HB 22-1391

Legislative Council Staff

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Fiscal Note

Drafting Number:	LLS 22-0916	**Date:**	April 25, 2022
Prime Sponsors:	Rep. McCluskie Sen. Hansen; Rankin	**Bill Status:**	House Finance
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Bill Topic: **MODIFICATIONS TO SEVERANCE TAX**

Summary of Fiscal Impact:

☒ State Revenue
☒ State Expenditure
☐ State Transfer
☒ TABOR Refund
☒ Local Government
☐ Statutory Public Entity

The bill modifies the ad valorem tax credit and creates a working group to develop an implementation plan for further changes to the severance tax. The bill reduces state revenue beginning in FY 2023-24 and increases state expenditures beginning in FY 2022-23.

Appropriation Summary: For FY 2022-23, the bill requires an appropriation of $133,401.

Fiscal Note Status: This fiscal note reflects the introduced bill. Due to time constraints, this analysis is preliminary and will be updated following further review and any additional information received.

Table 1
State Fiscal Impacts Under HB 22-1391

		Budget Year FY 2022-23	Out Year FY 2023-24*
Revenue	Severance Tax Cash Fund	-	($1.5 million to $7.0 million)
	Total Revenue	-	**($1.5 million to $7.0 million)**
Expenditures	General Fund	$133,401	$83,937
	Centrally Appropriated	$31,047	$9,571
	Total Expenditures	**$164,448**	**$93,508**
	Total FTE	**2.1 FTE**	**0.6 FTE**
Transfers		-	-
Other Budget Impacts	TABOR Refund	-	($1.5 million to $7.0 million)
	General Fund Reserve	$20,010	$12,591

**Revenue impacts for FY 2023-24 are a half year-impact, see the state revenue section for additional detail.*

Summary of Legislation

The bill modifies the ad valorem (AV) credit allowed under the state's severance tax on oil and gas. Under current law, taxpayers are able to claim a tax credit equal to 87.5 percent of the ad valorem (real property) taxes assessed or paid to a local government on oil and gas production. Because the credit is a function of property taxes paid, there is generally at least a one-year lag between when production actually occurs and when AV credits are claimed. Under the bill, beginning in 2024, the AV credit will be calculated on a per-well basis by applying the prior year's mill levy to the current year's gross income multiplied by an assessment rate of 87.5 percent, and then taking 87.5 percent of that amount. This calculation is simplified by taking 76.56 percent (87.5 percent x 87.5 percent = 76.56 percent) of each well's current year gross income multiplied by the previous year's mill levy.

Additionally, the bill establishes a working group consisting of the director of the Office of State Planning and Budgeting and the executive directors of the departments of revenue, natural resources, education, and local affairs. The working group must develop an implementation plan concerning additional changes to the state severance tax, including changing the legal incidence of tax from interest owners to operators while maintaining revenue neutrality, requiring electronic filing of returns for severance taxes, and requiring additional electronic data collection regarding the tax.

Background

The severance tax is one of the state's most volatile revenue streams. Severance tax revenue is volatile for a number of reasons, including the boom and bust nature of the oil and gas industry and fluctuations in commodity prices. Additionally, the current structure of the AV credit introduces volatility in severance tax collections due to the lag between actual production of oil and gas and when the AV credit is claimed. This volatility makes severance tax revenue forecasts less certain than those for other revenue streams.

State Revenue

The bill will reduce oil and gas severance tax revenue by an estimated $1.5 million to $7.0 million in FY 2023-24 (a half-year impact), and by $3.0 million to $14.1 million in FY 2024-25, with ongoing impacts in future years. Due to the volatility of commodity prices, there is significant uncertainty around this revenue estimate. The bill reduces severance tax revenue, which is subject to TABOR.

Data and assumptions. The bill is expected to decrease severance tax revenue by increasing the amount of AV credit claimed by taxpayers. Under current law, taxpayers do not claim the full value of AV credits available to them each year. This is likely due to the timing lag between when oil and gas production occurs and when the AV credit for that production becomes available to the taxpayer. The bill eliminates the timing lag between production and the utilization of the AV credit, and is therefore expected to decrease the amount of unused AV credits each year. Based on historical data, if taxpayers were to utilize the full value of AV credits available each year, net tax liability would be between 3 percent and 14 percent lower. As such, this fiscal note assumes that the bill will reduce oil and gas severance tax revenue by between 3 percent and 14 percent each year beginning in calendar year 2024.

Given the significant volatility in commodity prices and severance tax revenue overall, there is significant uncertainty surrounding this revenue estimate. The bill's impact on state revenue for 2024 will depend on how market conditions change between 2023 and 2024; the impact for 2025 will depend on how market conditions change between 2024 and 2025; and so on.

State Expenditures

The bill increases state expenditures by $164,448 and 2.1 FTE in FY 2022-23 and $93,508 and 0.6 FTE in FY 2023-24 from the General Fund. Expenditures are shown in Table 2 and detailed below.

Table 2
Expenditures Under HB 22-1391

Cost Components	FY 2022-23	FY 2023-24
Department of Revenue		
Personal Services	$94,819	$30,497
Operating Expenses	$3,105	$675
Capital Outlay Costs	$18,600	-
Programming and Testing	-	$43,560
Centrally Appropriated Costs[1]	$27,529	$7,743
FTE – Personal Services	1.9 FTE	0.5 FTE
DOR Subtotal	**$144,053**	**$82,475**
Office of State Planning and Budget		
Personal Services	$16,877	$9,205
Centrally Appropriated Costs[1]	$3,518	$1,828
FTE – Personal Services	0.2 FTE	0.1 FTE
OSPB Subtotal	**$20,395**	**$11,033**
Total	**$164,448**	**$93,508**
Total FTE	**2.1 FTE**	**0.6 FTE**

[1] *Centrally appropriated costs are not included in the bill's appropriation.*

Department of Revenue. The Department of Revenue (DOR) will require an additional 1.9 FTE in FY 2022-23 and 0.5 FTE in FY 2023-24 and subsequent years. Additional personnel will begin in October 2022 to participate in the working group, implement changes to the severance tax, and to provide statistical analysis of the tax changes. Standard operating and capital outlay costs are included.

For FY 2023-24 only, the bill will require changes to DOR's GenTax software system and additional testing. Changes are programmed by a contractor at a cost of $225 per hour. Approximately 60 hours of computer programming will be required to implement this bill, totaling $13,500. Additional computer and user acceptance testing are required to ensure programming changes are tested and functioning properly, resulting in an additional $30,060 in expenditures by the department.

Office of State Planning and Budget. The Office of State Planning and Budget (OSPB) will require an additional 0.2 FTE in FY 2022-23 and 0.1 FTE in FY 2023-24. OSPB will be responsible for organizing and leading the working group established in the bill, and additional personnel are necessary to provide support and staffing of the working group.

Department of Natural Resources. The bill directs the executive director of the Department of Natural Resources to participate in the bill's working group. This increase in workload can be accomplished within existing resources.

Department of Education. The bill directs the executive director of the Department of Education to participate in the bill's working group. This increase in workload can be accomplished within existing resources.

Department of Local Affairs. The bill directs the executive director of the Department of Local Affairs to participate in the bill's working group. This increase in workload can be accomplished within existing resources.

Centrally appropriated costs. Pursuant to a Joint Budget Committee policy, certain costs associated with this bill are addressed through the annual budget process and centrally appropriated in the Long Bill or supplemental appropriations bills, rather than in this bill. These costs, which include employee insurance and supplemental employee retirement payments, are shown in Table 2.

Other Budget Impacts

TABOR refunds. The bill is expected to decrease the amount of state revenue required to be refunded to taxpayers by the amounts shown in the State Revenue section above. Because TABOR refunds are paid from the General Fund, decreased cash fund revenue will increase the amount of General Fund available to spend or save. A forecast of state revenue subject to TABOR is not available beyond FY 2023-24.

General Fund reserve. Under current law, an amount equal to 15 percent of General Fund appropriations must be set aside in the General Fund statutory reserve beginning in FY 2022-23. Based on this fiscal note, the bill is expected to increase the amount of General Fund held in reserve by $20,010 in FY 2022-23 and $12,591 in FY 2023-24, which will decrease the amount of General Fund available for other purposes.

Local Government

The bill is expected to reduce the distribution of funds from the state government to local governments. The bill is expected to decrease severance tax revenue, a portion of which is distributed to local governments.

Effective Date

The bill takes effect 90 days following adjournment of the General Assembly sine die, assuming no referendum petition is filed.

State Appropriations

For FY 2022-23, the bill requires General Fund appropriations totaling $133,401 as follows:

- $116,524 to the Department of Revenue, and 1.9 FTE; and
- $16,877 to the Office of State Planning and Budgeting, and 0.2 FTE.

State and Local Government Contacts

Education	Local Affairs	Natural Resources
Office of State Planning and Budgeting	Personnel	Revenue