3rd Draft

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

Amendment (?) proposes changing the Colorado statutes to:

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

- allocate the increased severance tax revenue to college scholarships for state residents, wildlife habitat, renewable energy projects, transportation projects in energy-impacted areas, and water treatment 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 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 five 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 (?) eliminates a state tax credit, increases the number of oil and gas wells subject to the tax, and changes the tax rate on oil and gas companies. These changes are estimated to increase state severance tax collections by $304 million in budget year 2010.

Eliminating the state tax credit. The state currently allows companies to reduce their severance tax payment by 87.5 percent of local property taxes paid on oil and gas. 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 smaller wells subject to the tax. With this change, the production on which the tax is paid 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.

Changing the tax rate on oil and gas companies. Colorado currently taxes oil and gas companies at rates between 2 and 5 percent, depending on income. Amendment (?) changes the tax to a flat, 5 percent rate for companies earning

$300,000 or more, eliminating taxes for small companies and increasing taxes on large companies. As a result, a company earning more than $300,000 will pay 5 percent on all of its income, while a company earning less than $300,000 will pay no severance tax. The loss in revenue from small companies is expected to be minimal, while the tax increase on large companies is estimated to raise state severance tax collections 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 when each state's exemptions, deductions, and credits are taken into account. In budget year 2007, Colorado's actual severance tax rate was 1.3 percent; Montana's rate was the highest at 6.8 percent. Assuming the taxes in other states remain the same, Amendment (?) raises Colorado's severance tax ranking to the third lowest. 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 current law? Under current law, Colorado severance tax revenue is evenly divided between state programs and local governments. The state portion pays for water projects and programs related to mineral extraction, clean energy development, low-income energy assistance, and wildlife conservation. The local government portion is distributed to communities affected by mining, either based on mining activity in the area or through competitive loans or grants.

How does Amendment (?) distribute severance tax revenue? Under Amendment (?), the state programs and local governments that currently receive all of the severance tax revenue will evenly split 44 percent of severance tax collections. Although the portion of money set aside for these uses is less than under current law, the increased collections under Amendment (?) are estimated to provide existing programs with about the same amount of money. 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 programs as follows:

- 60 percent for a college scholarship program 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 Amendment ? provides to these uses over the next four budget years.

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

New Programs	2009 (half-year)	2010	2011	2012	Four-Year Total
Held in reserve	$14	$29	$32	$34	$109
College scholarships	$78	$156	$172	$183	$589
Wildlife habitat	$20	$39	$43	$46	$148
Clean energy	$13	$26	$29	$31	$99
Transportation projects	$13	$26	$29	$31	$99
Water grants	$7	$13	$14	$15	$49
Total new programs:	**$145**	**$289**	**$319**	**$340**	**$1,093**

How do Amendment (#113) and Amendment (#120) interact? Both Amendment (#113) and Amendment (#120) change how the state spends severance tax revenue, but the two measures propose different uses for the money. Thus, some of the provisions of these measures appear to conflict with one another. Amendment (#120) proposes a change to the state constitution, and this measure proposes a change to state statute. When conflicts arise between the constitution and statutes, the constitution prevails. Since Amendment (#120) is a constitutional change, if both measures pass, any parts of this measure that are found to be in conflict with Amendment (#120) will not take effect. These issues will be resolved after the election. The state will likely implement the measures based on a state legal opinion, or the court system may have to decide how the measures take effect.

Arguments For

1) Amendment (?) creates a new source of money for state and community programs that will help improve the state's economy, environment, and infrastructure. These programs are a sound investment in Colorado's future and a better use of state dollars than providing a tax credit to oil and gas companies. These companies are experiencing record profits and no longer need the tax break.

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 have much of an effect on production in Colorado. Colorado currently has the lowest severance tax rate among large-producing western states. By eliminating the state tax credit and tightening the small-well tax exemption, Amendment (?) increases the compensation that Colorado citizens receive for the extraction of natural 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 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. According to one recent analysis, the industry accounts for over 70,000 jobs in the state – either through direct employment or as a result of the industry's activities – and contributes around $23 billion to the state's economy. By more than doubling the state's severance tax, Amendment (?) is likely to make Colorado less attractive to the oil and gas industry, which may reduce investment and result in a loss of jobs. Moreover, the tax increase is occurring at a time when more production could help lower energy prices.

2) The spending plan for the new money is vague and relies upon a volatile source of money. Amendment (?) contains few specifics 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 state tax credit is justifiable given the higher property taxes paid by the industry. Currently, oil and gas property is valued at nearly three times the rate as other business properties. The higher property taxes paid by the industry provide local communities in energy-impacted areas with the financial resources to address the effects of oil and gas production. The state tax credit offsets these higher local 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 at record levels and electricity costs projected to increase by as much as 38 percent annually.

Estimate of Fiscal Impact

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 spending 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 current law. The new programs created by the amendment will gain a total of $1.1 billion over the next four years, of which a portion will cover the administrative costs of the programs.