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MEMORANDUM

April 17, 2007

TO: Matt Samelson and Megan Ferland

FROM: Legislative Council Staff and Office of Legislative Legal Services

SUBJECT: Proposed initiative measure 2007-2008 #13, concerning imposition and distribution of severance tax on oil and gas

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.

Proposed initiative 2007-2008 #13 was submitted with proposed initiatives 2007-2008 #14 through #15, which were all substantially similar. Accordingly, the questions and comments set forth in this review and comment memorandum also apply to those proposed initiatives, unless the context otherwise requires.

Purposes

The major purposes of the proposed amendment appear to be:

1. To eliminate the current state severance tax on oil and gas and replace it with a new tax on the severance of oil and gas at a rate of at least five percent;

2. To exempt the first three hundred thousand dollars of gross income from the new tax on the severance of oil and gas;
3. To prohibit a tax credit against the new tax on the severance of oil and gas for ad valorem taxes assessed;
4. To exclude the revenues received from the new tax on the severance of oil and gas from definition of fiscal year spending and from all spending limits; and
5. To require twenty-five percent of the revenues from the new tax on the severance of oil and gas to be distributed to energy-impacted communities.

Comments and Questions

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

Technical 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. The headnote (page 1, line 5) should be indented and in lower case (but initial cap the first word). Also, the constitutional language should go directly after the headnote instead of being on a separate line.
2. The preferred style is to use a comma after the last item in a series before the conjunction (page 1, lines 12 and 35).
3. The following comments relate to page 1, lines 20 and 21: Dollar amounts should be written out; "\$0 and" does not add any meaning to the phrase on line 20; and information that is introduced by a subsection should be set apart in a paragraph. So that line 20 would be written "(a) Under three hundred thousand dollars . . ." and line 21 would be written "(b) Three hundred thousand dollars and over . . ."
4. It is unnecessary to include the percentage written numerically in a parenthetical (page 1, lines 20, 21, and 32).
5. When referencing "this section" it is not necessary to include the section number (page 1, lines 30 and 37).
6. Paragraph (b) of subsection (5) of the proposed initiative does not appear to follow the introductory portion of subsection (5), insofar as it does not explicitly include a proportion.
7. On page 1, lines 37 and 38, "section 22 except for subparagraph (5) (a)," should be written as "paragraph (a) of subsection (5) of this section."

8. One page 1, line 40, the reference to "Section 105 of article 29 of title of 39", should be written as "Section 39-29-105." And, when referencing a statutory section the phrase "of the" does not need to be used before the phrase "Colorado Revised Statutes."
9. On page 2, line 7, General Assembly should not be initial capped.

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. By placing the new oil and gas tax in the Colorado constitution, it can only be modified by a constitutional amendment. Is this your intention?
3. The following questions relate to subsection (1) of the proposed initiative:
 - a. What is the purpose of the declaration in subsection (1)? Is it supposed to change the interpretation of the rest of the amendment?
 - b. The declaration references "nonrenewable natural resources" and "nonrenewable resources", but the actual tax is limited to "oil and gas". Is there a reason for the difference in the terminology?
 - c. If the section creates a new severance tax, is it correct to characterize the exclusion of an ad valorem credit as being "eliminate[d]"? Should it more specifically refer to the "existing statutory ad valorem property tax credit"?
 - d. What is a "long-term sustainable asset"? How is a severance tax or the revenue therefrom a "long-term sustainable asset"?
4. The following questions relate to subsection (2) of the proposed initiative:
 - a. If section 39-29-105, Colorado Revised Statutes, is repealed on January 1, 2008, and the new tax applies for each taxable year commencing on or after January 1, 2008, there may be a gap in the collection of the taxes. For example, a company whose tax year begins on October 1, 2007, will not be required to pay a severance tax for the first nine months of 2008. Also, the statutory authority for imposing and collecting taxes levied prior to January 1, 2008, would be eliminated. Was this your intention?
 - b. Do you intend this section to create a new tax or is the section supposed to be construed as a modification to an existing tax, which may potentially cause a tax policy change directly causing a net tax revenue gain to the state? The estimate of the revenue impact that will be required in the notice and ballot question pursuant to section 20 of article X of the Colorado constitution will vary depending on which one it is. As written, it seems more likely it will be interpreted as the former.

- c. Is this a statewide tax or a locally collected tax?
 - d. Who will administer and collect the tax?
 - e. How do you define "oil and gas"?
 - f. What is "gross income"? Is it the same as the definition set forth in section 39-29-102 (3) (a), Colorado Revised Statutes? Must it be the same?
 - g. Whose "gross income" is being referred to?
 - h. What happens if the sale of oil and gas is to a related party?
 - i. Who is required to pay the tax? Is there anything in the language of the proposed initiative that would prohibit the General Assembly from establishing that the tax was on the gross income of each well?
 - j. Why tax up to three hundred thousand dollars if the rate is zero? Is this the same thing as exempting the first three hundred thousand dollars?
 - k. With respect to gross income three hundred thousand dollars and over, the proposed initiative establishes a range of tax rates, but it is unclear what you intend the rate of taxation to be at the outset. Could the initial rate be set by the General Assembly, for example, at seven percent? Would voter approval be required for an initial rate in excess of five percent? Without establishing a specific rate, it may not be possible to prepare the notice of the estimate of the costs of the tax increase or the ballot question as required by section 20 of article X of the Colorado constitution. Would the proponents consider identifying the initial tax rate? In the absence of a clarification, who is supposed to decide what the rate should be?
 - l. It appears that the General Assembly is authorized to adjust the rate after the passage of the initiative, so long as the rate was above five percent? If it increased the rate, would such an increase be subject to the voter approval requirement in section 20 (4) of article X of the Colorado constitution?
 - m. If there is more than three hundred thousand dollars, would the entire amount be subject to the higher tax rate or just the amount equal to or above three hundred thousand dollars? For example, how would three hundred fifty thousand dollars be taxed?
 - n. Are any other taxes on the severance of oil and gas permissible?
5. The following questions relate to subsection (3) of the proposed initiative:
- a. Would there be any credit for ad valorem taxes assessed in the absence of subsection (3)? If not, why include this provision?

- b. Subsection (3) only prohibits one type of credit. Would the General Assembly be permitted to create any other type of credit? Could the General Assembly provide grants or other assistance to oil and gas producers?
6. The following questions relate to subsection (4) of the proposed initiative:
- a. The current severance tax on oil and gas is included in the definition of "fiscal year spending," as that term is defined in section 20 of article X of the Colorado constitution, and accordingly, it is included within the state fiscal year spending limit. Subsection (4) would exclude the revenue from the new tax on the severance of oil and gas? Is this your intention?
 - b. Referendum C, approved by the voters of the state at the November 2005 statewide election, specifies that the calculation of future caps on retained revenue after the 2009-10 fiscal year is based on the highest amount of revenue attained during the previous five fiscal years. How will the exclusion of revenues from state fiscal year spending impact this limit? Was it your intention to affect the amount of excess revenues that the state is permitted to retain and spend beginning in the 2009-10 fiscal year?
 - c. Subsection (4) refers to "spending limits . . . within any other law." What other spending limits are you referring to? Does it include the limit on appropriations established in section 24-75-201.1, Colorado Revised Statutes?
 - d. Are local governments going to collect any revenue from the proposed oil and gas tax? Assuming they are not directly receiving money, are the exclusions in subsection (4) that apply to local governments referring to money that a local government receives from the state, which the state in turn received from the proposed oil and gas tax?
7. The following questions relate to subsection (5) of the proposed initiative:
- a. The following questions relate to the phrase "appropriated annually":
 - i. As the General Assembly makes appropriations, was your intention to ensure that the General Assembly, rather than an executive agency has control over the use of the revenues from the new tax?
 - ii. Can the General Assembly appropriate the revenues on a fiscal year basis?
 - iii. Does this phrase limit the General Assembly from continuously appropriating any revenues that are received from the tax?
 - iv. Does this phrase prohibit the General Assembly from saving the money to be used in rainy day fund? (If the General Assembly is required to pass laws that grant spending authority over the revenues each year, then it is not

possible to save that money.)

- v. If the General Assembly is required to appropriate the revenue from the tax annually, how can the state "create a long-term sustainable asset" related to the new tax?

- b. Is there any limitation on which funds the revenues from the new tax may be deposited? To the extent that there is not a conflict, could the revenues be deposited in the same funds that the current severance tax is?

- c. If there is a conflict with the current statutory distribution of revenue from the new oil and gas tax, was it your intention to change the distribution?

- d. Prior to being distributed, can the revenues from the new tax be invested? If so, was it your intention that such interest income or interest be considered "revenues generated by operation of this section"?

- e. The following questions specifically relate to paragraph (a):
 - i. In the phrase "appropriated and distributed directly", does "directly" modify both "appropriated" and "distributed", or just "distributed"? (An appropriation is authority to spend, and the general assembly would not appropriate moneys to a municipality.)

 - ii. What are "energy-impacted communities"? Is an energy-impacted community different from one impacted by development, processing, transportation, or energy conversion of oil and gas? If not, is this sentence redundant?

 - iii. The phrase "distributed directly to energy-impacted communities in counties and municipalities . . ." appears to require money be distributed to a community rather than a county or municipality. Was this your intention? If so, how can this be accomplished?

 - iv. Is twenty-five percent the maximum amount that may be distributed to energy-impacted communities? Could the General Assembly appropriate more pursuant to paragraph (b) of subsection (5)?

 - v. What are examples of communities that are socially or economically impacted by the development, processing, transportation, or energy conversion of oil and gas? To the extent it is similar to the phrasing in section 39-29-110 (1) (b) (I), Colorado Revised Statutes, should it be interpreted in the same manner as the statute? Insofar as "transportation" has been added to the statutory language, what is an example of a community impacted by transportation?

- vi. While paragraph (a) describes the communities that the money is to be distributed to, it does not prescribe any uses. Was it your intention that the moneys be used for any particular purpose? Is the state permitted to assign any uses for the money, or must it simply distribute the money to the communities to be used as the community sees fit?
 - vii. Does it matter when the community was impacted by the extraction of oil and gas? For example, is it limited to the severance of oil and gas that is subject to the new tax in the proposed initiative or does it apply to any community that has been impacted historically?
 - f. In paragraph (b) of subsection (5), does the requirement that any other revenue be appropriated "as may be determined by the general assembly" limit the Governor's veto authority of any law containing such appropriations? Was it intended to permit the General Assembly to appropriate the revenues in a resolution, which is not presented to the Governor for his or her consideration?
 - g. The declaration in subsection (1) of the proposed initiative states that "it is appropriate and fitting that the state . . . dedicate a portion of the revenues collected as a result for the purpose of creating long-term sustainable assets for the people of Colorado." Was it your intention that this declaration should in any way affect or limit the distributions established in subsection (5)? This question is particularly important for paragraph (b) of subsection (5), which otherwise contains no limits on the authority of the state to distribute the moneys.
8. The following questions relate to subsection (6) of the proposed initiative:
- a. Section 39-29-105, Colorado Revised Statutes, establishes the current tax on the severance of oil and gas in Colorado. Pursuant to subsection (9) of the proposed initiative, the existing severance tax will be repealed on January 1, 2008, if the proposed initiative is approved by the voters. How will this impact a producer whose tax year commencing in 2007 was not complete? Is the rest of the tax year to be tax-free? If so, this will reduce state revenue and the state fiscal year spending for the 2007-2008 fiscal year and require the General Assembly to modify appropriations it made for the year.
 - b. Pursuant to section 39-29-111 (1), Colorado Revised Statutes, withholdings for the calendar quarter from October through December 2007 are to be paid to the Department of Revenue on or before March 1, 2008. If section 39-29-105, Colorado Revised Statutes, is repealed on January 1, 2008, will the withholding payment for the end of 2007 still be required to be made?
 - c. How will subsection (6) impact the requirement set forth in section 39-29-112 (1), Colorado Revised Statutes, that a return be filed on or before the fifteenth day of the fourth month following the end of the taxable year? Assuming that the return for the tax year commencing during 2007 has not been filed as of January 1, 2008, would a

return still be required to be filed during 2008? (If not, then presumably any estimated taxes or withholdings would need to be returned to the taxpayers.)

9. The following questions relate to subsection (7) of the proposed initiative:
 - a. What are "minimal production levels"?
 - b. Section 39-29-105 (1) (b), Colorado Revised Statutes, establishes exemptions based on production levels. Can the General Assembly depart from the amounts and method for calculating, which is based on a daily averages, set forth in that section?
 - c. What if the General Assembly established a minimal production level that eliminated half of the potential revenue from the tax?
 - d. Subsection (7) permits one type of exemption. Would the General Assembly be permitted to create any other type of exemption?

10. The following questions relate to subsection (8) of the proposed initiative:
 - a. What type of conforming amendments will be necessary and appropriate? What type of additional enactments? Would it include statutes relating to withholding payments, estimated payments, filing of declarations and returns, and penalties and interest?
 - b. The current severance tax on oil and gas is guided by other statutory provisions that relate to the collection and enforcement of the tax; for instance, withholding payments, estimated payments, filing of declarations and returns, and penalties and interest. Is the General Assembly permitted to retain those types of features?
 - c. By only referencing the General Assembly, was it your intention to somehow limit Governor's veto authority relating to laws ?
 - d. What happens if the General Assembly does not pass any laws? (For example, the House of Representatives and Senate cannot agree on the exemption or the gross income definition.) Who will address the necessary details to collect the tax?
 - e. What are the "purposes of the section"?
 - f. Does this really add anything to the authority of the General Assembly? Could the General Assembly pass laws on this subject even if this provision were not included in the proposed initiative?

11. If the proposed initiative becomes effective on January 1, 2008, does this give enough time for the General Assembly , the Department of Revenue, and private entities to implement, administer, and comply with its provisions?