# Initiative #22

Legislative Council Staff

*Nonpartisan Services for Colorado's Legislature*

# INITIAL FISCAL IMPACT STATEMENT

**Date:** February 4, 2019 **Fiscal Analyst:** Larson Silbaugh (303-866-4720)

**LCS TITLE:** SEVERANCE TAXES ON OIL AND GAS

***Disclaimer.*** *This initial fiscal impact statement has been prepared for the Title Board. If the initiative is placed on the ballot, Legislative Council Staff may revise this estimate for the ballot information booklet (Blue Book) if new information becomes available.*

**Table 1**
**State Fiscal Impacts Under Initiative #22**

| | | FY 2019-20 | FY 2020-21 |
|---|---|---|---|
| **Revenue** | Cash Funds | $1.1 billion* | $559.2 million |
| | **Total** | **$1.1 billion** | **$559.2 million** |
| **Expenditures** | General Fund | $205,611 | $44,636 |
| | Cash Funds | $1.04 billion | $523.8 million |
| | **Total** | **$1.04 billion** | **$523.9 billion** |
| | **Total FTE** | **0.9 FTE** | **0.9 FTE** |
| **TABOR Refund** | General Fund | ($169.9 million) | - |

**Revenue collected in FY 2019-20 includes a $410.8 million revenue increase from oil and gas extraction that occurs in FY 2018-19 and $703.9 million on extraction activity that occurs in FY 2019-20, the first full fiscal year that the measure is in effect.*

## Summary of Measure

Beginning January 1, 2019, the measure increases the oil and gas severance tax rate by 5 percentage points for all operators, eliminates the existing ad valorem tax credit, and halves the threshold for the stripper well exemption. The measure also exempts all future oil and gas severance taxes from the spending limits in the state constitution. Additionally, starting in 2019 the measure requires that oil and gas severance tax revenue is allocated as follows:

- 22 percent to the Severance Tax Trust fund within the Department of Natural Resources;
- 22 percent to the Local Government Severance Tax Fund within the Department of Local Affairs; and
- 56 percent to a newly created Severance Tax Stabilization Trust Fund which is distributed to the Department of Education, Department of Public Health and Environment, and the Perpetual Base Account.

## State Revenue

This measure will increase oil and gas severance tax revenue by $1.1 billion in FY 2019-20, and $559.2 million in FY 2020-21 with ongoing increases in future years. Revenue collected by the state in FY 2019-20 includes a $410.8 million revenue increase from oil and gas extraction that occurs in FY 2018-19 and $703.9 million on extraction activity that occurs in FY 2019-20, the first full fiscal year that the measure is in effect.

This fiscal impact statement assumes that the state will be able to achieve the revenue and distributions described in the measure even though voter approval of the measure would occur after the start of the period for which taxes are increased. Severance taxes for calendar year 2019 are due April 15, 2020, but are collected throughout the year. Therefore, revenue collections for FY 2019-20 in this fiscal impact statement represent collections for economic activity that occurs in the 18 months between January 1, 2019 and June 30, 2020.

**Oil and severance tax revenue.** Starting in tax year 2019, the measure increases oil and gas severance tax rates for all oil and gas producers as shown in Table 2.

**Table 2**
**Severance Tax Rates on Oil and Gas Producers Under Initiative #22**

| Gross Income | Current Law Tax Rate | Proposed Tax Rate |
|---|---|---|
| Under $25,000 | 2% | 7% |
| $25,000 and under $100,000 | 3% | 8% |
| $100,000 and under $300,000 | 4% | 9% |
| $300,000 and over | 5% | 10% |

The new tax rates are a 5 percentage point increase for all oil and gas producers, regardless of gross income level.

Under current law, oil and gas producers are allowed to claim an ad valorem tax credit against their severance tax liability equal to 87.5 percent of the amount they paid in property taxes to local governments in the prior year. In addition, current law exempts from taxation the value of production from oil and gas wells that produce either fewer than 15 barrels of oil per day or fewer than 90,000 cubic feet of natural gas per day. The measure also eliminates the ad valorem tax credit and halves the stripper well exemption starting in 2019. The measure also reduces the threshold for the exemption to 7.5 barrels of oil per day or 45,000 cubic feet of natural gas per day. Table 3 shows the revenue associated with each change in the oil and gas severance tax structure.

**Table 3**
**Change in Revenue Under Initiative #22**

| | FY 2019-20 | FY 2020-21 |
|---|---|---|
| **Current Law Forecast*** | **$169.9 million** | **$73.4 million** |
| Increased Tax Rates | $285.8 million | $73.8 million |
| Elimination of Ad Valorum Credit | $629.3 million | $435.7 million |
| Halve Stripper Well Exemption | $199.6 million | $49.6 million |
| **New Revenue** | **$1,114.7 million** | **$559.2 million** |
| **Total Oil and Gas Severance Tax Revenue** | **$1,284.6 million** | **$632.6 million** |

**December 2018 Legislative Council Staff oil and gas severance tax forecast.*

The revenue impact estimate is based on the December 2018 Legislative Council Staff oil and gas severance tax forecast. The price and production of oil and gas is volatile, introducing significant forecast error into the severance tax revenue projections.

**Revenue distributions.** The measure changes the current law distribution of oil and gas revenue to the Department of Natural Resources (DNR) and the Department of Local Affairs (DOLA), and creates an allocation to the new Severance Tax Stabilization Fund for oil and gas severance taxes collected beginning in 2019. Table 4 shows the distributions of oil and gas severance taxes under current law and the measure.

**Table 4**
**Distribution of Oil and Gas Severance Tax Revenue Under Initiative #22**

| Transfer | Current Law | Initiative #22 |
|---|---|---|
| Department of Natural Resources | 50% | 22% |
| Department of Local Affairs | 50% | 22% |
| Severance Tax Stabilization Fund | - | 56% |
| **Total** | **100%** | **100%** |

Table 5 compares the revenue distributions of oil and gas severance tax revenue under current law and under the measure and the net change for FY 2019-20 and FY 2020-21. The distributions in Table 5 align with revenue collections but the actual timing of these distributions for state accounting purposes are uncertain.

**Table 5**
**Distributions Under Initiative #22**

**FY 2019-20**

| Transfers | Current Law | Initiative #22 | Net Change |
|---|---|---|---|
| Department of Natural Resources | $84,932,279 | $282,607,524 | $197,675,245 |
| Department of Local Affairs | $84,932,279 | $282,607,524 | $197,675,245 |
| Severance Tax Stabilization Fund | - | $719,364,607 | $719,364,607 |
| **TOTAL** | **$169,864,558** | **$1,284,579,655** | **$1,114,715,097** |

**FY 2020-21**

| Transfers | Current Law | Initiative #22 | Net Change |
|---|---|---|---|
| Department of Natural Resources | $36,721,376 | $139,176,536 | $102,455,160 |
| Department of Local Affairs | $36,721,376 | $139,176,536 | $102,455,160 |
| Severance Tax Stabilization Fund | - | $354,267,546 | $354,267,546 |
| **TOTAL** | **$73,442,752** | **$632,620,618** | **$559,177,866** |

## State Expenditures

The measure increases cash funds available for appropriations by up to $1.04 billion in FY 2019-20 and $523.8 million in FY 2020-21. The measure also increases state General Fund expenditures by $205,612 and 0.9 FTE in FY 2019-20 and $43,781and 0.9 FY 2020-21 with ongoing expenditures for the Department of Revenue to administer the new tax structure. The timing of expenditures will be determined by the actual collection of taxes, budgeting decisions, and any implementing legislation. Table 6 summarizes potential appropriations under the measure.

**Table 6**
**Expenditures Under Initiative #22**

| Agency | FY 2019-20 | FY 2020-21 |
|---|---:|---:|
| Department of Revenue | $205,612 | $43,781 |
| **General Fund Total** | **$205,612** | **$43,781** |
| Department of Natural Resources | $197,675,245 | $102,455,160 |
| Department of Local Affairs | $197,675,245 | $102,455,160 |
| Department of Education | $323,714,073 | $159,420,396 |
| Department of Public Health and Environment | $323,714,073 | $159,420,396 |
| **Cash Fund Total** | **$1,042,778,636** | **$523,751,112** |
| **TOTAL** | **$1,042,984,248** | **$523,794,893** |

The measure changes the distribution to the Department of Natural Resources and the Department of Local Affairs, and creates the Severance Tax Stabilization Fund. Money is transferred from the new fund to the Colorado Department of Education, the Colorado Department of Public Health and Environment, and a newly created Perpetual Base Account. Table 7 summarizes the change in cash fund revenue available for appropriation by state agency.

**Table 7**
**Cash Fund Amounts Available for Appropriation Under Initiative #22**

| Fund | FY 2019-20 | FY 2020-21 |
|---|---:|---:|
| **Department of Natural Resources (22%)** | **$197,675,246** | **$102,455,160** |
| Perpetual Base Fund (50% of DNR) | $98,837,623 | $51,227,580 |
| Operational Fund (50% of DNR) | $98,837,623 | $51,227,580 |
| **Department of Local Affairs (22%)** | **$197,675,246** | **$102,455,160** |
| **Severance Tax Stabilization Fund (56%)** | **$719,364,607** | **$345,267,456** |
| Operational Account (90% of Stabilization Fund) | $647,428,146 | $318,840,792 |
| K-12 Education (CDE) (50% of Operational Account) | $323,714,073 | $159,420,396 |
| Medical Care (CDPHE) (50% of Operational Account) | $323,714,073 | $159,420,396 |
| Perpetual Base Account (10% of Stabilization Fund)* | $71,936,461 | $35,426,755 |
| **Total Cash Fund Expenditures** | **$1,042,778,638** | **$523,751,112** |
| **TOTAL** | **$1,114,715,099** | **$559,177,867** |

**Money in the Perpetual Base Account is not spent until the balance in the account exceeds 125 percent of operational account expenditures.*

**Department of Education (CDE).** The measure creates a statutory appropriation to the Colorado Department of Education to expand full-day kindergarten and increase funding for K-12 education. The appropriation is equal to 50 percent of oil and gas severance tax revenue in the newly created Severance Tax Operational account. Implementing legislation will be needed to specify how this money is used.

**Department of Public Health and Environment (CDPHE).** The measure creates a statutory appropriation within the Colorado Department of Public Health and Environment to fund medical care for people suffering negative health impacts caused by oil and gas production. The measure does not specify which fund or program will receive the revenue. Implementing legislation will be needed to determine how claims are made, which conditions are caused by oil and gas development, how the revenue is distributed, and authorization of administrative costs for the department.

**New Perpetual Base Account.** The measure creates a new Perpetual Base, which receives 10 percent of the revenue to the Severance Tax Stabilization Fund. Funds in the account are not appropriated until the Perpetual Base Account exceeds 125 percent of the previous year's operational account expenditures. Perpetual Base Account revenue will total $71.9 million in FY 2019-20 and $35.4 million in FY 2020-21; however, this revenue will not be spent until the balance in the account exceeds 125 percent of operational account expenditures.

**Department of Revenue.** Department of Revenue General Fund expenditures will increase by $205,612 and 0.9 FTE in FY 2019-20 and $43,781 and 0.9 FTE in FY 2020-21 as shown in Table 8. This amount includes personnel costs for additional staff to answer taxpayer questions, process additional returns from the elimination of the stripper well exemption, and computer programing to administer the new severance tax structure.

**Table 8**
**General Fund Expenditures Under Initiative #22**

| | FY 2019-20 | FY 2020-21 |
|---|---|---|
| **Department of Revenue** | | |
| Personal Services | $43,781 | $43,781 |
| Operating Expenses and Capital Outlay Costs | $5,558 | $855 |
| Computer Programing | $156,272 | - |
| **Total Cost** | **$205,611** | **$44,636** |
| **Total FTE** | **0.9 FTE** | **0.9 FTE** |

**TABOR refunds.** The measure exempts severance tax revenue for oil and gas production from TABOR.

The measure is expected to decrease state General Fund obligations for TABOR refunds by $169.9 million in the current FY 2019-20. Under current law and the December 2018 forecast, the measure will correspondingly reduce the amount refunded to taxpayers via sales tax refunds on income tax returns for the current tax year 2019. Specifically, the bill will eliminate $39.5 million in sales tax refunds expected to be paid on income tax returns for tax year 2020, as well as $130.4 million expected to be refunded via reimbursements to local governments for their property tax loss associated with the senior and disabled veteran property tax exemptions. Because a portion of the TABOR surplus set aside in FY 2019-20 will no longer be available to finance property tax reimbursements, the measure will obligate an equal amount for reimbursements to be paid from the FY 2020-21 General Fund budget instead.

The state is not expected to collect a TABOR surplus in FY 2020-21. A forecast of state revenue subject to TABOR is not yet available for FY 2021-22 and subsequent years.

## Local Government Impact

Local governments will receive increased local government impact grants administered by DOLA. In addition, some of the new expenditures in the measure may increase revenue to school districts and county health agencies depending on implementing legislation.

## Economic Impact

This measure increases severance taxes paid by the oil and gas industry, increasing the cost of oil and gas development in Colorado.

To the extent that the tax increase decreases oil and gas development in Colorado, there will be less oil and gas employment, less demand for associated services, reduced rent and royalty income to mineral owners, and reduced profits for oil and gas companies. The severance tax rate is only one consideration for the industry when deciding where to develop oil and gas; other factors include the cost of extracting oil and gas, the existence of supporting infrastructure, the ability to market extracted oil and gas, existing business commitments, and prevailing prices.

The new tax revenue will be spent on state and local government services, including K-12 education and the treatment of associated medical conditions. The additional spending may increase access to these services and may reduce the amount of money households need to budget for these services. To the extent that households have more money available in their budgets, they may increase other household purchases, savings, or investments.

## Effective Date

If approved by voters at the 2019 general election, this measure takes effect upon proclamation of the Governor, no later than 30 days after the official canvass of the vote is completed. The new tax rates and structure apply starting January 1, 2019.

## State and Local Government Contacts

| | | |
|---|---|---|
| Counties | Education | Local Affairs |
| Municipalities | Revenue | Natural Resources |
| Public Health and Environment | | |

**Abstract of Initiative 22: SEVERANCE TAXES ON OIL AND GAS**

*The abstract includes estimates of the fiscal impact of the proposed initiative. If this initiative is to be placed on the ballot, Legislative Council Staff will prepare new estimates as part of a fiscal impact statement, which includes an abstract of that information. All fiscal impact statements are available at www.ColoradoBlueBook.com and the abstract will be included in the ballot information booklet that is prepared for the initiative.*

**This initial fiscal estimate, prepared by the nonpartisan Director of Research of the Legislative Council as of February 2019, identifies the following impacts:**

**State revenue.** This measure will increase oil and gas severance tax revenue by $1.1 billion in FY 2019-20, and $559.2 million in FY 2020-21 with ongoing increases in future years. Revenue collected by the state in FY 2019-20 includes a $410.8 million revenue increase from economic activity that occurs in FY 2018-19 and $703.9 million on economic activity that occurs in FY 2019-20, the first full fiscal year that the measure is in effect.

**State expenditures.** The measure increases cash funds available for appropriations by up to $1.04 billion FY 2019-20 and $523.8 million in FY 2020-21. The measure also increases state expenditures by $223,434 and 0.9 FTE in FY 2019-20 and $62,459 and 0.9 FTE in FY 2020-21 and ongoing from the General Fund for the Department of Revenue to administer the new tax structure. The timing of expenditures will be determined by the actual collection of taxes, budgeting decisions, and any implementing legislation. Table summarizes potential appropriations under Initiative #22.

**Local government impact.** Local governments will receive increased local government impact grants administered by DOLA. In addition, some of the new expenditures in the measure may increase revenue to school districts and county health agencies depending on implementing legislation.

**Economic impacts.** This measure increases severance taxes paid by the oil and gas industry, increasing the cost of oil and gas development in Colorado.

To the extent that the tax increase decreases oil and gas development in Colorado, there will be less oil and gas employment, less demand for associated services, reduced rent and royalty income to mineral owners, and reduced profits for oil and gas companies. The severance tax rate is only one consideration for the industry when deciding where to develop oil and gas; other factors include the cost of extracting oil and gas, the existence of supporting infrastructure, the ability to market extracted oil and gas, existing business commitments, and prevailing prices.

The new tax revenue will be spent on state and local government services, including K-12 education and the treatment of associated medical conditions. The additional spending may increase access to these services and may reduce the amount of money households need to budget for these services. To the extent that households have more money available in their budgets, they may increase other household purchases, savings, or investments.