HB11-1125

Colorado Legislative Council Staff Fiscal Note

FINAL FISCAL NOTE

Drafting Number:	LLS 11-0140	**Date:**	August 2, 2011
Prime Sponsor(s):	Rep. Fischer	**Bill Status:**	Postponed Indefinitely
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TITLE: CONCERNING A CHANGE IN THE POINT OF TAXATION FOR THE STATE TAX ON THE SEVERANCE OF OIL AND GAS.

Fiscal Impact Summary	FY 2011-2012	FY 2012-2013
State Revenue		
Cash Funds		
Severance Tax Trust Fund	$1.1 million	$2.3 million
Local Government Severance Tax Fund	$1.1 million	$2.3 million
State Expenditures		
General Fund	$4,440	($19,132)
Cash Funds		
Severance Tax Trust Fund	See State	See State
Local Government Severance Tax Fund	Expenditures Section	Expenditures Section
FTE Position Change		(0.1 FTE)
Effective Date: The bill was postponed indefinitely by the House Agriculture Committee on February 7, 2011.		
Appropriation Summary for FY 2011-2012: $4,440 General Fund.		
Local Government Impact: See Local Government Impact Section.		

Summary of Legislation

Starting on January 1, 2012, this bill changes the point of taxation for the state severance tax on oil and natural gas production from "interest owners" to the operators of oil and natural gas wells.

Interest owners are entities who receive income from oil and gas production because they have an ownership stake in the production. Most interest owners do not operate the wells in which they have an ownership stake. However, most oil and gas operators are also interest owners, referred to as "working interest" owners, and thus already pay severance tax. There are currently about 14,000 interest owners in the state who pay severance tax. There are about 400 producers operating oil and natural gas wells in the state.

Under current law, interest owners claim a property tax credit against their gross severance tax liability. The credit is based on the amount of property taxes they pay on oil and gas production. The tax credit equals 87.5 percent of the local property taxes due on the value of oil and gas. This bill allows operators to claim the property tax credit against their gross severance tax liability, regardless of whether they paid local property tax on the value of oil and gas they produced.

Finally, the bill eliminates the requirement that producers withhold (and pay to the state) severance taxes from interest owners as they would no longer be subject to the tax. However, producers will be responsible for paying estimated severance taxes on a monthly basis if their annual severance tax is expected to be over $1,000. Currently, corporations with severance tax liability above $1,000 are required to make estimated monthly severance tax payments.

State Revenue

This bill is estimated to increase severance tax revenue to the state by $2.1 million in FY 2011-12 (half year impact) and $4.5 million in FY 2012-13. The additional revenue will be distributed half to the Local Government Severance Tax Fund and half to the Severance Tax Trust Fund.

The Local Government Severance Tax Fund is administered by the Department of Local Affairs (DOLA) and is allocated to local governments affected by the energy industry. The Severance Tax Trust Fund is administered by the Department of Natural Resources (DNR). Half of the money credited to this fund goes to the Perpetual Base Account, which is used for water-related projects. The other half goes to the Operational Account, which is mostly used for natural resource-related programs. The additional amounts of money allocated to these funds and accounts as a result of House Bill 11-1125 are shown in Table 1.

Table 1. Additional Revenue to Severance Tax Funds as a Result of HB11-1125*

Fund	FY 2011-12 (half year impact)	FY 2012-13
Local Government Severance Tax Fund	$1.1 million	$2.3 million
Severance Tax Trust Fund	$1.1 million	$2.3 million
Perpetual Base Account	$530,000	$1.1 million
Operational Account	$530,000	$1.1 million

* Totals may not sum due to rounding.

Determination of revenue impact. This bill will not change the amount of income from oil and gas production subject to tax, only who incurs the tax liability. However, changing the point of taxation for oil and gas severance taxes is expected to increase revenue by roughly 2.5 percent on average annually due to the structure of the tax. This is the case because more income from oil and gas production will be subject to the highest severance tax rate.

The current severance tax rate for oil and gas ranges from 2 percent to 5 percent, depending on the level of gross income from production. However, in many cases, the amount of the property tax credit currently exceeds a taxpayer's gross liability, which reduces the *net* tax liability to $0, and much of the available dollar amount of tax credits that can be claimed go "unused."

Almost all of the income generated from oil and gas production comes from large operators. Thus, changing the point of taxation to require operators to pay the tax would subject more income from oil and gas production to the highest 5 percent tax rate, generating higher *gross* tax liabilities. Because there would be overall higher gross liabilities, more of the tax credits for local property taxes due would be claimed, which would reduce gross tax liabilities. However, the additional gross liability from subjecting more income to the highest tax rate is estimated to more than offset the revenue reduction from the use of additional credits, causing an increase of roughly 2.5 percent annually in severance tax revenue to the state.

The 2.5 percent increase was applied to the December 2010 Legislative Council Staff forecast for severance taxes from oil and gas. Staff used 2008 and 2009 severance tax return data from the Department of Revenue and data from the Colorado Oil and Gas Commission on the sales of oil and gas by operators to estimate the additional revenue generated from this bill.

State Expenditures

Department of Revenue: Increase of $4,440 in FY 2011-12 and a decrease of $19,132 and 0.1 FTE in FY 2012-13. The Department of Revenue will incur programming expenses of $4,440 in FY 2011-12 to implement the provisions of this bill. Expenditures are based on an expected 60 hours of programming to modify the state's tax system, called GenTax, at a rate of $74 per hour.

The department will experience ongoing cost savings of $19,132 and 0.1 FTE beginning in FY 2012-13 due to the reduction in the number of oil and gas severance tax returns filed. The number of returns is expected to decline from about 14,000 to 400. Savings will result from less labor costs to process returns and from less printing and mailing costs. Table 2 summarizes the change in expenditures for the Department of Revenue as a result of House Bill 11-1125.

Table 2. Cost Changes Under HB11-1125

Cost Components	**FY 2011-12**	**FY 2012-13**
Personal Services	-	($2,779)
FTE	-	*(0.1)*
Operating Expenses	-	($16,353)
Computer Programming	$4,440	-
TOTAL	**$4,440**	**($19,132)**

Department of Local Affairs. As discussed in the State Revenue section, half of the additional revenue from this bill will go to DOLA. Thus, DOLA will have more money available to allocate from the Local Government Severance Tax Fund to local governments that are socially or economically impacted by the mineral extraction industry.

Under current law, 70 percent of the additional money will be allocated for DOLA's mineral impact program, which provides loans and grants to local governments. The remaining 30 percent of the additional money will be distributed directly to local governments using a formula based on the number of oil and gas employees, the number of well permits, and the amount of mineral production in each jurisdiction. Table 3 shows the additional money that will be made available for expenditures by these two programs as a result of House Bill 11-1125.

Table 3. Additional Money for DOLA Expenditures to Local Governments as a Result of HB11-1125

DOLA Program	FY 2011-12 (half year impact)	FY 2012-13
Direct Distributions to Local Governments	$320,000	$680,000
Local Government Mineral Impact Program	$740,000	$1.6 million

Department of Natural Resources. As discussed in the State Revenue section, DNR will have more severance tax revenue credited to its Severance Tax Trust Fund, which is divided evenly between two separate accounts. It is estimated that the department will have an additional $530,000 in FY 2011-12 and $1.1 million in FY 2012-13 available for water projects funded from the Perpetual Base Account. The same additional amounts will be credited to the Operational Account in FY 2011-12 and FY 2012-13.

Local Government Impact

Local governments will receive additional revenue from DOLA's direct distribution and mineral impact grant and loan programs. The amount of additional money available for local governments through these programs is estimated at $1.1 million in FY 2011-12 and $2.3 million in FY 2012-13.

State Appropriations

The Department of Revenue will require an appropriation of $4,440 General Fund in FY 2011-12.

Departments Contacted

Local Affairs   Natural Resources   Revenue