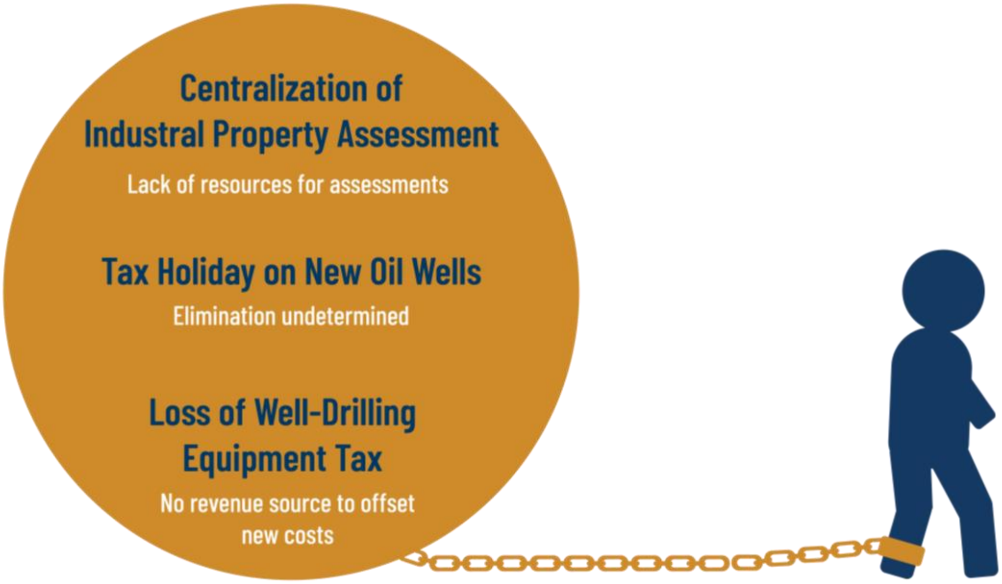
Further, the number of agreements in place is quite low considering the amount of taxes outstanding; this suggests that most companies that are not paying taxes either avoid payment willingly and are not interested in negotiating an agreement, or they are in such a poor financial situation that a payment agreement would not be adhered to. In other words, there are only a small number of companies that want to pay taxes but are unable to do so within legislated deadlines. In these few cases, repayment agreements can be a potential option, but their wider use will continue to be limited. In the survey specific to payment agreements, it was demonstrated that many municipalities are willing to develop agreements with unique terms to better accommodate companies facing financial challenges, as the chart below shows:

TYPE OF REPAYMENT AGREEMENTS AMONG RESPONDENTS INDICATED THEY HAVE AN ACTIVE AGREEMENT IN PLACE



Although payment agreements can be useful for both parties, without meaningful consequences to enforce payment of taxes more broadly, they are likely to never be a widely effective tool. Payment agreements are not the solution to this issue and therefore should not be looked at as an expected option for companies unwilling to pay taxes by the deadline unless a stronger enforcement backstop is implemented.

Cumulative Effects of Unpaid Taxes on Municipal Revenue



While the survey results are alarming in isolation, they become even more concerning when considered in combination with other recent provincial policy changes that have weakened the ability of municipalities to levy and collect property taxes from the oil and gas industry.

The RMA sees industry and municipalities as partners in driving economic development, and without access to a fair and consistent revenue source, rural municipalities will, quite simply, be unable to continue to build and maintain the infrastructure that the industry relies on. Some examples of other policy decisions include the following:

Well-Drilling Equipment Tax

Following the 2020 assessment model review, the Government of Alberta implemented several measures intended to provide relief to industry as an alternative to implementing massive changes to the assessment model that would seriously harm municipal viability. Among these measures was the elimination of the Well-Drilling Equipment Tax (WDET). The WDET was intended to provide support to rural municipalities to offset sudden costs associated with new drilling and the increased use of municipal infrastructure by drilling rigs and other industrial equipment. Eliminating it was intended to stimulate new drilling activity during a time of low commodity prices.

In 2019, rural municipalities collected approximately $23 million in WDET revenue. In 2020, this was suddenly no longer available. As commodity prices and drilling have increased dramatically since 2020, rural municipal infrastructure is being impacted like never before and municipalities have no revenue source available to offset new costs.

Tax Holiday on New Oil Wells

At the same time that it eliminated the WDET, the Government of Alberta implemented a three-year property tax holiday for newly drilled oil wells. This holiday exempts new wells and pipelines from taxation until the 2025 tax year. Although this holiday was introduced to help mitigate the effects of 2020's economic downturn on the oil and gas industry and promote growth, it is no longer necessary as the industry is in a boom phase with record profits and high levels of new drilling.

There has been no indication that this holiday will be eliminated after 2024, despite the Government of Alberta's knowledge of delinquent companies and high commodity prices.

Centralization of Industrial Property Assessment

Over the past several years, the Government of Alberta has gradually transitioned responsibility for assessing designated industrial properties (pipelines, wells, etc.) from individual municipalities to the provincial assessor's office. While this transition was intended to improve the consistency of assessment across the province, the process has taken much longer than expected and the Government of Alberta has been challenged in building the expertise, capacity, and processes needed to properly assess the massive amount of designated industrial properties spread across rural Alberta.

This lack of capacity has resulted in a lower quality of assessment in municipalities that have been centralized (some municipalities have not yet been transitioned to the centralized model and still conduct assessment using municipal or contracted staff). For example, centralized assessors are highly reliant on industry self-reporting, and due to work constraints for provincial staff, access a much lower portion of properties to visually confirm or audit self-reporting. While quantifying the exact impacts of centralization is extremely difficult as the technical assessment data is not publicly available, there is no doubt that in many cases, centralization has resulted in a reduction in the assessed value of properties due to self-reporting and an increasing reliance on standardized rather than site-specific assessments. In other words, while municipal assessors historically inspect a large portion of individual properties, the proportion inspected under a centralized system is much less, leading to lower assessments, lower taxes paid by industrial property owners, and lost tax revenue for municipalities.

Seeking Solutions

The survey results indicate that unpaid taxes owed by the oil and gas industry to municipalities continue to rise, even as oil prices recently reached historic highs, new well drills increase significantly, and the province's overall economic outlook improves each day. This survey has the most up-to-date data from all 69 member municipalities, which is an indication of the importance of this issue to rural Alberta. At this point, the Government of Alberta is out of excuses as to why it cannot hold industry accountable to meet the same property tax payment expectations **as every other residential and commercial taxpayer in the province**.

Rural municipalities are critical to supporting the oil and gas industry. They provide the infrastructure needed to dig new wells, build pipelines, and maintain existing assets. Increased industry activity intensifies strain on municipal infrastructure, requiring new roads and bridges to provide access to development opportunities. Despite this, each rural municipality faces an average of close to $4 million in outstanding taxes from the oil and gas industry, **which is being subsidized by other taxpayers in the municipality in the form of increased tax rates or reduced service levels**.

While the Government of Alberta has previously assumed that oil and gas companies did not pay property taxes because they lacked the ability to do so, what the economic recovery has shown is that the issue is less a lack of ability and more a lack of interest. While most oil and gas companies are excellent corporate citizens that operate accountably, those that continue to ignore their property tax obligations either don't care about meeting their obligations or are so poorly regulated that they continue to struggle even in the current economic environment.

In the recent budget, the province generated a significant surplus due to royalties and other revenue largely linked to the oil and gas industry. Despite this, the province continues to download more responsibilities onto municipalities and refuses to take meaningful action towards the recovery of the $268 million of taxes owed to municipalities. **Rural municipalities continue to get the "short end of the stick," while both the province and industry grow their wealth**. The Government of Alberta has shown a willingness to use public royalty funds to subsidize industry responsibilities (as R-Star demonstrates). It is highly concerning that the government refuses to require industry to operate accountably and in the public interest but is happy to use public funds to "incentivize" them to meet their legislative requirements.

The AER's mandate is to regulate the safe and responsible development of the oil and gas industry. Despite this, **the AER has ignored the impact of unpaid taxes on municipalities and the broader public interest**. Further, as the industry and province have emphasized the adoption of environmental, social, and governance (ESG) principles into their mandates and actions, they continue to ignore actions by industry that contradict good social and governance principles. The AER has the power and tools to solve this issue and uphold the public interest, but have continually refused to act.

Unpaid surface leases are also an ongoing issue. The current process for addressing surface lease disputes through the Land and Property Rights Tribunal (LPRT) is unfair to rural landowners who do not possess the same resources and means as the companies who desire the leases, which has allowed some companies to ignore private landowners. Landowners often do not have access to legal teams or are unfamiliar with the process set out by the LPRT. Although surface rights and leases are not part of the municipal scope, the impact on individual landowners contributes to the overall issue created by oil and gas companies. The RMA does not have the ability to gather data about the extent of unpaid surface leases but has heard from members and other stakeholders that it is also a widespread issue.

The RMA will continue advocating to the Government of Alberta to direct the AER to implement solutions to this issue, including the following:

- Rather than relying on industry to self-report on property tax payment, develop a mechanism to allow municipalities to regularly submit property tax payment information to the AER, and to easily share concerns related to companies not paying taxes.
- Update Directive 067 to specifically include full payment of all municipal taxes owed by a company as a requirement of any licence approval or transfer.
- Do not allow the transfer of ownership of a specific asset if there are any outstanding taxes attached to the asset.
- Update Directive 088 to specifically identify non-payment of municipal taxes as a factor in determining a company’s licensee capability assessment (LCA).
- Create a provincial fund to fully compensate municipalities for unpaid oil and gas taxes from recent years that are now uncollectable due to company assets having already been liquidated.
- Require the AER to report on its collection and use of unpaid tax information on an annual basis.