2nd Draft

Initiative #113
Severance Taxes on the Oil and Natural Gas Industry

Amendment (?) proposes changing the Colorado statutes to:

- increase the amount of severance taxes paid by oil and natural gas companies, primarily by eliminating an existing property tax credit;

- allocate the increased severance tax revenue to college scholarships for state residents, wildlife habitat, renewable energy projects, road improvements in energy-impacted areas, and safe-drinking-water grants; and

- exempt all oil and gas severance tax revenue from state and local spending limits.

Summary and Analysis

What is the severance tax? The severance tax is a tax that is paid by companies that extract nonrenewable natural resources from the earth. Colorado collects severance taxes on several minerals, including oil and gas, gold, coal, and molybdenum. Over the last 5 years, 92 percent of state severance tax collections have come from oil and gas, and nearly all of that is from gas. In budget year 2007, the state collected $117 million in oil and gas severance taxes.

How does Amendment (?) change Colorado's current severance taxes on oil and gas? Amendment (?) increases the amount of severance taxes paid by oil and gas companies by eliminating a state tax credit, increasing the number of wells subject to the tax, and increasing the tax on large companies. The total amount of additional revenue is estimated at $304 million in budget year 2010.

Eliminating the property tax credit. The state allows companies to claim a severance tax credit of 87.5 percent of the property taxes paid on oil and gas production. Amendment (?) removes this tax credit, increasing state severance taxes by an estimated $241 million in budget year 2010.

Increasing the number of wells subject to the tax. Companies currently do not have to pay the severance tax on small wells. Amendment (?) increases the number of wells subject to the tax by reducing the threshold for the exemption. With the new threshold, the percentage of oil and gas production subject to the severance tax increases from 40 percent to 56 percent for oil and from 80 percent to 90 percent for gas. This change is expected to increase state severance tax revenue by $62 million in budget year 2010.

Increasing the tax on large companies. Colorado currently taxes oil and gas companies using a graduated tax rate of 2 to 5 percent, depending on income.

Amendment (?) changes this graduated rate to a flat, 5 percent rate for companies earning $300,000 or more, eliminating taxes for small companies and increasing taxes on large companies. For example, a company earning more than $300,000 pays 5 percent on all of its income, while a company earning less than $300,000 pays no severance tax. This change is estimated to increase state severance tax receipts by about $1 million annually.

How do Colorado's oil and gas taxes compare to other states? Colorado's actual severance tax rate is the lowest of the eight large producing western states (Colorado, Kansas, Montana, New Mexico, Oklahoma, Texas, Utah, and Wyoming) when each state's exemptions, deductions, and credits are taken into account. Appendix A contains information on this ranking. Assuming the taxes in other states remain the same, Amendment (?) raises Colorado's severance tax ranking to the third lowest compared with the seven other states. These rankings do not take into account other taxes that oil and gas companies pay, such as income, sales, and property taxes, which vary among the states.

How is severance tax revenue distributed under this measure? Under current law, Colorado severance tax revenue is evenly divided between state programs and local governments. The state portion pays for state water projects and programs related to mineral extraction, clean energy development, low-income energy assistance, and wildlife conservation. The local government portion is directly distributed based on mining activity or through competitive loans or grants to local governments that are affected by mining.

Under Amendment (?), 44 percent of severance tax revenue continues to be split evenly between existing state programs and local governments. Although the portion of money set aside for these uses is less than under current law, collections under Amendment (?) are expected to double. Amendment (?) dedicates the remaining 56 percent of severance tax revenue to new uses. Ten percent is placed in a reserve account for future use by the state. Ninety percent pays for new state programs as follows:

- 60 percent for a college scholarship program to make attending college more affordable for lower- and middle-income Coloradans. The governor-appointed board that oversees the state's higher education system sets the specific eligibility criteria for the scholarship program, considering factors such as income, family size, and academic performance;

- 15 percent to assist local governments, nonprofit organizations, and the state to acquire and maintain wildlife habitat. The state board tasked with preserving Colorado's wildlife and open space distributes this money;

- 10 percent for projects that promote energy efficiency and the use of renewable, clean energy resources;

- 10 percent for transportation projects in areas of the state impacted by the oil and gas industry; and

- 5 percent for small community drinking water and domestic wastewater treatment projects.

Table 1 presents estimates of the money that will be provided to these uses over the next four budget years under the measure.

Table 1
Use of New Money Under Amendment (?) in Millions of Dollars

New State Programs	2009 (half-year)	2010	2011	2012	Four-Year Total
Held in reserve	$15	$29	$32	$34	$109
College scholarships	$78	$157	$172	$183	$590
Wildlife habitat	$20	$39	$43	$46	$148
Clean energy	$13	$26	$29	$31	$98
Transportation projects	$13	$26	$29	$31	$98
Water grants	$7	$13	$14	$15	$49
Total new programs:	**$146**	**$290**	**$318**	**$339**	**$1,093**

Arguments For

1) The property tax credit provided to oil and gas companies is no longer needed by an industry that is currently experiencing record profits. Better uses exist for state dollars than providing a tax break to oil and gas companies. The state has many unmet funding needs, and spending the new money to address these needs is a sound investment in Colorado's future.

2) Increasing access to college for middle- and low-income Coloradans is critical to ensuring the state's long-term economic health. The scholarships funded through this measure offset the high cost of college, making a college education attainable for more residents. As Colorado graduates more state residents, businesses benefit from a larger pool of educated workers that can help grow Colorado's economy.

3) Oil and gas production is necessarily limited by the location of reserves, so raising the extraction cost of those resources is not likely to substantially reduce production in Colorado. Colorado currently has the lowest severance tax rate among large-producing western states. By eliminating the property tax credit and tightening the small-well tax exemption, Amendment (?) increases the compensation that Colorado citizens receive for the extraction of these resources and brings Colorado's tax rate more in line with other states.

4) The money raised by Amendment (?) provides benefits to the state with little or no increase in the cost of energy for Colorado consumers. Oil and gas prices are influenced by numerous domestic and international factors, and a change in Colorado's severance tax is not a large enough factor to make a significant difference in Colorado's prices. Colorado produces less than one-tenth of one percent of the world's oil. Increasing the state's severance tax on this level of production is unlikely to affect the market price of gasoline. Likewise, since most of the natural gas produced in Colorado is sold elsewhere, any additional costs are likely to be paid by consumers outside of Colorado.

Arguments Against

1) Increasing taxes on oil and gas companies is likely to negatively affect the state's economy and its citizens by discouraging oil and gas production. According to one recent analysis, there are over 70,000 jobs in the state supported by the industry, contributing around $23 billion to the state's economy. By more than doubling the state's severance tax, this measure is likely to make Colorado less attractive to the oil and gas industry, which may reduce investment and result in a loss of jobs.

2) The spending plan for the new money is vague and relies upon a volatile source of money. Amendment (?) contains few specifications on the distribution of the scholarship money or the other programs it creates. Further, funding statewide programs with money from the energy industry is risky because it has endured boom-and-bust cycles in the past. It is better to fund programs that address statewide needs with money from multiple sources.

3) The existing property tax credit is justifiable given the high property values for the industry. Currently, oil and gas property is valued at nearly three times the rate as other commercial enterprises for property tax purposes. This tax structure ensures that local governments in energy-impacted areas have the financial resources to help them address the effects of oil and gas production. Eliminating the credit would harm a longstanding tax balance between state and local governments in Colorado, and may discourage production in areas of the state with higher property taxes.

4) Amendment (?) may increase energy prices for Colorado consumers. A portion of the gasoline sold in the state is refined from Colorado oil, and a major utility purchases gas from companies that produce in Colorado. Therefore, a portion of the higher costs from this measure could be passed on in monthly heating bills and higher gasoline prices. Colorado consumers are already faced with high energy costs with gasoline approaching $4.50 a gallon and electricity costs projected to increase by as much as 38 percent annually.

Estimate of Fiscal Impact

State Impacts. Amendment (?) is expected to increase state severance tax revenue by almost $1.1 billion over the next four years. The amendment also changes the allocation of severance tax revenue and increases expenditures for several new state programs. Based on the current state forecast, Amendment (?) reduces the money for existing state programs and local governments by $22 million in the current budget year, but provides between $3 and $7 million more per year over the next three budget years than under current law. Existing state and local programs are expected to lose a total of $5 million each over the next four years, while new state programs will gain all of the new revenue. The new programs created by the amendment will spend a total of $1.1 billion over the next four years, of which a portion will cover the administrative costs.

Appendix A: Severance Tax Rates in Other Large Producing Western States

State	Base Tax Rate	ACTUAL* Severance Tax Rate (FY 2006-07)
Colorado	2.0-5.0%	1.3%
Utah	5.0%	2.1%
Kansas	8.0%	2.8%
Texas	7.5%	4.4%
Wyoming	6.0%	4.5%
Oklahoma	7.0%	5.6%
New Mexico	7.94%	6.6%
Montana	9.26- 15.06%	x.x%

** ACTUAL tax rates are measured by dividing severance taxes after exemptions, deductions, and credits by the value of oil and gas produced in each state.*