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

1 **Amendment (?) proposes changing the Colorado statutes to:**

2 ♦ increase severance taxes on oil and natural gas producers through a
3 variety of measures;
4
5 ♦ allocate the increased severance tax revenue to college scholarships for
6 state residents, wildlife habitat, renewable energy projects, road
7 improvements in energy-impacted areas, and safe-drinking-water
8 grants; and

9 ♦ exempt all oil and gas severance tax revenue from state and local
10 spending limits.

11 **Summary and Analysis**

12 ***What is the severance tax?*** The severance tax is a state tax that is imposed on
13 the extraction of nonrenewable natural resources from the earth. Colorado collects
14 severance taxes on several minerals, including oil and gas, metallic minerals like gold
15 and silver, coal, and molybdenum, and has done so since 1977. Oil and gas
16 severance taxes are paid on gross income. Over the last 5 years, 92 percent of the
17 state's severance tax revenue has come from oil and gas, and nearly all of that is from
18 gas. In budget year 2006-07, the state collected $117 million in oil and gas severance
19 taxes.

20 ***How does Amendment (?) change Colorado's current severance taxes on oil***
21 ***and natural gas?*** Amendment (?) increases severance taxes on oil and gas
22 producers by increasing the tax on large producers, expanding the number of
23 producers who pay the tax, and eliminating a state tax credit.

24 *Increasing the tax on large producers.* Colorado currently taxes oil and gas
25 production using a graduated tax rate of 2 to 5 percent, depending on income.
26 Amendment (?) changes this graduated rate to a flat rate, eliminating taxes paid on
27 small levels of production and increasing taxes on large producers. Specifically,
28 producers with total income over $300,000 will pay 5 percent on all income earned.
29 This change in the rate is estimated to increase state severance tax receipts by
30 $1 million annually.
31

32 Gross Income	Current Rate	Amendment (?) Rate
33 income under $25,000	2%	0%
34 income between $25,000 and $100,000	3%	0%
35 income between $100,000 and $300,000	4%	0%
36 income above $300,000	5%	5% of total income

1 *Expanding the number of producers who pay the tax.* Colorado currently exempts
2 income from oil wells producing fewer than 15 barrels per day and natural gas wells
3 producing less than 90,000 cubic feet per day from the severance tax. Amendment
4 (?) decreases the number of wells exempt from the tax by reducing the exemption
5 threshold to 7½ barrels of oil per day and 45,000 cubic feet of gas per day. This
6 change is expected to increase state severance tax revenue by $62 million in budget
7 year 2009-10.

8 *Eliminating the property tax credit.* The state also allows producers to claim a
9 severance tax credit of 87.5 percent of the property taxes paid in the previous year.
10 Amendment (?) removes this tax credit, increasing state severance taxes by an
11 estimated $241 million in budget year 2009-10.

12 ***How do Colorado's oil and gas taxes compare to other states?*** Colorado's
13 severance tax rate is the lowest of the eight large producing western states (Kansas,
14 Montana, New Mexico, Oklahoma, Texas, Utah, and Wyoming) when each state's
15 exemptions, deductions, and credits are taken into account. When state and local
16 taxes are considered, including income, sales, property, and severance taxes,
17 Colorado's total tax rate on the oil and gas industry is the Xth lowest of the eight
18 western states. Assuming the taxes in other states remain the same, Amendment (?)
19 would raise Colorado's tax rates compared to the seven other states. Colorado would
20 be the 3rd lowest among major producing western states in terms of severance tax
21 rate and the Xth lowest in terms of total tax rate on the oil and gas industry. Appendix
22 A contains detailed information on the calculation of these rankings.

23 ***How will severance tax revenue be used under this measure?*** Under current
24 law, Colorado severance tax revenue is evenly divided between state programs and
25 local governments. The state portion is for state water projects and programs related
26 to mineral extraction, clean energy development, low-income energy assistance, and
27 species conservation. The local government portion is distributed through competitive
28 loans or grants to local governments that are impacted by the mineral extraction
29 industry, or paid directly to them based on mining activity in the area.

30 Under Amendment (?), 44 percent of severance tax revenue continues to be split
31 evenly between state programs and local governments, and allocated to existing
32 programs as under current law. Based on the current forecast of severance tax
33 revenue, these state programs and local governments would receive $21.7 million less
34 in the current budget year than they would under current law. Over the next three
35 budget years they would receive between $3.3 and $7.1 million more per year than
36 under current law.

37 The remaining 56 percent of severance tax revenue would be provided to new
38 uses. Ten percent is placed in a reserve account for future use by the state. Ninety
39 percent pays for new state programs as follows:

40 • 60 percent for a college scholarship program that makes attending
41 college more affordable for lower- and middle-income Coloradans.
42 The governor-appointed board that oversees the state's higher

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education system sets the specific eligibility criteria for the scholarship program, considering factors such as income, family size, and academic performance;

- 15 percent for a competitive grant program administered by the state board tasked with preserving Colorado's wildlife and open space. This money will be used to assist local governments, nonprofit organizations, and the state to acquire wildlife habitat;

- 10 percent for projects that advance energy efficiency and promote 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 would be provided to these uses over the next four budget years under the measure.

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

	2008-09 (half-year)	2 009-10	2010-11	2011-12
New Program Funding	$145.0	$289.8	$318.4	$339.4
10% Reserve	$14.5	$29.0	$31.8	$33.9
College Scholarships	$78.3	$156.5	$171.9	$183.3
Wildlife Habitat	$19.6	$39.1	$43.0	$45.8
Clean Energy	$13.0	$26.1	$28.7	$30.5
Road Improvements	$13.0	$26.1	$28.7	$30.5
Drinking Water Grants	$6.5	$13.0	$14.3	$15.3

Arguments For

1) The property tax credit provided to oil and gas companies is no longer necessary. The state originally established the credit to promote oil and gas production in Colorado. Today, with the price of oil and natural gas providing record profits for the industry, better uses for state dollars exist than providing a tax break to oil and gas producers. The state has many unmet funding needs, and investing the additional money generated from this measure to address these needs is 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

1 measure offset the high tuition costs associated with attending college. As Colorado
2 graduates more state residents, businesses will benefit from a larger pool of educated
3 workers that can help grow Colorado's economy.

4 3) Oil and gas resources are found only in limited geographic areas, and slightly raising
5 the cost of extracting those resources is not likely to affect production levels. Colorado
6 currently has the lowest severance tax rate among large producing western states.
7 Eliminating the property tax credit and tightening the small well tax exemption merely
8 brings Colorado's tax rate in line with other states. Moreover, because most of the gas
9 produced in Colorado is sold elsewhere, much of the additional costs are likely to be
10 paid by consumers outside of Colorado. The percentage sold outside the state will only
11 increase as additional pipeline capacity comes on-line as it is scheduled to do during
12 the next two years.

13

14 **Arguments Against**

15 1) Increasing taxes on oil and gas companies is likely to negatively affect the state's
16 economy and its citizens by discouraging oil and gas production and raising energy
17 costs. According to one recent analysis, there are over 70,000 people employed in the
18 state as a result of the industry, and it contributes around $23 billion to the state's
19 economy. By increasing the state's severance tax, this measure is likely to make
20 Colorado less attractive to the oil and gas industry, which may reduce investment and
21 result in a loss of jobs.

22 2) It is better to fund programs that address statewide needs with money from multiple
23 sources instead of just one industry. The oil and gas industry already pays taxes that
24 fund a number of state programs and are used to mitigate impacts on local
25 communities and the environment. Further, funding statewide programs with money
26 from this industry is risky because the industry has endured boom-and-bust cycles in
27 the past. A future downturn could leave these programs without a funding source.

28 3) The existing property tax credit is justifiable given the higher property tax
29 assessment for the industry imposed at the local level. Currently, property taxes for the
30 oil and gas industry are assessed at a higher rate than for all other commercial
31 enterprises. This tax structure ensures that local governments in energy impacted
32 areas receive the needed resources to help them address the impacts associated with
33 oil and gas production. Eliminating the credit would harm a longstanding tax balance
34 between state and local governments in Colorado, and may discourage production in
35 areas of the state with higher property taxes.

36 **Estimate of Fiscal Impact**

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Appendix A: Severance Tax Structure in Other Large Producing Western States

State	Base Tax Rate	Property Tax Credit	Small Well Tax Incentive (production/day)	Effective* Severance Tax Rate (FY 2006-07)	Effective* Total Tax Rate (FY 2006-07)
Colorado	2.0-5.0%	Yes	Oil: < 15 bbls Gas: < 90 mcf	1.3%	x.x%
Utah	5.0%	No	Oil: < 20 bbls Gas: < 60 mcf	2.1%	x.x%
Kansas	8.0%	Yes	Oil, Gas < $87	2.8%	x.x%
Texas	7.5%	No	NA	4.4%	x.x%
Wyoming	6.0%	No	NA	4.5%	x.x%
Oklahoma	7.0%	No**	NA	5.6%	x.x%
New Mexico	7.94%	No	Oil: < 10 bbls Gas: < 60 mcf	6.6%	x.x%
Montana	9.26-15.06%	No	Oil: < 10 bbls Gas: < 60 mcf	x.x%	x.x%

** Effective tax rates are measured by dividing severance taxes after exemptions, deductions, and credits by the value of oil and gas produced in each state. Similarly, effective total tax rates are measured by dividing state and local taxes collected on oil and gas production by the value of oil and gas produced in each state.*

***Oklahoma's severance tax is imposed in lieu of property taxes.*