HB13-1122

Colorado Legislative Council Staff Fiscal Note

STATE and LOCAL FISCAL IMPACT

Drafting Number:	LLS 13-0455	**Date:**	January 30, 2013
Prime Sponsor(s):	Rep. Scott	**Bill Status:**	House SVMA
		Fiscal Analyst:	Marc Carey (303-866-4102)

TITLE: CONCERNING SEVERANCE TAX ON OIL AND GAS PRODUCED FROM AN INCENTIVE WELL, AND, IN CONNECTION THEREWITH, ENACTING "THE ENERGY, JOBS, AND HIGHER EDUCATION ACT".

Fiscal Impact Summary	FY 2012-13	FY 2013-14	FY 2014-15	FY 2015-16
State Revenue				
Cash Funds				
Severance Tax Trust Fund		($19.5 M)	($38.3 M)	
Local Gov't. Sev. Tax Fund		(19.5 M)	(38.3 M)	
State Transfers and Diversions				
Transfer from State Education Fund (reduction)		($40,000)		
Diversion of Severance Tax Revenue to College Opportunity Fund				$76.6 million
State Expenditures				
General Fund	$40,000	$24,619	$22,003	$22,003
Cash Funds				
Severance Tax Trust Fund		See State Expenditures Section		($38.3 M)
Local Gov't. Sev. Tax Fund				(38.3 M)
College Opportunity Fund				76.6M
FTE Position Change		0.6 FTE	0.6 FTE	0.6 FTE
Effective Date: Upon signature of the Governor, or upon becoming law without his signature.				
Appropriation Summary for FY 2013-2014: See State Appropriations section.				
Local Government Impact: See Local Government Impact section.				

Summary of Legislation

This bill creates a two-year severance tax holiday for any oil and gas well that begins production between July 1, 2013 and July 1, 2015. Wells commencing production during this period are known as incentive wells. After July 1, 2015, production from incentive wells is taxed at the existing severance tax rate, and all severance tax revenue from incentive wells is credited to the College Opportunity Fund to be used to fund undergraduate stipends for higher education.

State Revenue

This bill will reduce state revenue by at least $39.0 million in FY 2013-14 and $76.6 million in FY 2014-15. Under current law, the revenue reduction would be divided equally between the Severance Tax Trust Fund administered by the Department of Natural Resources (DNR) and the Local Government Severance Tax Fund, administered by the Department of Local Affairs (DOLA). The money administered by the DNR is allocated equally between the Operational Account which funds regulatory agencies within the department and a variety of tier 2 programs, and the Perpetual Base Account which provides money for water projects. The money administered by the DOLA is distributed to local governments through energy impact grants and direct distributions. Thus, each of these agencies will receive at least $19.5 million less than otherwise in FY 2013-14 and at least $38.3 million less than otherwise in FY 2014-15.

Methodology. Legislative Council Staff severance tax forecast already expects a number of wells to begin production during this two-year window without this legislation. Thus, exempting these wells from state severance tax will reduce revenue that the state would otherwise have collected in FY 2013-14 and FY 2014-15. By comparing data on the assessed value of new wells to the overall assessed value for oil and gas, it is estimated that over the last four years, about 17 percent of the state's total oil and gas production came from new wells. However, because of the production path typically followed for oil and gas wells, this number may underestimate the true share of production from new wells annually.

Typically, production from a newly completed well starts high and declines over time. This declining production is known as a well's decline curve. Because a majority of production occurs in the early years of a well's producing life, low producing or "stripper" wells tend to be older wells. Eliminating stripper wells from the overall well population increases the percentage of production from new wells over the last four years to about 25 percent annually. Since stripper wells are not subject to severance tax, this higher percentage was applied to the December Legislative Council Staff severance tax revenue forecast to estimate the revenue losses from the bill in the two-year tax holiday window. Note that the severance tax revenue loss in the second year is compounded since both first and second year wells whose production would have been taxed would now be exempt.

Property Tax Credit. It should be noted that these numbers likely underestimate the true revenue reduction in these two years. This is because producers in Colorado receive an ad valorem credit against their severance tax liability in the amount of property taxes paid on the prior year's production. In the first year of production, however, no credit is available as there was no production in the prior year. Thus, the expected severance tax revenue from a new well per unit of production is higher - and is likely significantly higher - than for wells in general.

Revenue Reallocation. Beginning in FY 2015-16, severance tax rates would apply to incentive wells, provided their production exceeded the stripper well exemption threshold. Thus, there would be no further revenue loss in aggregate, but there would be a redistribution of the revenue from the Department of Natural Resources and the Department of Local Affairs to the College Opportunity Fund. Due to the declining production of incentive wells, it is expected that not more than $76 million would be reallocated to the College Opportunity Fund.

Incentivized Drilling. However, it is possible that there will be some number of wells that will begin production during the holiday solely due to the severance tax exemption. Once taxation of those wells resumes in FY 2015-16 and beyond, these wells will provide the state with revenue that it would not have otherwise realized. A literature review indicates that a permanent reduction in severance tax rates of 4 percentage points can be expected to result in a 1.7 percent production increase. Because the proposed severance tax holiday is temporary, the impact will likely be smaller. If the bill stimulated a 1 percent increase in production that would not otherwise have occurred, it is estimated that severance tax revenue would increase by about $4.5 million in FY 2015-16. This amount would decline over time as the aggregate production from incentive wells declined.

State Transfers and Diversions

State Education Fund Transfer. HB 12-1338 transfers all the General Fund surplus in FY 2012-13 to the State Education Fund for expenditure in FY 2013-14. A $40,000 increase in General Fund expenditure in FY 2012-13 implies a corresponding reduction of $40,000 in the amount that will be transferred to the State Education Fund in FY 2013-14.

College Opportunity Fund. Beginning in FY 2015-16, the bill diverts $76.6 million that would have been divided equally between the Severance Tax Trust Fund and the Local Government Severance Tax Fund. Instead, the money will be credited to the College Opportunity Fund for undergraduate stipends.

State Expenditures

Department of Revenue. ***Implementation of this bill will result in additional expenditures of $40,000 in FY 2012-13, $24,619 and 0.6 FTE in FY 2013-14, and $22,003 and 0.6 FTE in FY 2014-15 and beyond.***

It is not currently possible for the department to track severance tax revenue on a well-specific basis. The form used to file severance taxes would need to be reworked and it is estimated that 200 hours of computer programming would be required before the beginning of the severance tax holiday period on July 1, 2013, to accommodate the bill's provisions.

In addition, because the bill specifies that severance tax revenue from incentive wells be accounted for separately from severance tax revenue from other wells, the department will require additional resources to review the tax returns associated with incentive wells to insure proper revenue allocation. These costs are shown in Table 1 below.

Table 1. Department of Revenue Administrative Expenditures Under HB 13-1122			
Cost Components	**FY 2012-13**	**FY 2013-14**	**FY 2014-15**
Personal Services		$21,474	$21,474
FTE		0.6	0.6
Operating Expenses and Capital Outlay		$3,145	$529
Computer Programming (200 hrs.)	$40,000		
TOTAL	**$40,000**	**$24,619**	**$22,003**

Severance Tax Trust Fund. The bill reduces funding available from the Severance Tax Trust Fund by $19.5 million in FY 2013-14 and $38.3 million in FY 2014-15 and beyond. This money is allocated equally between the Operational Account which funds regulatory agencies within the DNR and a variety of tier 2 programs, and the Perpetual Base Account which provides money for water projects.

Local Government Severance Tax Fund. The bill reduces funding available from the Local Government Severance Tax Fund by $19.5 million in FY 2013-14 and $38.3 million in FY 2014-15 and beyond. This money is distributed to local governments through energy impact grants and direct distributions.

College Opportunity Fund. Beginning in FY 2015-16, the bill makes $76.6 million available for undergraduate stipends funded through the College Opportunity Fund.

State Education Fund Transfer. HB 12-1338 transfers all the General Fund surplus in FY 2012-13 to the State Education Fund for expenditure in FY 2013-14. A $40,000 increase in General Fund expenditure in FY 2012-13 implies a corresponding expenditure reduction of $40,000 from the State Education Fund in FY 2013-14.

Expenditures Not Included

Pursuant to a Joint Budget Committee policy, certain costs associated with this bill are addressed through the annual budget process and centrally appropriated in the Long Bill or supplemental appropriations bills, rather than in this bill. The centrally appropriated costs subject to this policy are summarized in Table 2.

Table 2. Expenditures Not Included Under HB 13-1122*		
Cost Components	**FY 2013-14**	**FY 2014-15**
Employee Insurance (Health, Life, Dental, and Short-term Disability)	$6,273	$6,273
Supplemental Employee Retirement Payments	2,445	2,767
TOTAL	**$8,718**	**$9,040**

**More information is available at: http://colorado.gov/fiscalnotes*

Local Government Impact

Severance tax revenue credited to the Local Government Severance Tax Fund is distributed to local governments through energy impact grants and direct distributions. The bill reduces funding available from that fund by $19.5 million in FY 2013-14 and $38.3 million in FY 2014-15 and beyond. The impact on individual local governments has not been estimated.

State Appropriations

For FY 2012-13, the Department of Revenue will require a General Fund appropriation of $40,000.

For FY 2013-14, the Department of Revenue will require a General Fund appropriation of $24,619 and 0.6 FTE.

Departments Contacted

Higher Education	Local Affairs	Natural Resources	Revenue