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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 #98, concerning Tax on Oil and Gas and Other Revenue for Public School Buildings and Programs

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 memoranda will provide a basis for discussion and understanding of the proposal.

This proposed initiative was submitted along with proposed initiative measures 2005-2006 #97, #99, #100, and #101. The language of this proposed initiative is similar and, in some cases, identical to language from these other proposed initiatives. As such, many of the comments or questions that are raised in this memorandum are identical to questions or comments that are also raised in the memoranda for these other proposed initiatives. Unless proponents indicate otherwise, it will be presumed that the proponents will have the same answers for identical or very similar questions. The number of the question or comment that also appears in other memoranda will be highlighted (for example, "2") and the location of its first occurrence will be identified after the question or comment (for example, "{#97-2.a}"). If the only change to the question or comment was to the name of the fund referenced, such change is noted (for example, "#97-2.a - fund name change).

Purposes

The major purposes of the proposed initiative, which creates a new article 51.5 in title 22, Colorado Revised Statutes, 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 require the revenue from the proposed oil and natural gas tax to be deposited into the public school improvement fund;
3. To exempt the revenue from the proposed oil and natural gas tax from state and local spending limits;
4. To modify the current distribution of the moneys that the state receives from the federal government pursuant to the "Mineral Lands Leasing Act" of February 25, 1920, as amended, by requiring a portion of the moneys to be deposited into the public school improvement fund;
5. To require a portion of the revenues in the public school improvement fund to be used for public school renovations or construction, prioritizing certain uses, and the remaining revenues to be transferred to the permanent school fund; and
6. To require interest generated from the permanent school fund be used to fund preschool through twelfth grade educational programs.

Comments and Questions

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

Technical questions and comments:

The following comments 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. {#97-1}
2. In the first sentence, it might read better to change the phrase "from such proceeds" to "of such proceeds". {#97-3}
3. The first two sentences would be easier to read if they were broken into shorter sentences.
4. "Fiscal year 2011-2012" should be written as "state fiscal year 2011-12".

5. The state receives money and then the state treasurer deposits or transfers it to the public school improvement fund. Accordingly, it would be more accurate may say the first hundred twenty million dollars that is deposited or transferred into the . . . fund each year", rather than "the first hundred twenty million dollars received each year by the . . . fund".
6. 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".) {#97-5}
7. The proper verb form of "pay" is "paid", instead of "payed". {#97-6}
8. In the third sentence of subsection (1), it would be more precise to say "may be paid for with annual moneys", instead of "may be payed for by annual moneys".
9. With respect to the phrase "revenues and expenditures of the public school improvement fund", it would be more accurate to speak of "revenues in and expenditures from the . . . fund". {97-8 - fund name change}
10. Instead of referring to "this amendment" in the last sentence of the first paragraph the proponents should refer to "this section". {#97-10}
11. Definitions in the Colorado Revised Statutes are usually preceded by an introductory phrase, which would read as follows: {#97-11}

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

(a) "Proceeds" means"
12. The definitions should be in alphabetical order. {#97-12}

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: {#97-1}
 - 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 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 improvement fund:
- a. Is the public school improvement fund to be created in the state treasury? Is there more than one public school improvement fund? (For example, a public school improvement fund for each school district)? {#97-2.a - fund name change}
 - b. The proposed initiative requires the public school improvement fund "to be established by the general assembly." However, the proposed initiative already seems to create the public school improvement fund. What is left for the general assembly to do? (Question 8 also addresses this topic.) {#97-2.b - fund name change}
 - c. Can any moneys other than the revenue from the proposed oil and natural gas tax and the state public school fund moneys received from the federal government pursuant to the federal "Mineral Lands Leasing Act" of February 25, 1920, as amendment, moneys (hereafter referred to as "federal mineral moneys") be deposited or transferred into the public school improvement fund?

3. The following questions relate to the federal mineral moneys that are required to be deposited into the public school improvement fund:
 - a. What does the phrase "by at least fiscal year 2011-2012" mean? Does it mean that beginning with the state fiscal year 2011-12 the state will have to deposit the identified moneys into the public school improvement fund, but before then it may deposit only a portion of the such moneys?
 - b. What are "state public school fund moneys received from the federal government pursuant to the 'Mineral Lands Leasing Act' of February 25, 1920, as amended"? Are they moneys that are currently paid into the state public school fund pursuant to section 34-63-102 (2) (a) and (3) (b) (I), Colorado Revised Statutes?
 - c. Do the federal mineral moneys include revenue from leases of federal lands for production of minerals other than oil and natural gas? If so, what other minerals?
 - d. Where will these moneys be transferred from?
 - e. The requirements of the proposed initiative are contrary to the requirements set forth section 34-63-102, Colorado Revised Statutes, for the distribution of the federal mineral moneys. Which statute will the state treasurer be required to follow? The proponents are encouraged to resolve this conflict by making a conforming amendment to section 34-63-102, Colorado Revised Statutes.
4. The following questions relate generally to the moneys in the public school improvement fund and to the proposed use of such moneys for public school renovations or construction:
 - a. Who will be using the moneys in the public school improvement fund? {#97-3.a - fund name change}
 - b. What does the requirement "shall be used" mean? Does it require the moneys to be spent? Are moneys in the public school improvement 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"? {#97-3.b - fund name change}
 - c. The required and permitted uses of moneys in the public school improvement fund are as follows: preschool through twelfth grade public school renovations or construction; administrative costs; and transfers to the permanent school fund. Is this correct?
 - d. The proposed initiative requires a certain amount of money "received each year" to be used for public school renovations or construction, and this amount will be adjusted annually. As written, this usage requirement appears to be on a calendar year basis. Is this your intention? If so, how do you anticipate the calendar year

funding requirement will work with the state fiscal year budget process? (This same calendar year versus fiscal year issue is also present in the language pertaining to administrative costs and to the requirement that any unexpended balance be transferred to the permanent school fund.)

- e. What does "adjusted annually for inflation" mean? How will "inflation" be defined? Inflation for what period? What corresponding calendar year or fiscal year will be adjusted by the value of inflation?
- f. What does "preschool" mean? How is it different from using the term "kindergarten"?
- g. By using the phrase "renovations or construction", it appears that moneys in the public school improvement fund could be used to repair existing buildings and construct new buildings. Is this your intention? {#97-3.e - fund name change}
- h. Who is responsible for determining which schools and districts should receive moneys from the public school improvement fund? {#97-3.f - fund name change}
- i. As used in the proposed initiative, does "priority" mean "something given or meriting attention before competing alternatives"? If not, what does it mean? {#97-3.g}
- j. There are five priorities established related to the moneys in the public school improvement 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?) {#97-3.h - fund name change}
- k. Can money from the public school improvement fund be used for schools and districts that do not fit within a priority? {#97-3.i - fund name change}
- l. 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? {#97-3.j}
- m. What does it mean to use the moneys from the public school improvement fund "to address immediate student health and safety needs in school buildings"? What are examples of using money for this priority? {#97-3.k - fund name change}
- n. The following questions relate to the code, law, and standard priority: {#97-3.l}
 - 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?
- o. If the moneys from the public school improvement fund are used to construct a building, who will own the building? Who is responsible for the maintenance of the building? {#97-3.m - fund name change}
 - p. How will the expenditures from the public school improvement 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? {#97-3.n - fund name change}
 - q. Can the moneys in the public school improvement fund be invested while they sit in the public school improvement 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 improvement fund. {#97-3.o - fund name change}
 - r. Can moneys in the public school improvement fund be transferred to another fund and used for another purpose? What language in the proposed initiative would prohibit this? {#97-3.p - fund name change}
5. The following questions relate to the use of moneys in the public school improvement fund for administrative costs:
- a. What are administrative costs? {#97-4.a}
 - b. Would any costs related to the general assembly's report qualify as administrative costs?
 - c. Why is the term "construction" only referenced, when the moneys may be used for "renovations or construction"? {#97-4.d}
 - d. What does "used annually" with regard to administrative costs? Does the term "used" mean appropriated or spent? Also, what are "annual moneys". (These references raise calendar year versus fiscal year issues that are similar to those discussed in Question 4.d.)

- e. Are the moneys used for administrative costs part of the one hundred twenty million dollars, adjusted for inflation, required expenditures, or are they on top of such amount?
 - f. Is the limit applied to each type of administrative cost from the public school improvement fund, or is it a limit on the total administrative costs from the public school improvement fund? It could be read either way, so the proponents might consider adding language to clarify your intention. { #97-4.f - fund name change}
6. The following questions relate to the transfer of moneys from the public school improvement fund to the permanent school fund:
- a. While the "unexpended balance remaining in the . . . fund" is to be transferred annually, there is no deadline for this transfer. Was this your intention? (Please note, if the rest of the proposed initiative is to work on a fiscal year basis, then such change should likewise be made here.)
 - b. Will moneys that are appropriated but not yet spent be subject to transfer under this provision of the proposed initiative?
 - c. Is the "permanent school fund" the one referenced in section 14 of the enabling act of the state of Colorado? In at least one instance the "permanent school fund" is defined to mean the public school fund of the state created by section 3 of article IX of the Colorado constitution. See section 22-43.7-102 (2.7), Colorado Revised Statutes. Was it your intention that the "permanent school fund" means the public school fund of the state, which is created in section 3 of article IX of the Colorado constitution and referenced in article 41 of title 22, Colorado Revised Statutes? Given the number school-related funds that currently exist, it might be helpful to specify exactly what the phrase "permanent school fund" is referring to.
 - d. The following questions are based on the assumption that the permanent school fund is the same as the public school fund of the state required by section 3 of article IX of the Colorado constitution and article 41 of title 22, Colorado Revised Statutes:
 - i. As section 5 of article IX of the Colorado constitution specifies the revenues that comprise the public school fund of the state, can the composition of the public school fund of the state be statutorily modified?
 - ii. Is it your intention that moneys that are transferred to the permanent school fund shall remain there inviolate and intact, as required by section 3 of article IX of the Colorado constitution? Have the proponents considered the long-term fiscal impact of the proposed measure on the permanent school fund and the ability of the state to meet future obligations from the fund?
 - iii. Section 3 of article IX of the Colorado constitution refers to "interest and other income thereon", while your proposed initiative only mentions

"interest". Would it avoid confusion to mention income as well?

- iv. The proposed initiative prescribes uses of the interest generated from the permanent school fund without limitation. Accordingly, it appears it will apply to all interest in the permanent school fund regardless of whether it is deposited in the permanent school fund as a result of your proposed initiative? Is this your intention? If it is not your intention, then you need to add language to limit this from happening.
- v. Section 3 of article IX of the Colorado constitution requires that interest in the public school fund of the state "shall be expended in the maintenance of the schools of the state". Are the interest uses set forth in the proposed initiative consistent with this constitutional mandate?
- vi. Section 22-41-101, Colorado Revised Statutes, establishes the composition of the public school fund of the state. Will the proposed initiative modify this composition? If so, a conforming amendment may be necessary.
- vii. Section 22-41-102, Colorado Revised Statutes, establishes a limit on the amount of interest that may be expended in a given year. Section 22-41-106, Colorado Revised Statutes, also requires that interest from the public school fund of the state be credited to the public school income fund. It appears that these statutes will still apply to the public school fund of the state, and will limit the application of the proposed initiative. Was this your intention?
- viii. Will the limits on investing moneys in the public school fund of the state, set forth in section 22-41-104, Colorado Revised Statutes, apply to the moneys deposited into the permanent school fund pursuant to the proposed initiative?
- ix. How will your proposed uses of the interest from the permanent school fund impact any school bonds that were guaranteed by the state pursuant to section 22-41-109, Colorado Revised Statutes?
- e. What does the requirement that interest "shall be allocated annually" mean? Who will do such allocation? If it is the general assembly, will the moneys be appropriated? Is it your intention that all interest and income earned on the money required to be spent in the year that it is earned?
- f. The list of allowable uses of the interest is not exhaustive, correct?
- g. What are examples of programs to lower the drop out rate?
- h. Is the state required to use the interest to fund educational programs or will the state give the money to school districts so that it may use the moneys to fund educational programs?

- i. Is funding to provide low income children the opportunity to attend voluntary quality preschool programs really an exception to the requirement the interest be allocated annually to fund preschool through twelfth grade?
 - j. How will the priority work? Does this mean that the interest must first be used for providing low income children the opportunity to attend voluntary quality preschool programs before it can be used for any other use?
 - k. The following questions relate to sentence that reads as follows: "Allocations of interest must be in addition to other education funding requirements as of passage of this amendment."
 - i. What is an "education funding requirement"? What other education funding requirements are there? It may be more clear if you specifically identify such requirements.
 - ii. Is it your intention that this sentence will limit which interest generated from the permanent school fund has to be used in the manner set forth in the proposed initiative?
7. The following questions relate to the report that the general assembly is required to annually publish (hereafter referred to as "document")?
- a. How is a "report" different from an "accounting" which was the term used in proposed initiatives #97 and #100?
 - b.** 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? {97-5.a}
 - c. How detailed will the document be? Will it only include the appropriations made by the general assembly? Will it include expenditures made by school districts?
 - d.** By using the phrase "revenues and expenditures", was it your intention to address both moneys deposited into the public school improvement fund and moneys appropriated from the public school improvement fund? {#97-5.c - fund name change}
 - e.** 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? {#97-5.d}
 - 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? {#97-5.e}

8. 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 9.d also addresses this topic.) {#97-6}
9. 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.) {#97-8.a}
 - 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 improvement 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 improvement fund? (This issue can be avoided by simply creating the public school improvement 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".) {#97-8.b.i - fund name change}
 - 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. {#97-8.b.ii}
 - 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.) {#97-8.b.iii}
 - 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? {#97-8.c}
 - 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? {#97-8.d.i}

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? {#97-8.d.ii}

e. How will the passage of a concurrent or subsequent tax on oil and natural gas affect the proposed oil and natural gas tax?