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MEMORANDUM

March 17, 2008

TO: James Udall and Tony Lewis

FROM: Legislative Council Staff and Office of Legislative Legal Services

SUBJECT: Proposed initiative measure 2007-2008 #78, concerning severance tax

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 amendment appear to be:

1. To modify the state severance tax on oil and gas that is collected on and after January 1, 2009, as follows:
 - a. Eliminating the graduated rate of taxation, establishing a tax rate of 4.85%, and exempting all gross income below \$300,000;
 - b. Eliminating an exemption for oil and gas wells that have minimal production; and

- c. Eliminating a credit against the tax that is based on property taxes paid;
2. To permit the state to retain and spend all the revenues received from the modified tax on the severance of oil and gas notwithstanding the constitutional limitation on fiscal year spending or any other spending limit; and
3. To modify the distribution of oil and gas tax revenues.

Comments and Questions

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

Technical questions:

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

1. References to paragraphs in new, small capped language should appear in lowercase, regular type (page 1, lines 17, 18, 19, 22, 23, 27, and 32; page 2, lines 10 and 12; and page 3, line 35).
2. The type of section subdivision being created in section 2 of the proposed initiative (page 1, line 13) is a subsection rather than a paragraph. Also, in the amending clause to section 2, and again in the amending clause to section 6, the words "BY THE ADDITION OF A NEW SUBSECTION" should be in all capital letters rather than small capitals.
3. The word "section" should precede references to statutory section numbers (page 1, line 17, and page 3, line 34).
4. Statutory definitions sections should be in alphabetical order. The definition of "higher education capital construction" in section 2 of the proposed initiative (page 1, lines 15-33) should be properly located in section 39-29-102 (4.5), Colorado Revised Statutes.
5. Should page 1, lines 29 and 30, refer to "higher education capital construction" rather than just "capital construction"?
6. The amending clause to section 3 of the proposed initiative (page 1, line 35) should read as follows:

"SECTION 3. The introductory portion to 39-29-105 (1) (b), Colorado Revised Statutes, is amended, and the said 39-29-105 (1) is further amended BY THE ADDITION OF A NEW PARAGRAPH, to read:"
7. The percentage on page 2, line 16, should read as follows: "four and eighty-five hundredths percent".

8. The newly created 39-29-105 (3), Colorado Revised Statutes, (page 2, lines 19-25) requires its own amending clause and section headnote, which should read as follows:

"SECTION 4. 39-29-105, Colorado Revised Statutes, is amended BY THE ADDITION OF A NEW SUBSECTION to read:

39-29-105. Tax on severance of oil and gas. (3) THE PROCEEDS OF THIS TAX..."

The succeeding sections of the proposed initiative would then need to be renumbered accordingly (page 2, line 27, and page 3, lines 11 and 28). Please note that, for the sake of clarity, the remainder of this memorandum refers to the proposed initiative sections as they currently read.

9. The amending clause to section 5 of the proposed initiative (page 3, line 11) should read as follows:

"SECTION 5. The introductory portion 39-29-110 (1) (c.5), Colorado Revised Statutes, is amended, and the said 39-29-110 is further amended BY THE ADDITION OF A NEW SUBSECTION, to read:"

10. Since 39-29-110 (1) (c.5) (I) and 39-29-110 (1) (c.5) (II), Colorado Revised Statutes, are not amended by the proposed initiative, they need not be included (page 3, lines 20-23).

Substantive questions:

1. Section 1 (5.5) of article V of the Colorado constitution requires all proposed initiatives to have a single subject. What is the single subject of the proposed amendment?
2. Was it your intention to modify the amount of state severance tax that is levied, collected, and paid each taxable year commencing on or after January 1, 2009?
3. The following questions relate to the changes made to section 39-29-105 (1) (b), Colorado Revised Statutes:
 - a. It appears that you are specifying that the current tax imposed on the oil and gas severed from the earth in this state will only apply through the taxable year commencing January 1, 2008. Is this your intention?
4. The following questions relate to the addition of paragraph (c) to subsection (1) of section 39-29-105, Colorado Revised Statutes:
 - a. Is it your intention that paragraph (c) impose a new tax on the oil and gas severed from the earth in this state from the taxable year commencing on and after January 1, 2009?

- b. Was it your intention to remove the exemption for a marginal wells from this new tax commencing on and after January 1, 2009?
 - c. The new paragraph (c) specifies that any gross income under \$300,000 is taxed at 0%. Why tax up to \$300,000 if the rate is zero? Is this the same thing as exempting the first \$300,000 for each taxpayer from the tax? Is it your intention that any income less than \$300,000 is not subject to any tax?
 - d. How will this new paragraph (c) modify the estimated payments that are calculated in section 39-22-606 (5), Colorado Revised Statutes, and owed for a taxable year commencing on or after January 1, 2009?
 - e. The current credit against the oil and gas tax that is set forth in section 39-29-105 (2) (b), Colorado Revised Statutes, only applies to "the tax computed in accordance with the provisions of [39-29-105 (1) (b)]." Was it your intention that the credit should not apply to the new tax set forth in paragraph (c)?
5. Unless a taxpayer's gross income is less than \$300,000, any gross income from the severance of oil and gas from a marginal well will be taxed at 4.85%. Was this your intention?
6. Could taxation of production from marginal wells that were previously exempt provide a disincentive for a producer to continue production at such wells, and in turn lead to more new drilling permits?
7. The following questions relate to the new subsection (3) that was added to section 39-29-105, Colorado Revised Statutes:
- a. What is a "voter-approved revenue change"?
 - b. What does it mean that the revenue shall be collected and spent "without regard to any spending limitation . . . "?
 - c. Subsection (3) applies only to the revenue received by operation of section 39-29-105 (1) (c), Colorado Revised Statutes, which applies to the taxable years commencing January 1, 2009. Accordingly, does subsection (3) then first apply to any revenue collected for the 2009 tax year?
 - d. What is "investment income"? How will it be tracked if the money is allocated pursuant to 39-29-108 (2) (b), Colorado Revised Statutes, and commingled with other state money?
 - e. Assuming that the changes you have made to section 39-29-105, Colorado Revised Statutes, will result in more tax income for tax years commencing on and after January 1, 2009, is all revenue collected pursuant to this section to be treated as a voter-approved revenue change or just the increased revenue that results from your changes?

- f. How would the collection of the severance tax otherwise limit "the amount of other revenue that may be collected and spent by the state or any district"? What does this phrase mean?
 - g. How will the tax revenue impact the revenue that the state is permitted to retain and spend pursuant to Referendum C, approved by the voters in 2005?
8. The following questions relate to section 39-29-108 (2), Colorado Revised Statutes:
- a. Was it your intention that revenue from the oil and gas severance tax should no longer be treated the same as other severance tax revenue?
 - b. Oil and gas severance tax revenues are currently split between the local government severance tax fund and the state severance tax trust fund. You have lowered the percentages of revenues credited to those funds, but also increased the total revenue generated from the tax. What will the net impact be on the amount that is credited to these funds?
 - c. The following questions relate to subparagraph (III) of paragraph (b):
 - i. One purpose of the proposed initiative appears to be providing money for higher education capital construction projects. Section 4 of the proposed initiative credits 7 % of severance tax revenues to the capital construction fund (CCF) "for the purposes set forth therein". The CCF is used to fund capital construction and controlled maintenance projects of all state agencies, including executive branch state departments (such as the department of revenue or the department of human services) and higher education institutions. Is it your intent that severance tax revenues transferred to the fund be used for non-higher education capital construction projects or controlled maintenance projects? If not, do you wish to amend the proposed initiative to clarify this?
 - ii. If it is your intent to use a portion of the revenues for non-higher education capital construction projects, is there an inconsistency in the initiative's amendment of section 39-29-101 (3), Colorado Revised Statutes, that states that a portion of severance tax revenues should be used for higher education capital construction?
 - iii. If you intend that the state use a portion of the severance tax revenue for general state capital construction in addition to higher education capital construction, do you intend to provide any guidelines on how the additional money for general state capital construction should be used?
 - d. With regard to subparagraph (III) of paragraph (b), is it your intention that this particular twenty three percent of the revenues credited to the local government severance tax fund be split 70% as set forth in section 39-29-110 (1) (c.5) (I),

Colorado Revised Statutes, and 30% as set forth in section 39-29-110 (1) (c.5) (II), Colorado Revised Statutes?

- e. With regard to subparagraph (IV) of paragraph (b), will there be enough to cover all of those current distributions from the fund? What happens if there is not enough? Would that leave current programs unfunded?
 - f. With regard to subparagraph (V) of paragraph (b), is it correct that all of this particular portion of the revenues is to be deposited into the local government severance tax fund and distributed as required in section 39-29-110 (1) (b), Colorado Revised Statutes, but that such revenue will not be part of the 70/30 split for the fund set forth in section 39-29-110 (1) (c.5), Colorado Revised Statutes? How will this work?
9. The following questions relate to section 39-29-110 (1) (c.5), Colorado Revised Statutes:
- a. House bill 08-1083, which is awaiting second reading in the Senate, repeals paragraph (c.5) as it is currently written. If that bill becomes law, will your change still work?
 - b. Would you consider saying "shall be distributed to political subdivisions in the manner specified in paragraph (b) of this subsection (1)"?
10. The following questions relate to section 39-29-108.6, Colorado Revised Statutes:
- a. You have created this fund in article 29 of title 39, Colorado Revised Statutes. This particular title is reserved specifically for taxation issues, and article 29 specifically for the severance tax. Since this fund relates to higher education, would you consider creating the fund in title 23, Colorado Revised Statutes, which relates specifically to general and administrative provisions related to the state universities and colleges?
 - b. Would you consider writing the first sentence of your new section as follows:

"There is hereby created in the state treasury the higher education capital construction trust fund."
 - c. Why is this a "trust fund"? Does this impose any additional duties on the state treasurer?
 - d. Is it your intention that the treasurer administer the trust and act as the trustee with all applicable fiduciary duties?
 - e. What do you mean by "the fund is perpetual"?
 - f. Was it your intention, in making this a perpetual trust fund, that the general assembly would not be able to transfer money out of the fund? Is it possible that only a

constitutional amendment would truly keep the general assembly from transferring money out of the fund?

- g. What is the difference between "income derived" and "interest earned"? Why are the two different terms used?
- h. To whom is the money to be appropriated?
- i. The proposed initiative says the "[I]nterest earned on the deposit and investment of the moneys in the higher education capital construction trust fund shall be appropriated annually for higher education capital construction." (Emphasis added). Colorado's fiscal year runs from July 1 through June 30, but the legislature adopts legislation for annual appropriations to state agencies by early- or mid- April each year. In which fiscal year will interest earnings on the higher education capital construction trust fund be calculated for appropriations? For example, the legislature typically appropriates capital construction fund interest earnings based on actual earnings through the 3rd quarter of the fiscal year (March) plus projected interest earnings through the 4th quarter of the fiscal year (June). Appropriations can also be made on actual capital construction fund interest earnings in a prior fiscal year. Do you intend to appropriate interest earnings on the higher education capital construction trust fund from the prior fiscal year or the current fiscal year?
- j. The proposed initiative says "interest earned on the deposit and investment of moneys in the higher education capital construction trust fund shall be appropriated annually for higher education capital construction." (Emphasis added.) Do you intend to require that appropriations be made for this purpose from this fund every year? If so, what happens if the amount of interest earned in a given year is insufficient to fund one or more projects?
- k. Will this effect the enterprise status of state institutions of higher education?
- l. You specify that the purpose of the fund is "...for capital construction." Do you mean higher education capital construction as you defined in section 39-29-102 (8), Colorado Revised Statutes?
- m. You limit the definition of state institutions of higher education to only paragraph (a) of subsection (10) of section 23-18-102, Colorado Revised Statutes. Does that mean that you do want junior colleges "that are part of a junior college district organized pursuant to article 71 of this title" to be included in your definition?
- n. Assuming you mean that the money from the fund is to be transferred rather than appropriated, does the last sentence of this section, "interest earned on the deposit and investment of moneys in the ... fund shall be appropriated annually for higher education capital construction" mean that you only want the interest to be transferred from the fund? Is it your intention that the corpus of the trust may not be expended?

- o. Would you consider moving the definition of higher education capital construction set forth in section 39-29-102 (8), Colorado Revised Statutes, to this section instead? For example, creating a paragraph (a) and (b), where (a) includes the language in your current proposal and (b) would specify, "For purposes of this section, higher education capital construction means: ...". If not, would you consider saying in your last sentence, "...for higher education capital construction as defined in section 39-29-102 (8)."?
- p. What is "scientific equipment"? Why a \$50,000 minimum?
- q. Capital construction projects are given a specific period of time to expend appropriations, typically 3 years. Sometimes a capital construction project's actual cost is less than its appropriation. What will happen to the appropriated but expired and unexpended funds from the higher education capital construction trust fund? Will they revert to the fund or be transferred to another fund? For example, with the capital construction fund, section 24-75-302, Colorado Revised Statutes, specifies that, "All moneys unexpended or not encumbered from the capital construction fund appropriation to each department for any fiscal year shall revert to the capital construction fund at the end of the period for which such moneys are appropriated."
- r. Do you intend to allow agencies to use unexpended balances from a capital construction appropriation from the higher education capital construction trust fund for additional higher education capital construction projects that are beyond the scope or design of the original project?
- s. Cash-funded higher education capital construction projects are initially submitted to the Colorado commission on higher education (CCHE) for review. Is it your intent that CCHE have initial decision-making authority for higher education capital construction projects to be funded from the higher education capital construction trust fund? Is it your intent that the general assembly have sole decision-making authority for higher education capital construction projects to be funded from the higher education capital construction trust fund?
- t. Cash-funded higher education capital construction projects costing more than \$500,000 are approved by Colorado commission on higher education (CCHE) and sent to the legislative capital development committee (CDC) for review. The CDC makes funding recommendations for these projects to the joint budget committee (JBC), and the JBC then proposes legislation to authorize revenue and expenditures for approved projects. Cash-funded higher education capital construction projects under \$500,000 are reported annually to the legislature in a report from CCHE. If this proposed initiative were to become law, the higher education capital construction projects to be funded from the higher education capital construction trust fund would go through the above process. Is this your intent? If not, would you consider amending the proposed initiative to clarify this?
- u. Capital construction projects currently request funds from one or more of four

possible sources: (1) Capital construction funds exempt (CCFE, or state funds); (2) cash funds exempt (CFE, or cash funds either appropriated to another department and counted under TABOR limits then transferred to the requesting agency, or cash funds such as gifts, grants, or donations not subject to TABOR limits); (3) cash funds (CF, or cash funds counted under TABOR limits); or (4) federal funds (FF). According section 3 of the proposed initiative, the higher education capital construction trust fund would be exempt from the limits of TABOR, and as such, would be considered CFE for purposes of capital requests and appropriations. Is this your intent? If not, would you consider amending the proposed initiative to clarify this?

- v. Capital construction projects receive appropriations via legislation such as the annual appropriation bill or supplemental bills. Funding sources for specific types of projects are tied to qualified projects through the use of a footnote in the annual appropriation bill or supplemental bills. For example, monies in the corrections expansion reserve fund (CERF) can only be used for prison construction or renovation projects. In Senate Bill 07-239 (page 2841, Session Laws of Colorado 2007), footnote b reads: "This amount shall be from the Corrections Expansion Reserve Fund created in Section 17-1-116, C.R.S.", indicating that \$4,566,949 shown in the cash fund exempt column is from the CERF, while the balance of the project's cost of \$10,399,102 comes from state funds, as shown in the capital construction funds exempt column . If the proposed initiative were to become law, the higher education capital construction trust fund would be cited similarly in footnotes of the annual appropriation bill or supplemental bills in the cash fund column. Is this your intent? If not, would you consider amending the bill to clarify this?
11. How much additional revenue is estimated to be generated from this proposed initiative? How was such estimate derived?
 12. If the proposed initiative is passed by the voters at the November 2008 general election, does this give enough time for the general assembly, the department of revenue, and private entities to implement, administer, and comply with its provisions? Initiated measures are effective upon proclamation of the governor unless a later effective date is specified. Would you care to specify a later effective date?