

STATE OF COLORADO

Colorado General Assembly

Kirk Mlinek, Director
Legislative Council Staff

Colorado Legislative Council
029 State Capitol Building
Denver, Colorado 80203-1784
Telephone (303) 866-3521
Facsimile (303) 866-3855
TDD (303) 866-3472
E-Mail: lcs.ga@state.co.us



Charles W. Pike, Director
Office of Legislative Legal Services

Office Of Legislative Legal Services
091 State Capitol Building
Denver, Colorado 80203-1782
Telephone (303) 866-2045
Facsimile (303) 866-4157
E-Mail: olls.ga@state.co.us

MEMORANDUM

April 5, 2006

TO: Liane Morrison and Bruce Broderius

FROM: Legislative Council Staff and Office of Legislative Legal Services

SUBJECT: Proposed initiative measure 2005-2006 #97, concerning Tax on Oil and Gas for Public School Buildings

Section 1-40-105 (1), Colorado Revised Statutes, requires the directors of the Colorado Legislative Council and the Office of Legislative Legal Services to "review and comment" on initiative petitions for proposed laws and amendments to the Colorado constitution. We hereby submit our comments to you regarding the appended proposed initiative.

The purpose of this statutory requirement of the Legislative Council and the Office of Legislative Legal Services is to provide comments intended to aid proponents in determining the language of their proposal and to avail the public of knowledge of the contents of the proposal. Our first objective is to be sure we understand your intent and your objective in proposing the amendment. We hope that the statements and questions contained in this memorandum will provide a basis for discussion and understanding of the proposal.

Purposes

The major purposes of the proposed initiative, which amends title 22, Colorado Revised Statutes, by adding a new article, appear to be:

1. To create a tax of one percent on the proceeds from the sale of oil and natural gas from large wells located in the state that will be imposed on producers who receive more than three hundred thousand dollars in such proceeds;
2. To exempt the revenue from the proposed oil and natural gas tax from state and local spending limits;
3. To require the revenue from the proposed oil and natural gas tax to be deposited into the

public school construction trust fund; and

4. To require the revenues in the public school construction trust fund to be used for public school renovations or construction, prioritizing certain uses.

Comments and Questions

The form and substance of the proposed initiative raise the following comments and questions:

Technical questions and comments:

The following are technical changes that we would recommend you make in order to conform the proposed initiative to standard drafting practices.

1. There should be spaces before and after the hyphens in the headnote.
2. After the headnote and before "A" there needs to be "(1)".
3. In the first sentence, it might read better to change the phrase "from such proceeds" to "of such proceeds".
4. The second sentence would be easier to read if it was broken into two or more sentences.
5. Commas need to be used in a series before the conjunction. (For example, the phrase "federal state and local laws, codes and standards for school buildings" would read as "federal, state, and local laws, codes, and standards for school buildings".)
6. The proper verb form of "pay" is "paid", instead of "payed".
7. The third sentence of the first paragraph is written so that it appears that the public school construction trust fund would be paying people, as opposed to the administrative costs being paid from the moneys in the public school construction trust fund. An example to avoid this problem is as follows: "[Administrative costs] may be paid from moneys in the public school construction trust fund."
8. With respect to the phrase "revenues and expenditures of the public school construction trust fund", it would be more accurate to speak of "revenues in and expenditures from the . . . fund".
9. In the second to last sentence of the first section, it would be more clear to specify what "this tax" is.
10. Instead of referring to "this amendment" in the last sentence of the first paragraph the proponents should refer to "this section".

11. Definitions in the Colorado Revised Statutes are usually preceded by an introductory phrase, which would read as follows:

"(2) As used in this section, unless the context otherwise requires:

(a) "Proceeds" means"

12. The definitions should be in alphabetical order.

Substantive comments and questions:

1. The following comments and questions relate to the one percent tax on the proceeds from the sale of oil and natural gas:

- a. Is this a new tax? (For the sake of this memorandum, we assume that it is a new tax or tax rate increase and shall refer to it as "the proposed oil and natural gas tax".)
- b. When will the proposed oil and natural gas tax begin?
- c. Section 39-29-105, Colorado Revised Statutes, levies a severance tax on oil and gas, which includes crude oil, natural gas, carbon dioxide, and oil and gas, and section 39-29-107, Colorado Revised Statutes, levies a severance tax on oil shale. Which of these are included in oil and natural gas?
- d. Aside from the natural resources being taxed, is there any difference between the calculation of the proposed oil and natural gas tax and the severance tax levied pursuant to section 39-29-105, Colorado Revised Statutes? If so, what is the difference?
- e. Who will administer the proposed oil and natural gas tax? Will it be administered in the same fashion as the current oil and gas severance tax? The proponents might consider adding language that clarifies that this is a state tax to be administered by the department of revenue as opposed to a local tax that is to be collected by a school district, or vice versa.
- f. The proposed oil and natural gas tax is limited as to the type of well it applies to and the producers who are required to pay it, correct?
- g. What is a "producer"?
- h. With respect to the requirement that producers receive more than three hundred thousand dollars in proceeds:
 - i. Would proceeds from oil and natural gas wells that do not qualify as large wells be included in the total to determine whether there are more than three

hundred thousand dollars in proceeds? What is meant by the phrase "such proceeds"? Is it an attempt to ensure that only large wells are included in the calculation to determine whether the three hundred thousand dollars threshold is reached?

- ii. In this context, what does "annually" mean? Is it based on the proceeds in the year that the proposed oil and natural gas tax is collected or a prior year? Is it based on a tax year, fiscal year, or calendar year? Is it a single year calculation or an average? How will the person administering the proposed oil and natural gas tax determine whether the producer has annually received more than three hundred thousand dollars from such proceeds?
 - iii. A producer who receives three hundred thousand dollars or less is exempt from the proposed oil and natural gas tax, but a producer who receives three hundred thousand dollars and one cent is subject to the proposed oil and natural gas tax, correct?
 - iv. In determining whether the three hundred thousand dollars threshold is met, would you add proceeds from both oil and natural gas wells for a single producer? (For example, two hundred thousand dollars from oil and two hundred thousands dollars from natural gas).
- i. The following questions relate to the definition of the term "proceeds":
- i. What does the phrase "amount realized" mean? Is it equal to gross lease revenues?
 - ii. Since not every person who receives proceeds from the sale of oil and natural gas will necessarily be a taxpayer, is it more accurate to use the term "producer" instead of "taxpayer" in the definition?
 - iii. For purposes of the proposed oil and natural gas tax, does it matter whether the sale of oil and natural gas occurs at the wellhead or after transportation, manufacturing, and processing of the product?
 - iv. What happens if the oil or natural gas is sold to a related party for a price that is lower than the price at which the oil or natural gas could otherwise have been sold on the open market? Will the proceeds be based on the depressed price?
 - v. Are the transportation, manufacturing, and processing costs only related to the oil and natural gas extracted in the state of Colorado?
 - vi. As it used in the context of the current severance tax on oil and gas, the term "transportation" is defined in section 39-29-102 (7), Colorado Revised Statutes. Does transportation have the same meaning in the proposed

initiative?

- j. Oil and natural gas wells that produce less than the amount needed to qualify as a large well are exempt from the proposed oil and natural gas tax, correct?
 - k. With respect to the definition of the term "large wells", are the daily thresholds based on average production for all producing days? If not, what are they based on? In either case, you may want to clarify your intention.
2. The following questions relate to the creation of the public school construction trust fund:
- a. Is the public school construction trust fund to be created in the state treasury? Is there more than one public school construction trust fund? (For example, a public school construction trust fund for each school district?)
 - b. The proposed initiative requires the public school construction trust fund "to be established by the general assembly". However, the proposed initiative already seems to create the public school construction trust fund. What is left for the general assembly to do? (Question 8.b.i also addresses this topic.)
 - c. Can any moneys other than the revenue from the proposed oil and natural gas tax be deposited or transferred into the public school construction trust fund?
3. The following questions relate to the proposed uses of the moneys in the public school construction trust fund:
- a. Who will be using the moneys in the public school construction trust fund?
 - b. What does the requirement "shall be used" mean? Does it require the moneys to be spent? Are moneys in the public school construction trust fund subject to appropriation by the general assembly? Would loaning money to a district to be used for school construction be consistent with the requirement that the moneys "shall be used"?
 - c. While the second sentence establishes the primary uses of the moneys in the public school construction trust fund, it does not require that a certain amount be used each year. Is this your intention? Are there any requirements on when the moneys be spent?
 - d. Does the use of the term "kindergarten" in the proposed initiative preclude the use of these moneys for any other type of preschool?
 - e. By using the phrase "renovations or construction", it appears that moneys in the public school construction trust fund could be used to repair existing buildings and construct new buildings. Is this your intention?

- f. Who is responsible for determining which schools and districts should receive moneys from the public school construction trust fund?
- g. As used in the proposed initiative, what does the term "priority" mean?
- h. There are five priorities established related to the moneys in the public school construction trust fund. These priorities can be divided into two categories: Those that relate to schools and districts (a rural priority and inability to address needs priority); and those that relate to the buildings themselves (a student health and safety priority, a code, law, and standard priority, and a forty-year-old buildings priority). How do the priorities rank within each category? How do the priorities rank between categories? (For example, what should be given priority: a rural school or an urban school that has a forty-three-year-old building?)
- i. Can money from the public school construction trust fund be used for schools and districts that do not fit within a priority?
- j. With respect to the inability to address needs priority, what are "school building needs"? Who decides whether there is sufficient revenue to address such needs?
- k. What does it mean to use the moneys from the public school construction trust fund "to address immediate student health and safety needs in school buildings"? What are examples of using money for this priority?
- l. The following questions relate to the code, law, and standard priority:
 - i. What is a standard?
 - ii. What are federal, state, and local laws, codes, and standards that apply to school buildings?
 - iii. Are there currently school buildings that do not meet federal, state, and local laws, codes, and standards?
 - iv. How will a person know whether a school meets such codes, laws, and standards?
- m. If the moneys from the public school construction trust fund are used to construct a building, who will own the building? Who is responsible for the maintenance of the building?
- n. How will the expenditures from the public school construction trust fund correspond with the school district capital construction assistance program established in article 43.7 of title 22, Colorado Revised Statutes, as well as the assistance provided from the capital construction expenditures reserve in the state public school fund that is established in section 22-54-117, Colorado Revised Statutes?

- o. Can the moneys in the public school construction trust fund be invested while they sit in the public school construction trust fund? What happens to any interest or income earned from the investment and deposit of such moneys? Currently, it would appear that the interest and income is not required to stay in the public school construction trust fund.
 - p. Can moneys in the public school construction trust fund be transferred to another fund and used for another purpose? What language in the proposed initiative would prohibit this?
4. With respect to the sentence pertaining to administrative costs:
- a. What are administrative costs?
 - b. Would any costs related to the general assembly's accounting qualify as administrative costs?
 - c. Does the annual limit apply to calendar years or fiscal years?
 - d. Why is the term "construction" only referenced, when the moneys may be used for "renovations or construction"?
 - e. Is the one percent based on the kindergarten through twelfth grade construction funded from the public school construction trust fund only?
 - f. Is the limit applied to each type of administrative cost from the public school construction trust fund, or is it a limit on the total administrative costs from the public school construction trust fund? It could be read either way, so you might consider adding language to clarify your intention.
5. The following questions relate to the annual public accounting prepared by the general assembly (hereafter referred to as "document")?
- a. Was it your intention to actually require the general assembly, as opposed to a staff agency, to prepare the document? Does the general assembly have the ability to complete this document?
 - b. What will the document include? Will it require a report, legislation, or something else? What will the general assembly do with the document?
 - c. By using the phrase "revenues and expenditures", was it your intention to address both moneys deposited into the public school construction trust fund and moneys appropriated from the public school construction trust fund?
 - d. When will the document be prepared? What period will it include? It should be

noted that the phrase includes "all revenues and expenditures" is not limited, so if the language is strictly construed, it would require all prior years revenues and expenditures to be included in the document?

- e. How detailed must the document be? Will it only include the appropriations made by the general assembly, or will it actually include the amount paid to each contractor?
6. The proposed initiative requires that "[r]evenue from this tax shall be exempt from state and local spending limits." What state and local spending limits are being referred to? (Question 8.d also addresses this topic.)
7. The following questions relate to requirement that "[t]his tax be reduced by an equal amount of any increase in tax on oil and natural gas proceeds passed by voters at a concurrent or subsequent election":
- a. Does the phrase "an equal amount of any increase" mean an "an amount equal to any increase"? If so, it might be more clear if it was changed to the suggested language.
 - b. Does "any increase" include new taxes or does it only apply to rate increases of existing taxes?
 - c. Is the reduction only required if the proposed oil and natural gas tax is on "proceeds" as defined in the proposed initiative? Would an increase in the tax set forth in section 39-29-105, Colorado Revised Statutes, reduce the amount of the proposed oil and natural gas tax collected?
 - d. Does the phrase "a concurrent or subsequent election" mean an election that is concurrent or subsequent to the election at which the proposed oil and natural gas tax was referred to and passed by the voters? While this language is easily understood prospectively, it may be more ambiguous years from now.
 - e. How is tax reduced? Is the rate changed based on estimates of the proceeds from the increased tax and the estimated reduction from changing the rate of the tax proposed in the proposed initiative? Can the tax be reduced by creating credits or modifying who pays the tax?
 - f. Once reduced, can the tax be increased again without voter approval?
8. The following are comments and questions that are raised by virtue of the proposed initiative being a statutory change as opposed to a constitutional change:
- a. Article 29 of title 39, Colorado Revised Statutes, establishes several severance taxes. It might be beneficial to locate the language that creates the proposed oil and natural gas tax in that article. (Please note that such move would also require some changes to the language relating to the tax to ensure that it harmonizes with the existing

language of that article.)

- b. Unlike a constitutional change, a statute generally cannot bind the general assembly to enact future legislation. This raises the following concerns:
 - i. The proposed initiative requires the public school construction trust fund "to be established by the general assembly". What happens if the general assembly does not pass any legislation related to the establishment of the public school construction trust fund? (This issue can be avoided by simply creating the public school construction trust fund in the statute, which can be done by substituting the phrase "which is hereby created in the state treasury" for the phrase "to be established by the general assembly".)
 - ii. The last sentence of the first paragraph requires the general assembly to enact laws to implement the purposes of the proposed initiative. What type of laws will be needed for implementation? To the extent that anything needs to be done to implement the language of the proposed initiative, such language should be included in the proposed initiative.
 - iii. If some technical aspects of the proposed oil and natural gas tax or distribution of the revenue therefrom were intentionally omitted in hopes that the general assembly may amend the statutes later, you are encouraged to include such language in the proposed initiative. (For example, ensuring that their sales of oil and natural gas are arms-length transactions.)
- c. As a statutory change, the proposed tax could be amended by subsequent legislation. For instance, it could be eliminated altogether or the allowable uses of the revenues could be modified. Is this your intention?
- d. The proposed initiative requires that "[r]evenue from this tax shall be exempt from state and local spending limits." The following questions relate to this language being part of a statutory change:
 - i. Section 20 of article X of the Colorado constitution (TABOR) establishes a limit on fiscal year spending. The revenue from the proposed oil and natural gas tax would seem to clearly qualify as state fiscal year spending under the definition of "fiscal year spending" set forth in section 20 (2) (e) of TABOR. How can a statute exempt revenue from the proposed oil and natural gas tax from the TABOR fiscal year spending limit, which is constitutionally required?
 - ii. Under referendum C, the amount of state revenues in excess of the limitation on state fiscal year spending that the state is permitted to keep in state fiscal years commencing on and after July 1, 2010, is based on the maximum annual state revenues that the state receives during the state fiscal years 2005-06 through 2009-10. These state revenues are defined to include all

revenues that qualify as fiscal year spending. Accordingly, if the revenue from the proposed oil and natural gas tax meets the definition of "fiscal year spending" set forth in section 20 (2) (e) of TABOR, such revenue will still have the effect of increasing the amount of revenues that the state is permitted to keep in future fiscal years under referendum C, even if these revenues are not subject to the fiscal year spending limit. Is this your intention?

- e. Even though the requirement that "[t]his tax be reduced by an equal amount of any increase in tax on oil and natural gas proceeds passed by voters at a concurrent or subsequent election" is included in a statute, it is possible that removing this offset requirement could require prior voter approval because doing so could arguably be "a tax policy change directly causing a net tax revenue gain to a district" as such phrase is used in section 20 (4) of TABOR. Is this your intention?