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MEMORANDUM

April 4, 2008

TO: Michael Bowman and David Theobald

FROM: Legislative Council Staff and Office of Legislative Legal Services

SUBJECT: Proposed initiative measure 2007-2008 #88, 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 5.0%, and exempting all gross income below \$300,000;
 - b. Eliminating an exemption for oil and gas wells that have minimal production;
 - c. Eliminating a credit against the tax that is based on property taxes paid; and

- d. Establishing a new taxpayer responsible for the tax;
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 severance taxes imposed on minerals and mineral fuels.

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. The following questions and suggested changes relate to section 1 of the proposed initiative:
 - a. The phrase "a vote of the people at the 2008 general election" (emphasis added) is standard drafting language.
 - b. There should be no comma after the words "following enumerated purposes".
 - c. The first word after a colon should be capitalized.
2. The following questions and suggested changes relate to section 2 of the proposed initiative:
 - a. The amending clause should indicate that "39-29-102 (3) (a), Colorado Revised Statutes, is amended . . ."
 - b. The "§" symbol before the section number in the headnote should be deleted.
 - c. The internal reference in subsection (I) of paragraph (a) should read as follows:
"For purposes of this ~~paragraph (a)~~ SUBPARAGRAPH (I),"
 - d. The reference to paragraph "(a)" before the addition of the new subparagraph (II) should be deleted.
 - e. Consider referring to "sale price" rather than "sales price".
 - f. The internal reference in subsection (II) of paragraph (a) should read as follows:
"For purposes of this subparagraph (II),"
3. The following questions and suggested changes relate to section 3 of the proposed initiative:

- a. The amending clause should read as follows:

"SECTION 3. 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:"

- b. References to paragraphs in new, small capped language should appear in lowercase, regular type.
- c. The internal reference in the last sentence of paragraph (c) should include the paragraph letter: "this paragraph (c)".
- d. A new amending clause is necessary for the addition of subsection (3), which should read as follows:

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

The succeeding sections of the proposed initiative would then need to be renumbered accordingly. Please note that, for the sake of clarity, the remainder of this memorandum refers to the proposed initiative sections as they currently read.

4. The following questions and suggested changes relate to section 4 of the proposed initiative:

- a. The amending clause should read: "The introductory portion to 39-29-108 (1) and 39-29-108 (2), Colorado Revised Statutes, are amended, and the said . . ."
- b. The "§" symbol before the section number in the headnote should be deleted.
- c. In order to identify to the reader what is being amended in the introductory portion to subsection (1), consider writing the internal reference contained therein as follows: "~~subsections (2) and (3)~~ SUBSECTIONS (2), (2.3), AND (3)".
- d. The proper name of the fund created in section 39-29-109, Colorado Revised Statutes, and referred to in subsection (2.3) is the "severance tax trust fund" rather than the "state severance tax trust fund". As a conforming amendment, consider striking the word "state" before the reference to the severance tax trust fund in subsection (2) as well.

5. The following questions and suggested changes relate to section 5 of the proposed initiative:

- a. The text of subsection (1) should immediately follow the headnote.
- b. The "(2)" referred to in the last sentence of (1) (a) is a subsection rather than a paragraph.

- c. It appears as though the first sentence of subparagraphs (I) and (II) of paragraph (b) are editorial headnotes rather than statutory language. As such, those sentences should be bold and lowercase. (See section 39-29-109 (1) (a), Colorado Revised Statutes, for an example.)
 - d. The internal reference in subparagraph (II) should read "subparagraph (I) of this paragraph (b)".
 - e. For the sake of clarity, the word "funds" should be changed to "moneys" in the introductory portion of subsection (2). The proposed initiative is creating a "fund"; to differentiate that "fund" with the moneys in it, consider using the term "moneys" in any place where the word "funds" is currently used if the change would make sense.
 - f. Paragraph (b) of subsection (2) should end with a period.
 - g. The first sentence of paragraph (d) of subsection (2) should refer to "the state" instead of "this state".
 - h. The first word of a sentence should be capitalized (i.e., "Each").
 - i. Paragraph (d) of subsection (2) contains a reference to "this subsection" that should instead refer to "this paragraph (d)". Also, since paragraph (d) contains more than one sentence, it should end with a period.
6. The following questions and suggested changes relate to section 6 of the proposed initiative:
- a. The amending clause should read as follows:

"SECTION 6. 33-60-107 (4), Colorado Revised Statutes, is amended BY THE ADDITION OF A NEW SUBSECTION to read:"
 - b. The state board of the great outdoors Colorado is defined in article 60 of title 33, Colorado Revised Statutes, as the "trust fund board" and should be referred to as such.
 - c. Consider rewriting your new subsection (4) as follows:

"33-60-107. State board of the great outdoors Colorado trust fund.
(4) In addition to its other powers under article XXVII of the Colorado constitution and this article, the trust fund board shall have the power to administer and oversee funds appropriated pursuant to section 39-29-110.5 (2) (b), C.R.S."
 - d. There should be spaces between the section number and any subsequent section subdivisions in an internal statutory reference (i.e., 39-29-110.5 (2) (b)).

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 subsection (4) of section 39-29-101, Colorado Revised Statutes:
 - a. What does the phrase "shall supplement, rather than supplant . . ." mean? In light of the fact that this is a legislative declaration, would this be binding on the general assembly in any way?
 - b. What is your intent in identifying the specific amounts of distributions from the severance tax stabilization trust fund both here and again in section 39-29-110.5, Colorado Revised Statutes? What is the effect of repeating the statutory distribution in a legislative declaration? Would you consider referring to section 39-29-110.5, Colorado Revised Statutes, rather than enumerating the distributions in the legislative declaration?
 - c. Your legislative declaration specifies that the "*additional revenue* generated by the changes to the severance tax paid" are to be used for the specific purposes you have enumerated. However, in sections 4 and 5 of the proposed initiative you change the distribution for *all* revenue generated from the severance of minerals and mineral fuels, not just any additional revenue generated from your changes to the tax paid for the severance of oil and gas. Is this inconsistent?
 - d. The language in the new subsection (4) is ambiguous. What is your intent by adding this language?
4. The following questions relate to changes made to section 39-29-102, Colorado Revised Statutes:
 - a. Subsection (3) changes the definition of "gross income" for taxable years "commencing on or after January 1, 2009"? If you mean for this change to the definition to apply to every tax year on and after January 1, 2009, we suggest you change the language to "commencing on **and** after".
 - b. The only difference between the two definitions appears to be a change from "net amount realized by the taxpayer for sale of the oil or gas," to "net amount attributable to the first sale of the oil or gas,". Is this correct? If so, what is the effect of this change?
 - c. Would any other aspects of the definition of "gross income" be changed? For

instance, are the allowable net back deductions for transportation, manufacturing, and processing of the product still the same?

- d. With respect to the new definition of "operator" what does it mean to "exercise the right to control the severance . . ."?
5. With respect to the changes made to section 39-29-105 (1) (b), Colorado Revised Statutes, 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 years commencing prior to January 1, 2009. Is this your intention?
 6. 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 for the taxable years commencing on and after January 1, 2009?
 - b. The new paragraph (c) specifies that any gross income of \$300,000 and over is taxed at 5%. Is this the same thing as exempting any gross income less than \$300,000 from the tax? Is it your intention that any income less than \$300,000 is not subject to the tax?
 - c. Was it your intention to remove the exemption for marginal wells from this new tax commencing on and after January 1, 2009?
 - d. 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)?
 - e. 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?
 - f. Currently anyone who receives taxable income from oil or gas produced in Colorado must file a severance tax return. This means that a producer, a person who owns a working interest, or a person who receives a royalty interest must pay severance tax. Your initiative proposal specifies that the tax "shall be levied against every operator for the gross income from the sale of the oil and gas severed by the operator".
 - i. How will this change the tax?
 - ii. How will this affect revenues?
 - iii. How will this impact royalty owners? Will royalty owners have to pay the

tax?

- g. What tax will be owed if the operator uses the oil and gas instead of selling it?
 - h. Is it possible that the first sale of the oil and gas could be to a consumer at a gas station?
 - i. You specify that "each interest owner who takes production in kind from the operator shall be responsible for the tax on such production." What is the effect of this additional language?
 - j. Is an "operator", as that term is defined in the newly created section 39-29-102 (6.7), Colorado Revised Statutes, created in section 2 of the proposed initiative, different from a "producer of oil and gas" referenced in paragraph (c)? If so, how?
 - k. Severance tax paid is an allowable deduction for determining property taxes on oil and gas production. So, by increasing the severance tax collected by the state, you may in turn decrease the property taxes collected by local governments. Was this your intention?
7. 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?
8. 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. Assuming that the changes you have made to section 39-29-105, Colorado Revised Statutes, will result in more revenues 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? If it is the latter, is it possible to calculate that amount?
 - e. 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?

- f. 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?
9. The following questions relate to the changes made to section 39-29-108, Colorado Revised Statutes:
- a. Subsection (2) refers to the distribution of severance tax revenues "after June 30, 1981, but prior to January 1, 2009," and subsection (2.3) details severance tax distributions "after January 1, 2009". Those revenues collected on January 1, 2009, are not accounted for. Consider referring to distributions "on and after January 1, 2009".
- b. The effect of your changes to section 39-29-108, Colorado Revised Statutes, is to change the distribution of revenues realized from the severance taxes on all minerals and mineral fuels, not just those realized from the severance of oil and gas. Is that your intention? If so, how does that affect your single subject for this proposed initiative?
- c. By reducing the percentage of revenues allocated to the state severance tax trust fund and the local government severance tax fund, will there be enough moneys to cover all the current distributions from those funds? What happens if there is not enough? Would that leave current programs unfunded?
10. The following questions relate to the section creating the severance tax stabilization trust fund, section 39-29-110.5, Colorado Revised Statutes:
- a. You specify in section 39-29-110.5 (1) (b) (I), Colorado Revised Statutes, that "Fifteen percent of the severance tax receipts . . . and the interest generated by the fund shall be retained in the perpetual base account." Does this mean that all interest earned on the severance tax stabilization trust fund should be held in the perpetual base account?
- b. You specify that "[t]he maximum balance in the perpetual base account shall be two hundred percent of the previous fiscal year's revenue to the severance tax stabilization trust fund." Is the "previous fiscal year's revenue" referring to the 58% of the total gross receipts realized from the severance taxes imposed on minerals and mineral fuels? Would you consider including a cross-reference to that effect? Does this mean "fiscal year's revenue credited to the severance tax stabilization trust fund"?
- c. With respect to the maximum balance calculation, when will this estimate take place? For example, is it the perpetual base account's beginning fiscal year balance, ending fiscal year balance, or some quarterly fiscal year balance that will be compared with the prior year's revenue to the severance tax stabilization trust fund? Or, is it the intent of the proponents that this comparison occur at some regular frequency, such as monthly or daily?

- d. Is it your intention that, if the balance of the perpetual base account reaches the maximum level you specify that, the interest earned on the severance tax stabilization trust fund be credited to the operational account of the severance tax stabilization trust fund? Is it your intention that, if all the interest earned on the severance tax stabilization trust fund is credited to the operational account and the balance remaining in the perpetual base account still exceeds the maximum balance you specify, then other revenue credited to the perpetual base account be credited to the operational account so as to keep a balance in the perpetual base account at the maximum level?
- e. You specify that "the interest generated by the severance tax stabilization trust fund . . . shall be credited to the operational account..." Technically, don't the two accounts in the trust fund generate interest, not the fund itself?
- f. It appears that the moneys in the perpetual base account, up to the maximum balance specified in subparagraph (I) of paragraph (b), are not to be expended by the general assembly. Is this your intention? What is the purpose of this account? Under what circumstances, if any, do you expect the general assembly to appropriate money from the perpetual base account? Could the general assembly change the terms of the perpetual base account?
- g. The following questions relate to paragraph (a) of subsection (2) of section 39-29-110.5, Colorado Revised Statutes:
- i. HB08-1025 was signed by the governor on March 18, 2008. The bill creates the governor's energy office in section 24-38.5-101, Colorado Revised Statutes. The office's duties and powers are set forth in section 24-38.5-102, Colorado Revised Statutes. Would you consider specifying moneys "shall be appropriated to the governor's energy office created in section 24-38.5-101, C.R.S."?
 - ii. Would you consider adding a paragraph in section 24-38.5-102, Colorado Revised Statutes, regarding the governor's energy office's duties related to this new stream of funding?
 - iii. You specify in paragraph (a) of subsection (2) that the money is to be used for "new energy economy programs." Is it your intention that the items listed after the word "including" are "new energy economy programs"? Is the governor's energy office limited to funding only those particular programs, efforts, and activities?
 - iv. What are "direct programs for communities and citizens to advance energy efficiency and renewable energy"?
 - v. What is a "transmission buildout for rural communities"? Does this include transmission buildouts for traditional energy sources?

- vi. What kind of research and development efforts do you envision?
 - vii. What kind of economic development activities do you envision?
 - viii. What does the term "collaboratory" mean? Would you consider defining that term?
- h. The following questions relate to paragraph (b) of subsection (2) of section 39-29-110.5, Colorado Revised Statutes:
- i. An appropriation is spending authority. You specify that "[f]ifteen percent shall be appropriated for the exclusive purpose of making competitive grants . . ." Is the money to be appropriated to the state board of the great outdoors Colorado trust fund so they can spend it as you describe?
 - ii. Is the board to spend money directly from the severance tax stabilization trust fund? Or is it your intention that this money be held in a newly created fund managed by the state board of the great outdoors Colorado trust fund? Is this money to be kept separate from the great outdoors Colorado trust fund? If so, would you consider creating the fund in your initiative proposal?
 - iii. Is it your intention that the state board of the great outdoors Colorado trust fund establish a grant program for the use of these funds? Should that grant program be established by rule? If so, does the state board of the great outdoors Colorado trust fund have the rule-making authority necessary to create a grant program by rule?
 - iv. Is it your intention that the state board of the great outdoors Colorado trust fund have the same powers over your newly created fund as are specified in subsection (2) of section 6 of article XXVII of the Colorado constitution?
 - v. You specify that the state board of the great outdoors Colorado trust fund is to administer and oversee "the funds". The board is constitutionally tasked to oversee the expenditures from the great outdoors Colorado trust fund but the actual fund is held by the state treasurer. If you create a fund, do you intend for your fund to be held in the same manner?
 - vi. Is it constitutionally permissible to give the state board of the great outdoors Colorado trust fund additional duties beyond those specified in article XVII of the Colorado constitution?
 - vii. Do you intend for the state board of the great outdoors Colorado trust fund to have a fiduciary responsibility over these funds? If so, does your statutory language accomplish that intent?

- viii. Do you anticipate that the state board of the great outdoors Colorado trust fund will incur any additional administrative costs in administering these moneys? If so, how will those administrative costs be provided for?
 - ix. What are "nonprofit conservation organizations"?
 - x. What are "working farms or ranches"?
 - xi. Which of the listed entities did you intend to be able to receive competitive grants?
- i. The following questions relate to paragraph (d) of subsection (2) of section 39-29-110.5, Colorado Revised Statutes:
- i. An appropriation is spending authority. Did you intend for the money to be transferred to the college opportunity fund?
 - ii. Would the money be spent in the same manner as other money in the college opportunity fund?
 - iii. The college opportunity fund is created in section 23-18-202, Colorado Revised Statutes, and the uses of the fund are primarily set forth in that section, with some other pieces of legislation in the remainder of part 2 of article 18 of title 23, Colorado Revised Statutes. If you intend for the money to be spent in the same manner as other money in the college opportunity fund, would you consider correcting the statutory references?
 - iv. The college opportunity fund provides stipends for eligible undergraduate students. The legislative declaration in section 1 of your proposed initiative specifies that 5% of the additional revenue is to be used to fund scholarships for students. Is this inconsistent?
- j. The following questions relate to paragraph (d) of subsection (2) of section 39-29-110.5, Colorado Revised Statutes:
- i. How will a distribution of money to the colleges and universities of this state affect the enterprise status of those institutions?
 - ii. Do you intend to include all colleges and universities of this state? What about community colleges? Would you consider defining the term "colleges and universities"?
 - iii. What do you mean by "provides incentives through performance contracts"?
 - iv. What do you mean by "contribute to work force development in the state"?

- v. Is this portion of the distribution to be appropriated by the general assembly?
- k. The following questions relate to paragraph (e) of subsection (2) of section 39-29-110.5, Colorado Revised Statutes:
 - i. Is the department of transportation to determine what counties or municipalities have been impacted by the development, processing, or energy conversion of oil and gas?
 - ii. Is this money to be deposited in a fund? If so, was it your intention to create a new fund?
 - iii. Would the general assembly be able to use its appropriation power to dictate to the department of transportation which counties and municipalities will benefit from this use of the funds?
- 11. With regard to the new subsection (4) of section 33-60-107, Colorado Revised Statutes, would you consider changing the word "appropriated" as discussed in question 10.f. above?
- 12. How much severance tax revenue is estimated to be generated under the proposed initiative in comparison to current revenues? How was this estimate derived?
- 13. 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?