Amendment 58
Severance Taxes on the Oil and Natural Gas Industry

Amendment 58 proposes changing the <u>Colorado statutes</u> 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, 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. Last year, the state collected $140 million in oil and gas severance taxes. Collections fluctuate annually with changing energy prices.

How does Amendment 58 change Colorado's current severance taxes on oil and gas? Amendment 58 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 $321 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 production. Amendment 58 removes this tax credit, increasing state severance taxes by an estimated $258 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 58 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 58 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 58 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 58 distribute severance tax revenue? Under Amendment 58, 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 estimated increase in collections under Amendment 58 is expected to provide existing programs with about the same amount of money over the next four years. However, severance tax collections fluctuate with energy prices, and state programs and local governments could receive more or less money than currently anticipated.

Amendment 58 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 58 provides to these uses over the next four budget years.

Table 1. Use of New Money under Amendment 58 in Millions of Dollars

New Programs	2009 (half-year)	2010	2011	2012	Four-Year Total
Held in reserve	$14	$30	$32	$33	$109
College scholarships	$78	$162	$171	$183	$594
Wildlife habitat	$20	$40	$43	$46	$149
Clean energy	$13	$27	$29	$31	$100
Transportation projects	$13	$27	$29	$31	$100
Water grants	$7	$13	$14	$15	$49
Total new programs:	**$145**	**$299**	**$318**	**$339**	**$1,101**

How do Amendment 58 and Amendment 52 interact? Both Amendment 58 and Amendment 52 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. Should both measures pass, the state will be required to implement these conflicting provisions, but if challenged the courts will have to decide how the measures take effect. Amendment 52 proposes a change to the state constitution, while this measure proposes a change to state statute. To date, Colorado courts have not addressed this type of conflict between ballot measures, but it is likely that the constitutional provision would prevail.

Arguments For

1) Amendment 58 eliminates a state tax credit for an industry that is currently experiencing record profits. Better uses exist for state dollars than this credit. Amendment 58 directs the new money to state and community programs that help improve the state's economy, environment, and infrastructure. These programs are a sound investment in Colorado's future.

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. 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 58 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 58 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 could negatively affect the state's economy and its citizens. The industry directly contributes $16.5 billion and employs about 20,000 workers in the state. In addition, industry activity supports another 20,000 to 50,000 jobs as a result of its Colorado extraction activities. By more than doubling the state's severance tax, Amendment 58 is likely to make Colorado less attractive to the oil and gas industry, which may reduce the industry's investment in the state 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 58 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 58 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 gasoline and electricity costs.

Estimate of Fiscal Impact

Amendment 58 is expected to increase state severance tax revenue by $1.1 billion over the next four years, as indicated in Table 2. Amendment 58 also changes the allocation of severance tax revenue and directs revenue to several new and existing state programs. Based on the current state forecast, Amendment 58 reduces the money for existing state programs and local governments by $44 million in the current budget year, but provides between $7 and $22 million more per year over the next three budget years than current law. These numbers are estimates based on forecasts of oil and gas prices; existing state programs and local governments could receive more or less money depending on actual prices. The new programs created by Amendment 58 will receive a total of $1.1 billion over the next four years, of which a portion will cover the administrative costs of the programs.

Table 2
Estimated Fiscal Impact of Amendment 58 in Millions of Dollars

	2009	2010	2011	2012	Total
Projected severance taxes under current law	$315	$213	$244	$254	$1,026
Projected severance taxes under Amendment 58	$416	$534	$569	$606	$2,125
New severance taxes under Amendment 58	**$101**	**$321**	**$325**	**$352**	**$1,099**
Distribution to state programs and local governments under current law	$315	$213	$244	$254	$1,026
Distribution to state programs and local governments under Amendment 58	$271	$235	$251	$267	$1,024
Difference in distribution to existing state programs and local governments	-$44	$22	$7	$13	-$2
Distribution to new programs, identified in Table 1	$145	$299	$318	$339	$1,101

State Spending and Tax Increases

The state constitution requires that the following fiscal information be provided when a tax increase question is on the ballot:

1. the estimated or actual state spending under the constitutional spending limit for the current year and each of the past four years with the overall percentage and dollar change; and

2. for the first full fiscal year of the proposed tax increase, an estimate of the maximum dollar amount of the tax increase and of state fiscal year spending without the increase.

Table 1 shows the dollar amount of state spending under the constitutional spending limit.

Table 1. State Spending

	Actual 2005	Actual 2006	Actual 2007	Estimated 2008	Estimated 2009
State Spending	$8.314 billion	$8.045 billion	$8.334 billion	$8.836 billion	$9.168 billion
Four-Year Dollar Change in State Spending: $854 million					
Four-Year Percent Change in State Spending: 10.3 Percent					

The numbers in Table 1 show state spending from 2005 through 2008 for programs that were subject to the constitutional spending limit during those years. However, the constitution allows a program that operates similar to a private business to become exempt from the limit if it meets certain conditions. Because some programs have done this during the last five years, the numbers in Table 1 are not directly comparable to each other. Furthermore, Referendum C, which was passed by voters in 2005, allows the state to spend money above the limit that it otherwise would have refunded to taxpayers. If the numbers are adjusted to account for both of these factors, the four-year dollar change is $2.413 billion and the four-year percent change is 30.4 percent.

Table 2 shows the revenue expected from the increased severance taxes, state fiscal year spending without these taxes for 2010, the first full fiscal year for which the increase would be in place, and the sum of the two.

Table 2. State Fiscal Year Spending and the Proposed Tax Increase

	2010 Estimate
State Spending Without New Taxes	$9,672.5 million
New Severance Tax Increase	$321.4 million
State Spending Plus the New Taxes	$9,993.9 million

* *The new severance tax revenue and existing severance tax revenue is not subject to the state's fiscal year spending limits.*