

JOINT BUDGET COMMITTEE



STAFF BUDGET BRIEFING FY 2019-20

DEPARTMENT OF NATURAL RESOURCES

(Division of Reclamation, Mining, and Safety, Oil and Gas
Conservation Commission, State Board of Land Commissioners,
and Severance Tax Policy)

JBC WORKING DOCUMENT - SUBJECT TO CHANGE
STAFF RECOMMENDATION DOES NOT REPRESENT COMMITTEE DECISION

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DEPARTMENT OF NATURAL RESOURCES

(Division of Reclamation, Mining, and Safety, Oil and Gas Conservation Commission, State Board of Land Commissioners, and Severance Tax Policy)

DEPARTMENT OVERVIEW

The Department of Natural Resources is responsible for developing, protecting, and enhancing Colorado’s natural resources for the use and enjoyment of the State’s present and future residents and visitors. The Department is comprised of the following divisions:

- The DIVISION OF RECLAMATION, MINING, AND SAFETY (DRMS) regulates development and reclamation at mining sites, reclaims abandoned mine sites, and provides safety training for mine operators and employees.
- The OIL AND GAS CONSERVATION COMMISSION (OGCC) promotes the exploration, development, and conservation of Colorado's oil and natural gas resources by issuing permits, conducting inspections, pursuing enforcement actions, and engaging in public outreach efforts.
- The STATE BOARD OF LAND COMMISSIONERS (State Land Board or Land Board) manages agricultural, commercial, mineral, and other leases on state-owned lands to generate reasonable and consistent revenue for public schools and other trust beneficiaries over time.

The four remaining divisions (THE EXECUTIVE DIRECTOR’S OFFICE, THE DIVISION OF PARKS AND WILDLIFE, THE COLORADO WATER CONSERVATION BOARD, AND THE WATER RESOURCES DIVISION) were discussed in a separate staff briefing today.

This packet also includes an overview discussion of STATEWIDE SEVERANCE TAX POLICY.

DEPARTMENT BUDGET: RECENT APPROPRIATIONS

FUNDING SOURCE	FY 2016-17	FY 2017-18	FY 2018-19	FY 2019-20 *
General Fund	\$28,742,941	\$30,864,532	\$32,005,418	\$33,326,757
Cash Funds	202,967,586	230,795,872	238,857,665	223,394,936
Reappropriated Funds	7,703,225	6,932,593	7,933,687	7,483,247
Federal Funds	26,641,222	26,699,468	26,568,474	26,683,622
TOTAL FUNDS	\$266,054,974	\$295,292,465	\$305,365,244	\$290,888,562
Full Time Equiv. Staff	1,462.7	1,458.6	1,464.5	1,475.5

*Requested appropriation.

DIVISION OF RECLAMATION MINING AND SAFETY: RECENT APPROPRIATIONS

FUNDING SOURCE	FY 2016-17	FY 2017-18	FY 2018-19	FY 2019-20 *
General Fund	\$0	\$0	\$0	\$0
Cash Funds	4,485,633	4,460,425	4,502,244	4,595,101
Reappropriated Funds	0	0	0	0
Federal Funds	3,512,878	3,488,792	3,391,838	3,477,981
TOTAL FUNDS	\$7,998,511	\$7,949,217	\$7,894,082	\$8,073,082
Full Time Equiv. Staff	67.9	67.9	65.8	65.8

*Requested appropriation.

OIL AND GAS CONSERVATION COMMISSION: RECENT APPROPRIATIONS

FUNDING SOURCE	FY 2016-17	FY 2017-18	FY 2018-19	FY 2019-20 *
General Fund	\$0	\$0	\$0	\$0
Cash Funds	12,397,060	12,370,025	17,950,270	18,679,866
Federal Funds	104,559	101,129	100,289	96,559
TOTAL FUNDS	\$12,501,619	\$12,471,154	\$18,050,559	\$18,776,425
Full Time Equiv. Staff	110.3	110.3	116.3	121.3

*Requested appropriation.

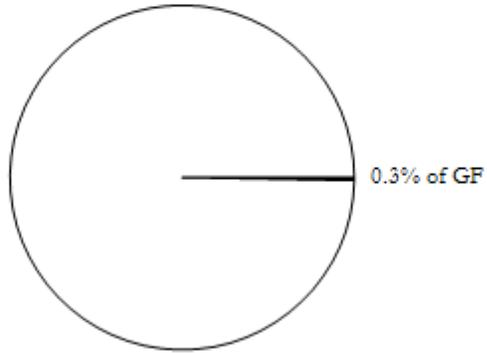
STATE BOARD OF LAND COMMISSIONERS: RECENT APPROPRIATIONS

FUNDING SOURCE	FY 2016-17	FY 2017-18	FY 2018-19	FY 2019-20 *
General Fund	\$0	\$0	\$0	\$0
Cash Funds	4,766,219	4,864,096	4,956,149	5,039,566
Reappropriated Funds	225,000	225,000	225,000	225,000
Federal Funds	0	0	0	0
TOTAL FUNDS	\$4,991,219	\$5,089,096	\$5,181,149	\$5,264,566
Full Time Equiv. Staff	41.0	41.0	42.0	42.0

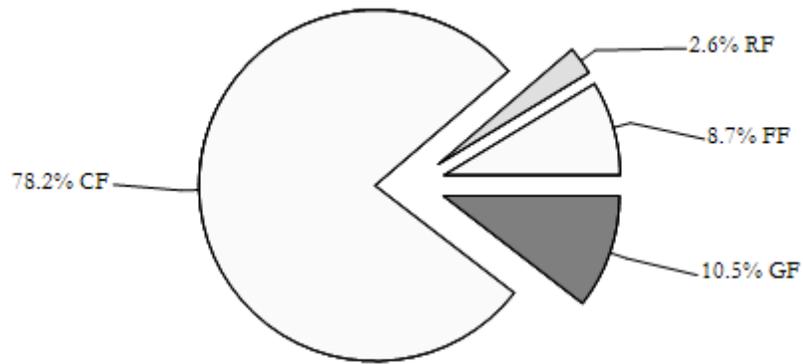
*Requested appropriation.

DEPARTMENT BUDGET: GRAPHIC OVERVIEW

Department's Share of Statewide General Fund

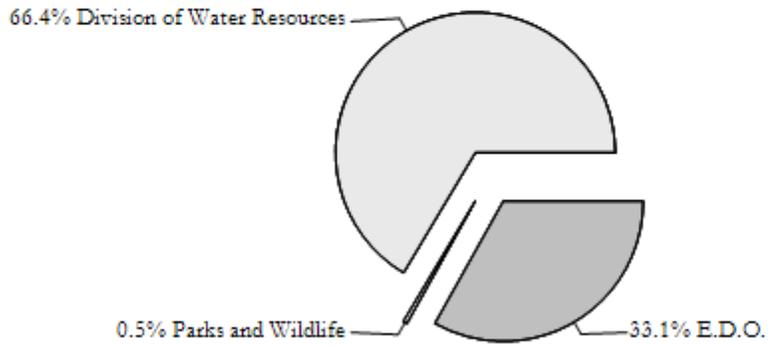


Department Funding Sources

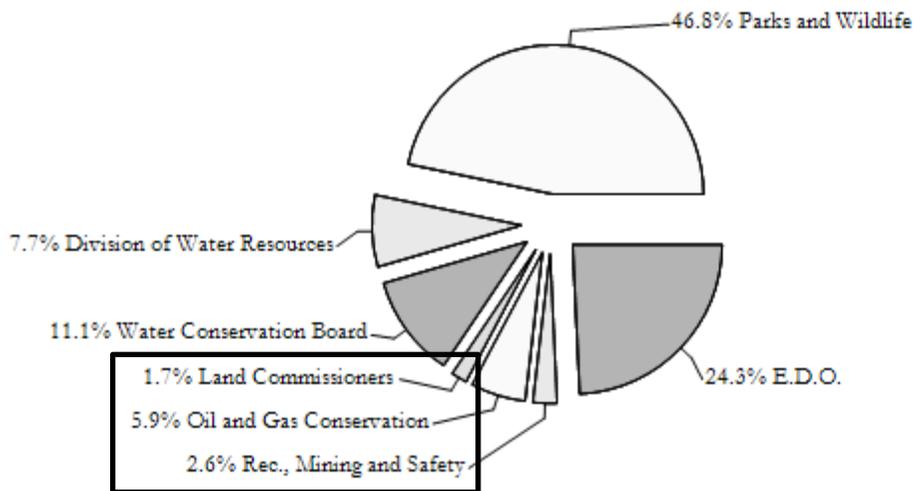


All charts are based on the FY 2018-19 appropriation.

Distribution of General Fund by Division



Distribution of Total Funds by Division



All charts are based on the FY 2018-19 appropriation.

GENERAL FACTORS DRIVING THE BUDGET

Funding for the Department of Natural Resources in FY 2018-19 consists of 10.5 percent General Fund, 78.2 percent cash funds, 2.6 percent reappropriated funds, and 8.7 percent federal funds.

Funding for the divisions covered in this briefing packet consists of 88.1 percent cash funds, 0.7 percent reappropriated funds, and 11.2 percent federal funds in FY 2018-19. These divisions did not receive General Fund appropriations in FY 2018-19 and have not requested General Fund appropriations in FY 2019-20. Some of the major factors driving the Department's budget are discussed below.

SEVERANCE TAX REVENUE (OPERATIONAL FUND)

Colorado levies a tax on the severance of non-renewable resources including oil and gas, coal, molybdenum, and metallic minerals. The Department administers 50.0 percent of total severance tax revenue which is credited to the Severance Tax Trust Fund for "programs that promote and encourage sound natural resource planning, management, and development related to minerals, energy, geology, and water" (Section 39-29-109, C.R.S.). This revenue is split equally between the Operational Fund, used to support Department programs and personnel, and the Perpetual Base Fund, which provides loans or grants for water projects.

Oil and gas production has accounted for approximately 94.0 percent of total severance tax revenue for at least the last five years with the exception of FY 2016-17 where net oil and gas refunds of \$14.3 million, offset \$7.1 million revenue from other minerals. Ostensibly due to higher oil prices, the Oil and Gas Conservation Commission is experiencing record numbers of filings indicating a very active industry. The September 2018 Legislative Council Staff revenue forecast estimates total severance tax revenues to be \$211.5 million for FY 2018-19, which represents a 63.4 percent increase from projected revenue for the prior year. The forecast for FY 2019-20 currently estimates some restriction, with severance tax revenues totaling \$176.0 million.

Severance tax is discussed in further detail in three of the four issues presented in this document including its current status, a bill proposed by the Interim Water Resources Review Committee, and an information request response on changes that would allow the Department of Revenue tools to provide data requested by legislators.

STATE BOARD OF LAND COMMISSIONERS

The State Board of Land Commissioners (State Land Board) manages agricultural, commercial, mineral, and other leases on eight public trusts of land and is tasked with generating reasonable and consistent revenue for trust beneficiaries over time. Total trust revenues have more than tripled over the past ten years, with a record high of \$191.4 million in FY 2014-15, largely driven by record one-time bonus payments on mineral leases and by rental payments and royalties on oil and gas production, which accounted for more than 77.4 percent of total trust revenue last year. However, bonus payments are expected to not contribute significantly over the next two years as the number of available land parcels decreases and payments for oil and gas development leases on the State Land Board's Lowry Range and 70 Ranch properties are completed.

The Public School Trust benefiting K-12 education is the largest of the trusts managed by the State Land Board, accounting for more than 98.0 percent of total trust revenues. Fifty percent of the gross

amount of income received during the fiscal year from state public school lands is deposited in the Public School Capital Construction Assistance Fund for the Building Excellent Schools Today (BEST) program.

PUBLIC SCHOOL TRUST REVENUE						
	FY 2014-15 ACTUAL	FY 2015-16 ACTUAL	FY 2016-17 ACTUAL	FY 2017-18 ACTUAL	FY 2018-19 FORECAST	FY 2019-20 FORECAST
Mineral Royalties	\$113,189,670	\$63,157,705	\$72,503,247	\$85,106,825	\$82,799,760	\$54,750,000
Mineral Bonuses	50,445,063	42,672,837	20,292,014	15,343,624	1,285,566	1,250,000
Mineral Rental	2,231,912	1,771,837	1,473,543	1,465,315	1,583,528	1,750,000
Surface Rental	11,744,758	13,149,443	13,336,103	13,792,419	13,572,158	12,000,000
Commercial/Other	7,208,034	9,124,821	8,998,807	13,356,400	13,005,656	10,265,000
Land and Timber Sales	58,558	32,431	79,120	1,675	35,172	35,000
Non-Reinvested Sales	3,750,892	5,302,996	1,354,697	0	0	0
Interest Income	875,725	952,322	319,329	543,225	543,225	550,000
Total Revenues	\$189,504,612	\$136,164,392	\$118,356,860	\$129,789,483	\$112,825,065	\$80,600,000

OIL AND GAS ACTIVITY

The Colorado Oil and Gas Conservation Commission (OGCC) is charged with fostering the responsible, balanced development, production, and utilization of the natural resources of oil and gas in the state of Colorado in a manner consistent with protection of public health, safety, and welfare, including protection of the environment and wildlife resources. The OGCC is funded primarily by two sources of cash funds: the severance tax operational fund and the Oil and Gas Conservation and Environmental Response Fund. The level of oil and gas drilling activity, shown in the table below, impacts the OGCC's workload and necessary expenditures:

OGCC WORKLOAD MEASURES						
	FY 2014-15 ACTUAL	FY 2015-16 ACTUAL	FY 2016-17 ACTUAL	FY 2017-18 ACTUAL	FY 2018-19 ESTIMATE ^a	FY 2019-20 ESTIMATE ^b
Active Wells	53,608	53,651	54,605	53,738	55,000	56,000
Drilling Permits Requested	3,895	3,317	4,624	8,127	8,400	8,400
Well Starts (Spud)	1,986	1,083	1,525	1,889	1,900	1,900
Active Drilling Rigs	58	25	25	34	34	34
Site Investigations & Remediation Workplans	551	514	456	617	575	575
Avg. Inspection Frequency (per year)	2	1	1	2	2	2
Hearing Applications	672	680	635	950	1,050	1,050
OGCC Expenditures ^b	\$10,307,697	\$11,403,628	\$12,501,619	\$12,471,154	\$18,050,559	\$18,776,425
Total FTE	94.6	104.0	110.3	110.3	116.3	121.3

^a Data included for FY 2018-19 and FY 2019-20 are estimates provided by the Oil and Gas Conservation Commission.

^b Expenditures are shown for the Division only. They include all fund sources (including bond claims) but do not include centrally appropriated items funded in the Executive Director's Office. Expenditures for FY 2018-19 and FY 2019-20 reflect the appropriated and requested amounts, respectively.

SUMMARY: FY 2018-19 APPROPRIATION & FY 2019-20 REQUEST

DEPARTMENT OF NATURAL RESOURCES						
	TOTAL FUNDS	GENERAL FUND	CASH FUNDS	REAPPROPRIATED FUNDS	FEDERAL FUNDS	FTE
FY 2018-19 APPROPRIATION:						
HB 18-1322 (Long Bill)	\$31,125,790	\$0	\$27,408,663	\$225,000	\$3,492,127	224.1
TOTAL	\$31,125,790	\$0	\$27,408,663	\$225,000	\$3,492,127	224.1
FY 2019-20 REQUESTED APPROPRIATION:						
FY 2018-19 Appropriation	\$31,125,790	\$0	\$27,408,663	\$225,000	\$3,492,127	224.1
Annualize prior year budget actions	422,409	0	337,092	0	85,317	0.0
Annualize prior year legislation	46,945	0	39,650	0	7,295	0.0
R2 Additional staffing to address oil and gas backlogs	570,564	0	570,564	0	0	5.0
Nonprioritized request items	1,380	0	791	0	589	0.0
Centrally appropriated line items	(53,015)	0	(42,227)	0	(10,788)	0.0
TOTAL	\$32,114,073	\$0	\$28,314,533	\$225,000	\$3,574,540	229.1
INCREASE/(DECREASE)	\$988,283	\$0	\$905,870	\$0	\$82,413	5.0
Percentage Change	3.2%	0.0%	3.3%	0.0%	2.4%	2.2%

ANNUALIZE PRIOR YEAR BUDGET ACTIONS: The request includes an increase of \$422,409 total funds to reflect the second year impact of decisions made during a previous budget cycle.

ANNUALIZE PRIOR YEAR BUDGET ACTIONS					
	TOTAL FUNDS	GENERAL FUND	CASH FUNDS	FEDERAL FUNDS	FTE
Annualize prior year salary survey	\$539,472	\$0	\$454,155	\$85,317	0.0
Additional staffing and equipment for flowline safety	(105,105)	0	(105,105)	0	0.0
Additional FTE for orphan wells program	(11,958)	0	(11,958)	0	0.0
TOTAL	\$422,409	0	\$337,092	\$85,317	0.0

ANNUALIZE PRIOR YEAR LEGISLATION: The request includes an increase of \$46,945 total funds to reflect the second-year impact of S.B. 18-200 (PERA).

R2 ADDITIONAL STAFFING TO ADDRESS OIL AND GAS BACKLOGS: The request includes an increase of \$570,564 cash funds and 5.0 FTE from the Oil and Gas Conservation and Environmental Response Fund to improve operations for the Colorado Oil and Gas Commission including permitting, engineering, field inspections, reclamation, and data analysis. An increase in oil and gas activity and citizen complaints has led to backlogs in many activities carried out by the Commission and without additional funding could lead to delays in development or potentially pose a risk to public safety.

NON-PRIORITIZED REQUEST ITEMS: The request includes a reduction of \$1,380 total funds for the Divisions in this packet's share of the request submitted by Department of Personnel for increased material costs for Integrated Document Solutions.

CENTRALLY APPROPRIATED LINE ITEMS: The request includes a reduction of \$53,015 total funds to reflect changes in anticipated funding available from cash and federal funds sources to pay overhead costs for the Department via indirect cost recoveries.

ISSUE: SEVERANCE TAX OPERATIONAL FUND UPDATE

Severance Tax Programs continue to be difficult to budget for even as oil and gas activity rebounds.

SUMMARY

- Based on the revenue forecast presented by Legislative Council in September 2018, the requirement that severance tax revenue pay back a portion of the General Fund utilized to support Tier 1 and Tier 2 programs in FY 2017-18 may be met in time for Tier 2 programs to receive their April 1st transfers.
- No Tier 2 programs in FY 2018-19 have received disbursements to date and, when initially budgeted, programs were under notice that no funding would likely be available but for a few programs targeted with General Fund transfers. An Interim Water Resources Review Committee bill may preempt any April 1st transfers (and is discussed in the next issue).
- This issue discusses the structure of the severance tax policy, provide a little bit of history, and to share a model of the Severance Tax Operational Fund, under current law and given the current conditions.

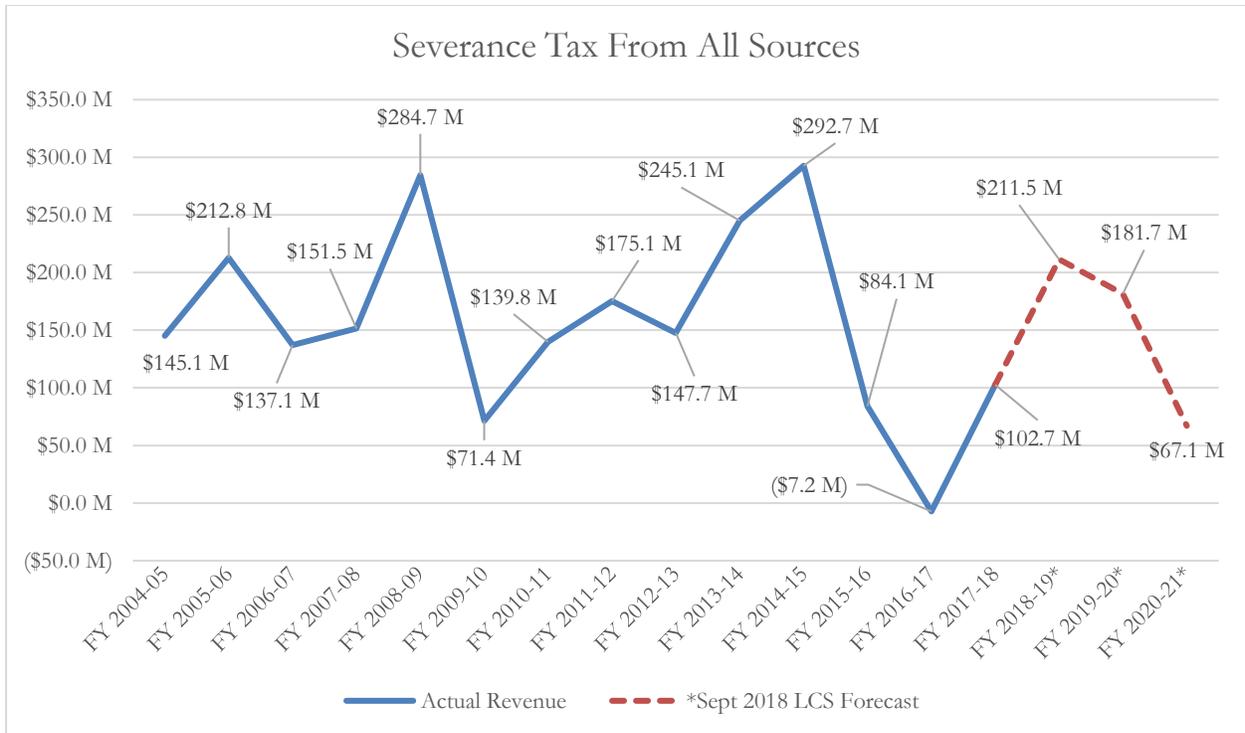
RECOMMENDATION

JBC staff recommendation is pending having the opportunity to observe how quickly the Water Resources Review Committee's recommended bill moves at the beginning of the legislative session. If action on the bill is still pending when figure setting for the Department of Natural Resources occurs, JBC staff will have a recommendation on how to prevent Tier 2 programs to receive their April 1, 2018 transfers if the bill still has life, or another path forward if not.

DISCUSSION

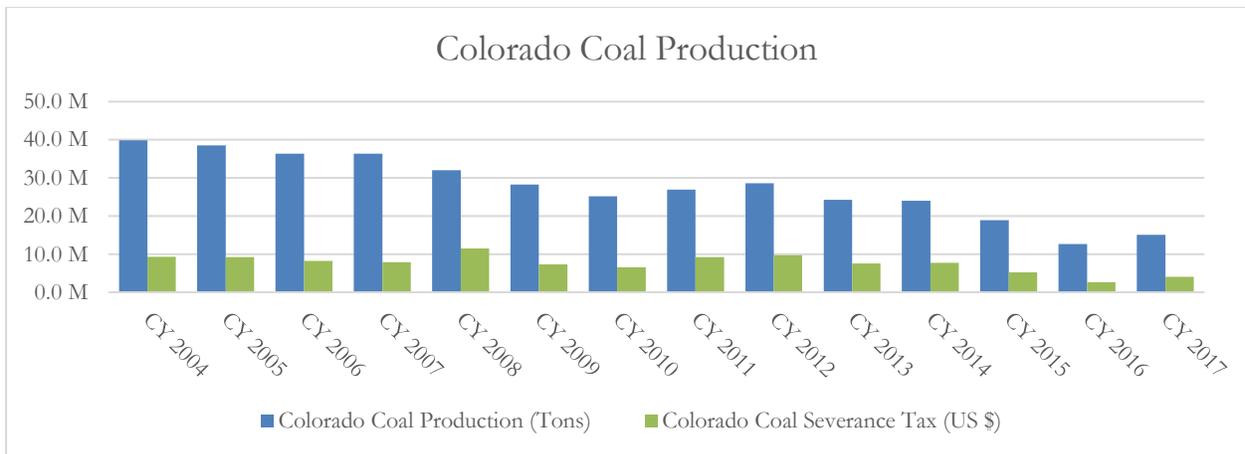
SEVERANCE TAX PROGRAMS GENERAL STRUCTURE

Under statute (Sections 39-29-101 through 107, C.R.S.), first enacted in 1977, the State levies a tax on the severance of non-renewable natural resources. Colorado collects taxes on the severance of oil and gas, coal, molybdenum, and metallic minerals, and on oil shale. Severance tax revenues are highly volatile which the following chart showing recent severance tax revenue and projected future revenue illustrates well.



Volatility stems from: (1) inherent price volatility in the resources generating severance tax (most importantly oil and gas); (2) an *ad valorem* tax credit (Section 39-29-104 (2)(b), C.R.S.) allowing severance taxpayers to deduct a portion (87.5 percent) of local property taxes paid on production from severance tax liability; and (3) a “stripper well” exemption allowing producers to exempt production from low-production wells from severance tax liability.

Severance tax volatility was once slightly stabilized by severance tax on coal production, but as the market for coal constricts because there are fewer communities wishing to power themselves with coal-generated electricity, the volume of coal severed in Colorado continues to shrink. Severance tax from coal production ranged from a high of \$11.5 million in calendar year 2008 and a low of \$2.7 million in calendar year 2016. The following chart visualize both production volume and severance tax revenue derived from coal.



Because of a lag in the way property taxes are calculated, the amount of the deduction against the severance tax is based on production values from two years prior, which can generate significant swings in severance tax liability.

In addition, changes in local tax policy can change a producer's deduction against the state severance tax liability. Finally, geographic shifts in production (for example from portions of the state with lower local property tax rates to regions with higher rates) will affect statewide severance tax collections. As a result of these factors, severance tax revenues do not always track trends in resource price, making forecasting the revenues particularly challenging.

The average lifespan of an active oil and gas production site in Colorado is approximately 12 years, but lifespans vary by region. Typically, both due to the release of formation pressure and operators desire to extract as much from the site as soon as possible, production from a well follows a negative exponential curve. The first year a well is in production, it will have a maximum production volume that then quickly tapers off in subsequent production years. The well lifecycle amplifies the volatility because operators in year-three of production are offsetting *ad valorem* taxes from year-one production volume.

DISTRIBUTION OF SEVERANCE TAX REVENUES

Pursuant to statute, 50.0 percent of severance tax revenues are credited to the Severance Tax Trust Fund and 50.0 percent to the Department of Local Affairs for grants and distributions to local governments impacted by mining activities. Of the revenue credited to the Severance Tax Trust Fund, 50.0 percent is allocated to the Perpetual Base Account of the Severance Tax Trust Fund (or 25.0 percent of total severance tax revenues), which is used by the Colorado Water Conservation Board for water construction projects. The other 50.0 percent of Severance Tax Trust Fund revenues (or 25.0 percent of total severance tax revenues) is allocated to the Operational Fund for programs that "promote and encourage sound natural resource planning, management, and development related to minerals, energy, geology, and water and for use in funding programs to reduce the burden of increasing home energy costs on low-income households."

Current statute, enacted as a JBC bill in 2008 (H.B. 08-1398), divides Operational Account expenditures into two categories. Tier 1 expenditures primarily support salaries and on-going core programs of the Department of Natural Resources. Tier 2 programs generally support grants, loans, research, and construction. Because of the volatility in severance tax revenues, the General Assembly has established statutory reserve requirements for Operational Account expenditures. The reserve requirement for tier 1 programs is equal to one full year of operating appropriations to mitigate against a need to change staffing and operating levels from year to year based on fluctuating revenues. The reserve requirement for tier 2 programs is equal to 15.0 percent of authorized expenditures, based on an expectation that Tier 2 programs are better suited to absorb fluctuations in revenue than Tier 1 programs. The distribution of funding for Tier 2 programs is staggered with 40.0 percent released July 1, 30.0 percent released January 4, and the final 30.0 percent released April 1.

TEMPORARY CHANGES FOR FY 2018-19

House Bill 18-1338 (Severance Tax Stabilization) made a number of transfers from the General Fund to support Tier 1 and Tier 2 severance tax programs. In an effort to reduce the total impact

the legislation had on the General Fund, it includes a provision to divert all severance tax revenue that would otherwise be distributed to the Operational Fund between February 1, 2018, and June 30, 2019, to the General Fund up to a cap of just under \$41.0 million.

At the time of passage, the Legislative Council Revenue Forecast from March 2018 predicted it was extremely unlikely the state would realize revenue sufficient to fulfil the repayment obligation. As things often do with severance forecasts, this changed by the one made in September 2018, which estimates the repayment obligation may be fulfilled before April 1, 2019. Between February 2018 and October 2018, an estimated \$32.3 million severance tax revenue that would have otherwise been placed in the Operational Fund was transferred to the General Fund for the repayment obligation. Staff from the Department of Natural Resources had doubts the repayment obligation would be met *prior* to April 2019, nonetheless.

Absent an act by the General Assembly and without clear direction provided to the Department that legislative action is pending, Tier 2 programs could receive April transfers in 2019. The amounts of each estimated transfer is detailed in the table in the next section and represents proportional reductions from the statutory authorized transfers of about 74.0 percent.

Since at least March or April 2018, Tier 2 programs have been on notice that, for the FY 2017-18 and FY 2018-19, they could not rely on severance tax to provide funding for their programs. The Interim Water Resources Review Committee has recommended legislation for introduction in 2019 that would utilize this period where programs budgeted no new funding to begin spending *some* of the operational fund program in arrears. This bill is described in detail in the next issue brief in this document.

OPERATIONAL FUND PROJECTIONS UNDER CURRENT LAW

The following model provides an estimate of the cash flow for the Severance Tax Operational Fund for Tier 1 and Tier 2 programs. The assumptions in this model are based on the revenue forecast presented by Legislative Council in September 2018 and current law. Notably, while unlikely to remain repealed due to popular support, this model does not include transfers for the Species Conservation Trust Fund since those transfers repeal at this end of FY 2018-19.

Severance Tax Operational Fund				
	FY 2017-18 Actual	FY 2018-19 Projected	FY 2019-20 Projected	FY 2020-21 Projected
Beginning Balance	\$14,405,310	\$9,314,849	\$17,214,854	\$17,223,826
Revenue	13,167,662	52,507,916	45,742,994	17,102,980
Total Available for Tier (1) and (2) Appropriations	\$27,572,972	\$61,822,765	\$62,957,848	\$34,326,806
Tier (1) Appropriation/Request				
Colorado State Parks	\$2,341,732	\$2,473,291	\$2,473,291	\$2,473,291
Colorado Division of Wildlife	84,744	54,343	54,343	54,343
Subtotal Parks and Wildlife Appropriation Request	\$2,426,476	\$2,527,634	\$2,527,634	\$2,527,634
Avalanche Information Center	\$578,958	\$640,822	\$660,047	\$679,848
Colorado Geological Survey	1,395,721	1,585,133	1,632,687	1,681,668
Oil and Gas Conservation Commission	6,148,067	6,148,067	6,148,067	6,148,067
Reclamation, Mining, and Safety	4,112,930	4,792,370	4,936,141	5,084,225
Water Conservation Board	1,274,007	1,319,250	1,319,250	1,319,250

Severance Tax Operational Fund				
	FY 2017-18 Actual	FY 2018-19 Projected	FY 2019-20 Projected	FY 2020-21 Projected
Total Appropriation/Request for Tier (1) Programs	\$15,936,159	\$17,013,276	\$17,223,826	\$17,440,692
Other Transfers				
Roll forward for Legacy Mine Hydrology Projects	\$0	\$688,856	\$0	\$0
Tier (2) Appropriation/Request				
Water Supply Reserve Fund	\$0	\$7,396,153	\$9,086,026	\$0
Soil Conservation Grant Program	65,510	332,827	408,871	0
Water Efficiency Grant Program	0	406,788	499,731	0
Species Conservation Trust Fund	0	3,698,077	0	0
Low Income Energy Assistance Program (LEAP)	1,892,509	9,614,999	11,811,833	0
Interbasin Compact Committee Fund	0	551,063	676,970	0
Forest Restoration and Wildfire Mitigation Grant Programs	363,944	1,849,038	2,271,506	0
Aquatic Invasive Species	0	2,962,903	3,639,866	0
Forfeited Mine Site Reclamation	0	93,931	115,393	0
Total Appropriation/Request for Tier (2) Programs	\$2,321,963	\$26,905,779	\$28,510,196	\$0
Ending Balance after Appropriation/Expenditure	\$9,314,850	\$17,214,854	\$17,223,826	\$16,886,114
Tier (1) Reserve = 100% of Appropriation	15,936,159	17,013,276	17,223,826	17,440,692
Tier (2) Reserve = 15 % of Authorized Transfers	5,456,711	5,456,711	4,706,711	4,706,711
Total Reserve Requirement	21,392,870	22,469,987	21,930,537	22,147,403
Reserve funded over /(under) Statutory Requirement	(12,078,020)	(5,255,133)	(4,706,711)	(5,261,289)

ISSUE: TIER 2 SEVERANCE TAX BILL RECOMMENDED BY THE WATER RESOURCES REVIEW COMMITTEE

The Interim Water Resources Review Committee has recommended introduction of a bill to change the name of Tier 1 and Tier 2 programs, to Core Department Programs and Natural Resources and Energy Grant Programs, respectively. In an effort to make budgeting more reliable for Tier 2 Programs, transfers to Tier 2 cash funds would be delayed until August 15 of the following fiscal year.

SUMMARY

- When initially budgeted, “Tier 2” Severance Tax programs anticipated and thus planned on receiving zero transfers for FY 2018-19, however, the Revenue Forecast made by Legislative Council in September 2018 reflects severance tax revenue sufficient to make 75 percent of the authorized transfers to Tier 2 programs.
- Several Tier 2 programs the General Assembly determined were critical received direct General Fund appropriation in FY 2018-19 to offset the anticipated revenue shortfall, which included aquatic nuisance species, species conservation trust fund, forestry and wildfire grants, soil conservation districts, and forfeited mine site reclamation.
- The Interim Water Resources Review Committee voted unanimously to recommend legislation, LLS 19-0138.02, to capitalize on programs planned zero revenue year and defer current year transfers anticipated under current law to next fiscal year. Programs will then begin receiving transfers in arrears beginning August 2019. The bill includes other changes, which are detailed in the full issue brief.

RECOMMENDATION

Staff will continue to monitor the bill recommended by the Interim Water Resources Review Committee and provide updates to the Committee as it progresses. If amendments are adopted, staff will analysis on what changes were made by such.

DISCUSSION

The Interim Water Resources Review Committee (WRRC) unanimously agreed to recommend a bill to Legislative Council, which subsequently agreed to approve the WRRC bill. The vote in Legislative Council was nine to zero with one excused. Due to the pre-session bipartisan support of the bill, sufficient legislative momentum exists for the Joint Budget Committee to be aware of its existence. This issue will describe the changes it proposes to make to current law and how it will affect budgeting for severance tax programs in the future.

The bill and fiscal note have been included in Appendix E, and are available on the WRRC’s interim committee page on the General Assembly’s website.

The bill is focused primarily on “solving” the problem severance tax funded programs have with budgeting due to uncertainty and fluctuations in severance tax revenue. One unintended consequence of the current structure of the severance tax statute is the allusion that “Tier 2” programs are less important or critical than “Tier 1” programs. However, these nicknames stem from Tier 1 programs being enumerated under subsection (I) while Tier 2 are under subsection (II). This bill seeks to formally name Tier 1 programs as “Core Departmental Programs” (Core Programs), and Tier 2 programs as “Natural Resources and Energy Grant Programs” (Grant Programs).

Under current law, Tier 1 programs are prioritized in the Severance Tax Operational Fund and a restricted by program to a maximum amount of 100 percent of funding available each year. Under the recommended bill, this provision remains unchanged and the Core Programs will include operations for the:

- Oil and Gas Conservation Commission (35 percent max);
- Geological Survey (15 percent max);
- the Avalanche Information Center (5 percent max); the Division of Reclamation, Mining, and Safety (25 percent);
- Water Conservation Board (5 percent);
- Division of Parks (5 percent max) and Wildlife (10 percent max); and
- Fulfilling the Operational Fund's statutory reserve.

The bill continues to keep Grant programs as recipients of Operational Fund transfers after Core Program obligations are met and include water-related programs, agriculture-related programs, clean and renewable energy development, soil conservation, the control of invasive species, the Species Conservation Trust Fund, and low-income energy assistance programs (LEAP).

TIMING OF TRANSFERS TO THE GRANT PROGRAMS

As noted in a previous section of this document, severance tax revenues are distributed to Tier 2 programs three times annually and each transfer is determined based on the most recent Revenue Forecast made by Legislative Council. Transfers typically occur on July 1, January 1, and April 1 of the year in which the revenue was generated. Budgeting for and making transfers to programs this way has proved to be difficult at best. The bill recommended seeks to alleviate the programs from uncertainty by making only one transfer on August 15 the year after in which the revenue was generated.

Preliminary severance tax revenue reporting data reviewed by JBC staff is shared by the second week of each month with a final report available at the end of the month for the previous month. Recent reports have rarely fluctuated between the preliminary data and finalized report. Since transfers will occur after August 15th, programs can start the year on July 1 by planning their grant cycle knowing an estimated amount of funding based on the first 11 months of severance tax collection. By the time transfers are made, controllers have made any year-end adjustments needed and know exactly how much revenue exceeded Core Program appropriations and reserve and thus transferred to Grant Programs. That change will avoid the need for the General Assembly to pass future legislation to reverse transfers if forecasts change dramatically, like it did last year by enacting H.B. 18-1338 (Severance Tax Stabilization).

RESERVES

The bill seeks to increase the reserve to 100 percent of the statutory authorized transfers to Grant Programs in the Grant Program Reserve. If the General Assembly intends for the Grant Programs to operate annually without wild fluctuations and the possibility of receiving nothing, the reserve under current law was arguably never sufficient. JBC staff modeled the severance tax cash flow since FY 2013-14 if the Grant Program Reserve had equaled 100 percent and neither the Core Program Reserve nor the Grant Program Reserve were sufficient to fulfill 100 percent reserves. Grant Programs still would have experienced proportional reductions in FY 2015-16, and FY 2018-19 through FY 2020-21.

While the General Assembly envisioned Grant Programs to be programs that were capable of absorbing operational fluctuations due to the revenue stream's uncertainty, over time many of these programs became somewhat operational or at a minimum have passionate advocates that expect annual funding. The Core Reserve, the one for the Core Departmental Programs, remains unchanged at 100 percent of the amount appropriated.

It may be wise to budget to maintain a 100 percent reserve given the uncertainty of the revenue stream but the General Assembly has a history of treating severance tax as one of its unofficial General Fund reserve. Between FY 2001-02 and FY 2016-17, approximately \$276.3 million has been transferred from severance tax funds to the General Fund including \$121.6 million that would have otherwise been distributed to the impacted local governments. Anecdotally, many of these local governments rely on this funding stream for operational activities or to bring much needed services, which private industry has yet to provide. At a very minimum, the additional reserve can be highlighted as a basis for not transferring severance tax to the General Fund when it is forecast to be not completely fulfilled.

The basics of the current severance tax revenue allocation formula were created in FY 1996-97, splitting half of the receipt of revenues evenly between DNR and DOLA. Prior to this time, DNR did still get some severance tax revenue to support some of its programs. However, much of the severance tax revenue before FY 1996-97 was, on an off-and-on basis, still transferred directly to the General Fund. In fact, between FY 1987-88 and FY 1993-94, all revenue which was to have accrued to the State Severance Tax Trust Fund was instead transferred to the General Fund.

Much of the opposition to any bill seeking to transfer severance tax to the General Fund over the last 5 years has come from local governments. This bill does not change any of the funding credited to the Local Government Severance Tax Fund, which is direct distributed or available for grants and loans to local governments affected by mineral extraction activities. Staff from Colorado Municipal League had no position on the bill.

SPILOVER TO SEVERANCE TAX PERPETUAL BASE FUND (FOR WATER PROJECTS)

Perhaps one provision that is easily overlooked is one JBC staff finds important from a policy-perspective. Severance tax is levied on the permanent extraction of minerals from the state and once severance has occurred the activity can never be taxed again. Therefore, severance tax should be expended to either allow the state to recover from activities undertaken to deprive the state of those resources or for programs that enhance the value the public holds on the natural resources with which they interact.

The recommended bill contains a provision that directs the state treasurer to make the August 15th transfer to Grant Programs if there is sufficient funding to fulfill the Core Reserve. Then, if there is sufficient funding to completely fill the Grant Program Reserve, any remaining revenue will “spillover” into the Severance Tax Perpetual Base Fund, which is also the beneficiary of 25 percent of the initial severance tax revenue. Low interest loans for water projects are made from the Perpetual Base Fund and the fund is managed to maintain the corpus of the fund as a revolving fund for that purpose.

OPERATIONAL FUND MODEL UNDER PROPOSED BILL

Below is a preliminary model provided by the Department of Natural Resources to illustrate the Severance Tax Operational Fund through the period forecast by Legislative Council in its September 2018 forecast, FY 2020-21. Please note, this model assumes the Species Conservation Trust Fund is reauthorized for FY 2020-21 at its current authorized level (\$5 million).

SEVERANCE TAX OPERATIONAL FUND MODEL UNDER PROPOSED 2019 WRRC LEGISLATION				
		FY 2018-19 APPROPRIATION	FY 2019-20 REQUEST	FY 2020-21 PROJECTION
Revenue				
Beginning Fund Balance		\$9,314,849	\$44,120,633	\$45,734,022
Grant Program Distributions in Arrears		0	(26,905,779)	(28,510,196)
<i>Balance after Grant Program Distributions</i>		<i>\$9,314,849</i>	<i>\$17,214,854</i>	<i>\$17,223,826</i>
HB 18-1338 Transfers from GF		20,030,925	0	0
Forecasted Revenue		32,094,091	45,424,966	16,765,258
Projected Interest		<u>382,900</u>	<u>318,028</u>	<u>337,722</u>
Total Available Revenue		\$61,822,765	\$62,957,848	\$34,326,806
Core Departmental Programs - DNR & CGS				
(a) Oil & Gas Conservation Commission		\$6,148,067	\$6,148,067	\$6,148,067
(b) CO Geo Survey		1,585,133	1,632,687	1,681,668
(b.5) Avalanche Information Center		640,822	660,047	679,848
(c) Reclamation, Mining, & Safety		4,792,370	4,936,141	5,084,225
(d) CO Water Conservation Board		1,319,250	1,319,250	1,319,250
(e) CPW - Wildlife		54,343	54,343	54,343
(g) CPW - Parks		<u>2,473,291</u>	<u>2,473,291</u>	<u>2,473,291</u>
Core Programs Total		\$17,013,276	\$17,223,826	\$17,440,692
Core Reserve Requirement (100%)				
		\$17,214,854	\$17,223,826	\$17,440,692
Revenue Held in Section 1 Reserve		17,214,854	17,223,826	16,886,114
<i>% Held in Section 1 Reserve</i>		<i>100%</i>	<i>100%</i>	<i>97%</i>
Other Expenditures				
DRMS Legacy Mine Hydro Rollforward		<u>\$688,856</u>	<u>\$0</u>	<u>\$0</u>
Other Expenditures Total		\$688,856	\$0	\$0
Revenue Available for Grant Program				
		\$26,905,779	\$28,510,196	\$0
Amount Held for Distribution		26,905,779	28,510,196	0
<i>% of Authorized Distribution</i>		<i>74.0%</i>	<i>78.4%</i>	<i>0.0%</i>
Grant Program Reserve Requirement (100%)				
		\$36,378,072	\$36,378,072	\$36,378,072
Revenue Held in Grant Program Reserve		0	0	0
<i>% Held in Grant Program Reserve</i>		<i>0%</i>	<i>0%</i>	<i>0%</i>
Transfer to Perpetual Base Fund		\$0	\$0	\$0
Natural Resources and Energy Grant Program Distributions in Arrears				

SEVERANCE TAX OPERATIONAL FUND MODEL UNDER PROPOSED 2019 WRRC LEGISLATION

	FY 2018-19 APPROPRIATION	FY 2019-20 REQUEST	FY 2020-21 PROJECTION
(a) Water Supply Reserve Fund	\$0	\$7,396,153	\$7,837,193
(b) Soil Conservation District Grants	0	332,827	\$352,674
(c) Water Efficiency Grant Program	0	406,788	\$431,046
(e) Species Conservation Trust Fund	0	3,698,077	\$3,918,596
(f) LEAP - Low-income Energy Assistance	0	9,614,999	\$10,188,350
(i) Interbasin Compact Committee	0	551,063	\$583,923
(k) and (n) Forestry Grants	0	1,849,038	\$1,959,298
(m) Aquatic Nuisance Species	0	2,962,903	\$3,139,583
(n) Abandoned Mine Reclamation	0	93,931	99,532
Grant Program Total Distributions	\$0	\$26,905,779	\$28,510,196

JBC STAFF ANALYSIS

Overall, this is one of the least complicated bills involving severance tax policy that the General Assembly has considered in recent years. The bill was crafted with support and collaboration from the Department of Natural Resources and essentially gained unanimous support in both the Interim Water Resources Review Committee and Legislative Council. Legislator may need to be prepared to educate Severance Tax Grant Program stakeholders that, although forecasts suggest they may receive their April 1st transfers, in an effort to provide them with more ongoing stability the payment would be postponed until August 15th.

One item discovered during analysis was that, although a 15 percent reserve for the Grant Programs was never a sufficient reserve for Grant Programs to benefit the programs itself, it seems unlikely under current conditions that the Grant Program Reserve will ever reach 100 percent. If that thought proves correct, the spillover to the Perpetual Base Fund included in the bill would never occur. That said, JBC staff believes aspiring to maintain such reserves and keeping severance tax revenue dedicated to programs that align with the purpose the severance tax was enacted is good fiscal policy. Ultimately, if the state does experience some kind of enormous windfall in severance tax in the future, having a clear policy in place on where the additional revenue belongs may prevent a future General Assembly from pillaging severance tax for other new programs or to bolster the General Fund.

ISSUE: UPDATE ON LONG BILL RFI FOR RECOMMENDATIONS TO ENHANCE USEFULNESS OF SEVERANCE TAX REPORTING DATA

The Department of Revenue administers the state's system of taxation. After numerous requests for information highlighted the technical limitation of the state's tax processing system for data reporting and personnel costs of accessing the data requested, specifically regarding severance tax, the General Assembly asked the Department for guidance on how it could provide information it sought. This issue describes statutory changes recommended by the Department to allow it to provide more granularized data.

SUMMARY

- After a recent Colorado Supreme Court decision concerning tax deductions allowed by the severance tax statute resulted in even more uncertainty when it came to budgeting severance tax revenue, the General Assembly continued to reach dead ends when it requested data about severance tax from the Department.
- The state's tax processing software, GenTax, was deployed in 2007 and severance tax was one of the first taxes implemented in the new system. Since implementation, very little resources have been dedicated to increasing reporting access to information related to severance tax returns.
- Newer taxes that were added to GenTax later, such as adult use marijuana, are more sophisticated and work papers will update the same field on similar forms throughout the system. This issue highlights the statutory changes the Department identified would assist it in providing the data the General Assembly seeks.

RECOMMENDATION

JBC staff recommends the Joint Budget Committee discuss the nine statutory changes recommended by the Department of Revenue to determine whether any should be considered as a Joint Budget Committee bill.

DISCUSSION

This issue discusses statutory changes identified by the Department of Revenue at the request of the General Assembly. The request for information, the response to which can be found in Appendix K, asked the Department to highlight statutory changes, computer system improvements, and staff needs that would allow it to provide the General Assembly with data to help it make policy decisions concerning severance tax.

This issue does not address the computer system improvements and staff changes identified by the Department, which will be addressed in figure setting for the Department of Natural Resources (severance tax policy). The Department's response estimates computer system and staff changes will

cost \$187,486 in year one, \$214,806 in year two and annualizing to \$86,961, if all statutory changes were fully implemented. The likely source is General Fund.

The funding estimates in the request for information *are not included in the Governor's budget request*, and therefore were not part of the Governor's balanced budget submission. Making any of the statutory changes will include some portion of the costs identified above and beyond the Department of Revenue's *R1 GenTax Support Enhancements* request item. Prior to making any recommendations concerning staff and computer system adjustments, JBC staff would like to gain an understanding whether members of the Joint Budget Committee are interested in seeking any of the Department-recommended statutory changes in a JBC bill. The Department of Revenue analyst will also be presenting more generalized information on issues that concern a look at GenTax overall, while this issue focuses in tightly on severance tax.

BACKGROUND

In the waning days of the 2016 legislative session, the Colorado Supreme Court decided a case involving BP America and the Colorado Department of Revenue in favor of the oil and gas industry. The Court held the Department had routinely denied certain deductions operators were entitled to by statute. The deductions were related to the opportunity cost, or "cost of capital," of investing in transportation and processing facilities instead of other uses of capital. Not understanding the full impact of this decision on short-term and long-term severance tax revenue, member of the General Assembly began making myriad requests for data and, more often or not, were disappointed at the lack of detail the Department of Revenue was able to provide to inform policymaking.

Since the case was the decided, the General Assembly has adopted legislation each year primarily to prevent programs funded with severance tax revenue from having no source of funding. As discussed earlier, severance tax forecasting is subject to both extreme volatility and uncertainty and each time the General Assembly looks to make budgeting for severance tax programs more predictable and equitable, the data it desires is unobtainable or comes with costs many legislators find unfathomable.

One of these major costs is that obtaining it by Department or vendor staff requires manual data entry. While the Department often *has* the requested data, they are not the data captured and stored in its searchable database. The tax forms will have many lines of data but for tax processing purposes, and unless an audit is performed, the Department may only capture a few fields from each. Readers should also note that statute prevents the Department from sharing tax data when the data can clearly identify a specific taxpayer.

Finally, in an effort to enhance data available for policy decisions the General Assembly included a footnote and request for information with the 2018 Long Bill asking the Department to provide guidance concerning potential statutory changes, increased staff, or changes to the state's tax administration software, GenTax.

GenTax is the state's comprehensive tax processing software and the system was implemented initially in 2008. Interestingly, severance tax was one of the first taxes to migrate to GenTax and the Department reports the goal in severance tax migration was two-fold: (1) as a proof-of-concept to transfer relatively smaller taxes to the new systems and (2) to maintain existing processes with minimal business disruption for taxpayers and Department staff. Newer tax structures developed

since initial GenTax implementation, such as those in place for adult-use marijuana, include data captures that provide more granularized data and work papers that automatically update data contained in other forms. Department staff acknowledge decisions made previously prioritized the Department's resources in a way that superseded opportunities to improve administration or increase systematic collection and reporting of tax data.

ANALYSIS

The following pages contain statutory citations recommended by the Department for changes or additions, the Department's reason for seeking a change, and notes or comments from JBC staff. The report was submitted, as requested, on November 1, 2018, and therefore JBC staff has not yet had an opportunity for meaningful engagement with oil and gas industry stakeholders the statutory changes are likely to effect.

Suggestions and Rationale for Statutory Changes

Recommended C.R.S.	Department's Description of Change and Rationale	JBC Staff Notes or Comments
#1 39-7-101(4)	Mandate sharing of NERF data electronically from the counties with DOR to (a) centralize the information and (b) help improve the correct assessment of tax and (c) streamline audit efficiency. Or consider centralized reporting from all the producers to DOLA or DOR into a database system all of the assessors could access (and then share from DOLA to DOR if necessary.) This suggestion represents an opportunity (like a state managed GIS for sales tax boundaries) to invest in a centralized data repository that could be used by state and local agencies, as well as a repository for more complete deduction information.	JBC staff contacted Colorado Counties, Inc. related to this statutory change, who did not have a formal position at this time but expressed limited concern that some members may not support centralized reporting.
#2 39-21-110	The fact that the original due date of a filing rather than the timely filing drives the payment of refund interest could result in variations in collection that are unexpected and difficult to budget for. CDOR has 90 days from the return due date to process returns prior to having to pay refund interest. This is a very large task in and of itself. Additionally, there is no clear guidance on how to treat taxpayers who file late (after the due date) or upon extension. The Income Tax refund interest statute is subject to different rules, one of which is that the state does not have to pay refund interest if a return has been selected for review and one which begins any interest calculations at the date of the receipt of the filing or return rather than the original due date of the return. Some severance tax returns are in excess of 200+ pages and often are more lengthy reviews. A change to this statute would result in less chance for variations in collections that are a result of interest being paid on late or amended filings.	JBC staff agrees that this statute likely needs clarification. It seems inequitable for a late-filing taxpayer to earn interest if CDOR cannot meet a statutory deadline that is already curtailed by actions of the taxpayer. It is surprising this issue was not highlighted to Finance Committees earlier.
#3 39-29-102(3)(a)	<p>Clarify in statute the General Assembly's intent, scope, and definition of deductions allowed against "gross income".</p> <p>Consider statutory changes regarding "related parties" and provide specific direction on what can be allowed to be considered an arm's length transaction vs. a related party transaction, statute allows DOR to define in rule however the Department had to modify the regulation as a result of the court decision. Statutory clarification defining related parties could allow the Department more direction to prevent related party pricing to avoid tax.</p>	<p>The gross income calculation is what was in contest in the BP America decision and the Department seeks clarification over General Assembly intent.</p> <p>As noted by the Department, while it has statutory authority to define related parties, it also had similar authority when defining what "transportation and processing costs" were prior to the Supreme Court determining its definition was wrong. Clarifying in statute what this term means will give the Department stronger tools to prohibit tax avoidance by entities owned by a common interest.</p>

Suggestions and Rationale for Statutory Changes

Recommended C.R.S.	Department's Description of Change and Rationale	JBC Staff Notes or Comments
#4 39-29-103(2) & 39-29-102(2)	Eliminate the option to use cash or accrual methods to determine the credit allowed and just follow the federal rule for most taxes of cash accounting for purposes of establishing the credit. This change would avoid taxpayers who use accrual accounting getting the value of the credit before the payment that generates the credit is actually made in some cases. This nuance in filing, reporting, and qualifying for the credit complicates filing and can result in audit adjustments that make predicting the revenue flow of severance taxes challenging.	JBC staff agree that making this change will likely simplify severance tax reporting and reduce the ability for accrual accounting tax filers to know its ad valorem tax credit prior to filing current liabilities.
#5 39-21-110	Codify the requirement that producers or first purchasers must file their withholding statements with the Department in addition to sending copies of withholding statements to the interest holder. This reporting requirement provides a check and balance system for refund claims by interest holders and reinforces the Department with a systematic tool rather than selection for audit to ensure that producers are withholding correctly.	It is unclear to JBC staff at this time whether the industry would oppose including an additional recipient of information it already provides to others. A concern may stem from reporting required to be on a new or underused form designated by the Department.
	Consider conforming producer withholding requirements to similar standards as wage withholding requirements to include a penalty for failure to correct withholding documents and provide corrected documents to taxpayers.	See above
	Consider moving the requirement to complete 4th quarter withholding and annual reconciliation earlier than March 1 to improve the filing timelines and correct information. If taxpayers do not receive withholding statements until the first or second week of March and annual filing is due by April 15 there is little time to file correctly. Additionally, if there are delays in producers providing withholding reconciliations to DOR the Department is unable to verify withholding for interest holders who file earlier. Producers or first purchasers who have employees are accustomed to providing employment withholding statements and reconciliations to the IRS, SSA and the state by January 31 for the prior year.	If taxpayers are already required to provide similar information to the federal government by January 31, it does not seem overly burdensome to require it be filed by the same date.
#6 39-29-112(1)	Mandate electronic filing of severance tax returns with DOR (and fund and complete the subsequent development to create an electronic filing method). If all of the requisite data for reporting is provided by taxpayers in an electronic format directly to the Department, the significant reporting barrier of manual data entry costs and errors is removed.	Property tax administrators across the state manage severance tax with varying degrees reporting. Much of the detail provided by taxpayers is provided voluntarily and therefore is not a complete picture. Staff from Colorado Counties, Inc. and the State Property Tax Administrator were uncertain how counties would react to centralized reporting.

Suggestions and Rationale for Statutory Changes

Recommended C.R.S.	Department's Description of Change and Rationale	JBC Staff Notes or Comments
#7 39-29-112(7)	If the general assembly needs complete information related to severance tax in order to make decisions, statute currently does not include reporting from individuals with less than \$250 withheld from all unit operators and for whom the \$250 minimum meets or exceeds the tax obligation. As a result, there are a large number of rent/royalty taxpayers who never file an actual return. When this exclusion from filing is combined with the previous bullet, it is likely that a large number of interest holders are not only not filing, and if they all submitted returns for prior periods be eligible for refunds of over withholding that is not currently captured or anticipated. To the extent that the producer or first purchaser submits DR 0021Ws to the Department, the Department has this information, just from a different source. If the submission and collection of data from DR 0021W's provided by producers or first purchasers were addressed (as in suggestion #5 above) this exclusion would not necessarily need changed.	JBC staff is unable to quantify the magnitude of potential refund obligation that may exist if all interest or royalty owners were required to submit tax reporting documents. Staff will work with the Department, royalty owners, and other stakeholders to determine whether this warrants a closer look or contributes only <i>de minimis</i> tax revenue to the state.
#8 39-29-115(2)	Modify or add a penalty provision for failure to report to DOR correctly. Even minor changes to tax reporting are adopted with varying rates of success and the suggested changes are substantial. Most taxpayers will voluntarily comply with the new reporting requirements however DOR has no recourse to compel any serious standouts to report correctly on the filing. Consider borrowing language from 39-26-118(2) re: failure to "correctly account" for the tax. Include a requirement that if errors are discovered during an audit, the taxpayer is required to file an amended return to correct the errors. Taxpayers have similar requirements for federal severance audits.	JBC staff finds providing the Department with some enforcement tools outside a pure audit as a reasonable mechanism to encourage taxpayer compliance. Though some concern exists if a statutory penalty is implemented and the Department has no discretion on its application.
<i>For consideration, a simplification of the tax structure overall in order to create the easiest structure for filing and for reporting on information:</i>		
#9 39-29-102(3) & 39-29-111	Significant changes to reporting and liability structure of the tax so that the incidence of the tax is entirely on the producer and not interest or royalty holders at all. The withholding scheme convolutes where the tax liability ultimately rests, complicates reporting and filing significantly, and benefits the producers over the royalty holders by reducing overall the tax that is due on severance throughout the state at the current rates. Since a change like this has the potential to implicate TABOR by resulting in a revenue increase, this type of change is not included in the resource costs of this analysis. Careful review and potentially an adjustment and decrease in rates to account for an increase in taxable gross income could mitigate overall revenue increases, however that analysis has not been conducted by DOR at this time.	Some royalty owners are savvy but are often not the most sophisticated of taxpayers. JBC staff agrees that placing the reporting burden on an oil and gas producer as opposed to individual interest or royalty owners, who are in a position to have access to tax expertise, is reasonable. JBC staff will investigate whether this change would implicate TABOR.

ISSUE: R2 ADDITIONAL STAFFING TO ADDRESS OIL AND GAS BACKLOGS

Since 2007, the mill levy fee on oil and gas production that funds portions of the Oil and Gas Conservation Commission has remained at 0.7 mills due mostly to pressure on overall revenue limits imposed by Article X, Section 20, of the Colorado Constitution, or TABOR. The Commission has found numerous efficiencies while operating in these lean years and in January 2018, finally voted to increase the fee to 1.1 mills. This issue describes a budget request to supports most of the activities undertaken by the Commission.

SUMMARY

- Higher, more stable oil prices led to an increase in oil and gas activity to levels that, by some measures, made FY 2017-18 the busiest on record. The resulting uptick in workload for the OGCC quickly gave rise to large backlogs throughout its regulatory program despite assistance from state temporary employees.
- Activity on the ground has led to large volumes of notices and regulatory forms related to active drilling and completion activities, thus increasing workload for engineers, field inspectors, and reclamation specialists, who must ensure adherence to state rules designed to protect public health, the environment, and wildlife.
- The Oil and Gas Conservation Commission (OGCC) requests an increase of \$648,304 from the Oil and Gas Conservation and Environmental Response Fund for 5.0 FTE, two state temporary employees, and two state vehicles to address workload increases and severe backlogs in permitting, engineering, field inspections, reclamation, and data analysis. Ongoing costs are \$628,113.

RECOMMENDATION

Staff recommendation for the Department's request is pending and will be made during figure setting for this Department.

DISCUSSION

The Oil and Gas Conservation Commission (OGCC) regulates the oil and gas extraction industry and to “foster the responsible, balanced development, production, and utilization of the natural resources of oil and gas in the state of Colorado in a manner consistent with protection of public health, safety, and welfare, including protection of the environment and wildlife resources.” Section 34-60-101 (1)(a)(I), C.R.S. Staff from the OGCC are involved in field inspections, complaint response, enforcement, permitting, plugging and reclaiming orphaned wells, regulatory report reviews, environmental studies, mitigation of impacts caused by oil and gas activity, and management of data associated with 55,000 active oil and gas wells.

The OGCC is primarily funded with cash funds from the Severance Tax Operational Fund (Operational Fund) and the Oil and Gas Conservation and Environmental Response Fund

(Response Fund). The Response Fund derives fee revenue from the industry based on a mill levy on annual production and the mill level rate was recently increased from 0.7 mills to 1.1 mills, effective April 1, 2018. This last occurred in 2007 and, while the OGCC has authority to adjust the fee up or down with a maximum being to 1.7 mills. Pressure from cash fund revenue on the overall TABOR revenue limit have prevented the OGCC from raising mill level until it was favorably supported by industry and the executive branch in January 2018.

The OGCC reports that higher, stable oil prices led to an increase in oil and gas activity to levels that, by some measures, made FY 2017-18 the busiest on record. The resulting uptick in workload for the Oil and Gas Conservation Commission (OGCC) quickly gave rise to large backlogs throughout its regulatory program despite assistance from temporary staff. Backlogs are not new to the OGCC; they even grew during the recent industry downturn because overall workload never actually slowed as many might have expected. But the current backlogs are severe. They add unnecessary risk to the public and environment and will likely cause major delays in drilling and completion operations by early FY 2019-20.

JBC staff inquired about whether OGCC staff believed the recent increase in activity can be traced to the industry attempting to start wells prior to the potential impact of Proposition 112 would have had on the industry, if it had been supported by voters. While the OGCC only has a few weeks of data since the election, the workload indicators tracked by the Department do not suggest its increase was the result of the ballot measure.

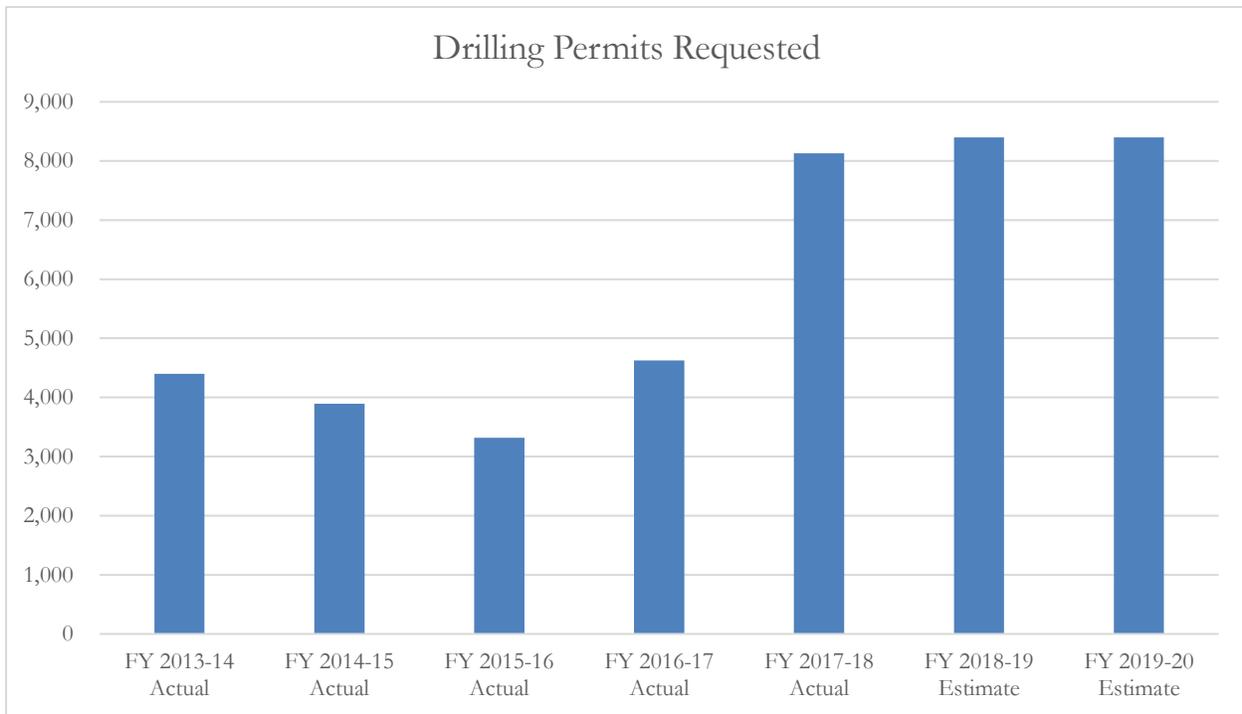
The OGCC is requesting an increase of \$648,304 from the Oil and Gas Conservation and Environmental Response Fund and 5.0 FTE to address the increased workload issues before they reach a level that is both disruptive to the industry and risky for the public and environment. This includes a permit technician, an engineer, a field inspector, a reclamation specialist, a data analyst, two state vehicles, and two state temps. The OGCC continues to seek non-FTE solutions, such as developing new eForms, improving existing eForms, and making wholesale changes to longstanding programs, as was accomplished recently with the orphaned well program. However, the requested additional resources are the bare minimum required to slow the growth of backlogs while these additional solutions are sought. Ongoing costs would be \$628,113 and require no statutory change.

It is important to note that the OGCC prides itself on taking a calculated and balanced approach to adding new full-time staff and thus this request seeks to address workload trends that OGCC is confident will continue. While its hearings unit has also experienced a sharp increase in work requests, 950 hearing applications, mostly for spacing units and forced pooling, were received in FY 2017-18, exceeding the previous record by 40 percent, it did not have sufficient data to justify a request for FY 2019-20. It seems prudent to expect a budget request from the hearings unit in next year's budget request. The OGCC believes its hearings unit still has efficiencies to be gained by implementing more eForms.

This issue brief aims to describe the major workload issues in permitting, engineering, field inspections, reclamation, and data analysis and the Department's proposed solution to address shortcomings.

PERMITTING

In FY 2017-18, the OGCC received 8,127 Applications for Permit to Drill (APDs), exceeding the previous all-time high of 7,664 set in FY 2007-08 and doubling the most recent five-year average of 4,026. The OGCC approved 3,804 APDs in FY 2017-18 an 11 percent improvement over the previous year after assigning the equivalent of 2.5 FTE temporary staff. However, by the end of FY 2017-18, the backlog had grown to 4,890 APDs, which is nearly triple the backlog in FY 2016-17. At current processing rates, the APD backlog will take more than a year to process. The Chart below illustrates the change in volume.



Recognizing the potential magnitude of this problem in mid-2017, the permitting unit started requesting prioritized lists of APDs from operators on a monthly basis. Permit staff have been prioritizing their APD reviews according to these lists. For the short term, this approach has been somewhat successful; permitting staff can thoroughly review APDs, while oil and gas operators get their highest priority permits first, but the total time is still much too slow and is the most frequent source of industry complaints.

Furthermore, requesting these lists and constantly checking them to ensure permits are reviewed in priority order is inefficient. Median permit processing time, the calculation of which includes only those permits that have already been approved, was 89 days in FY 2017-18, exceeding the OGCC's goal of 65 days. It could have been worse, though, had the OGCC not changed course and continued to process APDs on a first-come first-served basis. The growing backlog would have already significantly disrupted industry activity, and inefficiencies would have cropped up industry-wide. For example, construction crews and drilling rigs would have routinely been idled and timing restrictions related to wildlife habitat, hunting, agriculture and other surface uses stipulated in permit conditions of approval would have been missed, causing delays of up to a year.

FIELD INSPECTIONS

The rise in these regulatory reports also cause workload increases for field inspectors. Notices of Intent to Abandon, for instance, mean additional on-the-ground work for inspectors, as plugging operations are considered high priority activities to witness, especially when the wells to be plugged are in proximity to existing homes and/or future development. An inspector's workload also directly correlates with Spud Notices and Hydraulic Fracturing Notices, as these operational phases generate a significant number of citizen complaints due to increased truck traffic, dust, odors, and noise. Moreover, hydraulic fracturing activities, specifically identified as high risk in the OGCC's 2014 Risk-Based Inspections report, receive a heightened level of attention to ensure operators follow conditions of approval placed on drilling permits. Observing materials management practices is important in all of the aforementioned activities.

The number of inspections dropped from approximately 42,000 in FY 2015-16 to about 30,000 in FY 2017-18. The recent increased emphasis on the OGCC's orphaned well program also factors into the reduced inspection count. Inspectors, due to their operational knowledge and proximity to many of these activities, are frequently called upon to serve as onsite project managers during plugging operations, to conduct site walks for contractor bidding purposes, and to assist in retaining contractors to remove old oil field equipment. In FY 2016-17 and 2017-18, field inspectors participated in 10 and 28 of these orphaned well projects, respectively.

RECLAMATION

Currently there is a backlog of approximately 19,284 wells (Plugged and Abandoned, Dry and Abandoned, and Abandoned Locations) requiring final reclamation inspections. Assuming two wells per location, the backlog is equivalent to about 9,642 locations that require reclamation inspection. At an average annual rate of about 500 final reclamation inspections per FTE, the current staff of 5.0 reclamation specialists could eliminate the backlog in about 4 years, assuming no increase in locations or other responsibilities. However, as indicated in the engineering and field inspection sections, plugging and abandonment of wells has increased significantly since FY 2013-14, and the OGCC expects this trend to continue, thus increasing the number of locations requiring final reclamation inspections. Visiting these sites as soon as possible and working with the operator lead to quicker remediation of common problems including problem from noxious weeds, gullies, salt kills, and un-reclaimed evaporation pits.

Additionally, the reclamation team plans, organizes, and acts as the project manager for final reclamation projects at locations where the commission has claimed a bond from a delinquent operator, resulting in an orphaned well location. The work includes site inspections, the development of project scopes of work, contract management and onsite review. Final reclamation may include an entire suite of tasks from recontouring to natural grade, de-compacting soils, soil sampling, seed mix identification, and seeding application plus the addition of mulches or other erosion control methods.

Final reclamation projects involving construction conducted by the OGCC require the preparation of stormwater management plans and permits, stormwater inspections and weed management until vegetative standards have been met. Reclamation Specialists participated in 15 of these projects in FY 2016-17 and 26 in FY 2017-18. With Executive Order D 2018-012 directing the OGCC to plug, remediate, and reclaim all medium- and high-priority orphaned oil and gas wells and sites by July 2023 the workload for reclamation specialists is expected to increase substantially. Of the additional

4.0 FTE appropriated for the orphaned well program in FY 2018-19, only one will be dedicated to reclamation work.

DATA ANALYSIS

The OGCC receives vast quantities of data that require tens of thousands of lines of code to access and manage in the Colorado Oil and Gas Information System (COGIS). The OGCC is committed to transparency and making this data public, so multiple analysts are required to write these lines of code as well as the queries needed to generate requested reports or informational tools in a readily understandable format.

As with many industries, oil and gas is constantly changing in technology, practices, and procedures. These changes and events, such as the 2017 Firestone home explosion, lead to regulatory and programmatic updates that can profoundly affect the OGCC's database. For example, the adoption of new flowline rules requires the submission of Flowline Reports for over 100,000 flowlines. That alone, in addition to the ongoing development and updating of eForms, has driven the workload associated with receiving, archiving, and retrieving the state's oil and gas-related data to a level far exceeding the capacity of the two existing data analysts, often slowing overall workflow and OGCC's response to incidents and stakeholder requests for data. Most OGCC staff members use COGIS on a daily basis, and as overall staff size increases, so do the demands for data and the development of new queries.

CONCLUSION

Generally, JBC staff is supportive of this budget request. The anticipated new revenue from the increase fee on oil and gas production is sufficient to support expanding this program so it can provide the oversight an industry like oil and gas need and the public desires. A final recommendation on how much funding will be provided during figure setting.

Appendix A: Number Pages

	FY 2016-17 Actual	FY 2017-18 Actual	FY 2018-19 Appropriation	FY 2019-20 Request	Request vs. Appropriation
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DEPARTMENT OF NATURAL RESOURCES Bob Randall, Executive Director

(2) DIVISION OF RECLAMATION, MINING, AND SAFETY

Primary Functions: Provides regulation and enforcement related to the development and reclamation of mining sites. Primary sources of cash funds are fees on metal and aggregate mining operations and the severance tax.

(A) Coal Land Reclamation

Program Costs	<u>2,260,134</u>	<u>2,228,653</u>	<u>2,091,993</u>	<u>2,147,453</u> *	
FTE	17.9	16.3	20.0	20.0	
Cash Funds	440,302	400,041	448,645	460,148	
Federal Funds	1,819,832	1,828,612	1,643,348	1,687,305	
Indirect Cost Assessment	<u>158,631</u>	<u>94,313</u>	<u>108,517</u>	<u>105,411</u>	
Cash Funds	26,050	21,551	22,789	22,136	
Federal Funds	132,581	72,762	85,728	83,275	
SUBTOTAL - (A) Coal Land Reclamation	2,418,765	2,322,966	2,200,510	2,252,864	2.4%
FTE	<u>17.9</u>	<u>16.3</u>	<u>20.0</u>	<u>20.0</u>	0.0%
Cash Funds	466,352	421,592	471,434	482,284	2.3%
Federal Funds	1,952,413	1,901,374	1,729,076	1,770,580	2.4%

(B) Inactive Mines

Program Costs	<u>1,362,648</u>	<u>1,525,448</u>	<u>1,892,035</u>	<u>1,944,216</u>	
FTE	16.3	5.5	16.3	16.3	
Cash Funds	541,720	547,691	624,345	629,374	
Federal Funds	820,928	977,757	1,267,690	1,314,842	

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	FY 2016-17 Actual	FY 2017-18 Actual	FY 2018-19 Appropriation	FY 2019-20 Request	Request vs. Appropriation
Legacy Mine Hydrology Projects	<u>549,204</u>	<u>215,290</u>	<u>384,636</u>	<u>384,636</u>	
FTE	1.2	0.3	1.2	1.2	
Cash Funds	549,204	215,290	384,636	384,636	
Reclamation of Forfeited Mine Sites	<u>187,422</u>	<u>634</u>	<u>121,162</u>	<u>121,162</u>	
FTE	0.3	0.3	0.3	0.3	
Cash Funds	187,422	634	121,162	121,162	
Indirect Cost Assessment	<u>137,297</u>	<u>87,506</u>	<u>117,665</u>	<u>125,345</u>	
Cash Funds	15,991	7,525	8,955	24,701	
Federal Funds	121,306	79,981	108,710	100,644	
SUBTOTAL - (B) Inactive Mines	2,236,571	1,828,878	2,515,498	2,575,359	2.4%
FTE	<u>17.8</u>	<u>6.1</u>	<u>17.8</u>	<u>17.8</u>	0.0%
Cash Funds	1,294,337	771,140	1,139,098	1,159,873	1.8%
Federal Funds	942,234	1,057,738	1,376,400	1,415,486	2.8%
(C) Minerals					
Program Costs	<u>2,199,434</u>	<u>2,125,486</u>	<u>2,279,205</u>	<u>2,341,423</u>	
FTE	20.1	3.7	23.0	23.0	
Cash Funds	2,199,434	2,125,486	2,279,205	2,341,423	
Indirect Cost Assessment	<u>110,704</u>	<u>100,333</u>	<u>121,734</u>	<u>112,839</u>	
Cash Funds	110,704	100,333	121,734	112,839	
SUBTOTAL - (C) Minerals	2,310,138	2,225,819	2,400,939	2,454,262	2.2%
FTE	<u>20.1</u>	<u>3.7</u>	<u>23.0</u>	<u>23.0</u>	(0.0%)
Cash Funds	2,310,138	2,225,819	2,400,939	2,454,262	2.2%

Appendix A: Number Pages

	FY 2016-17 Actual	FY 2017-18 Actual	FY 2018-19 Appropriation	FY 2019-20 Request	Request vs. Appropriation
(D) Mines Program					
Colorado and Federal Mine Safety Program	<u>626,599</u>	<u>589,868</u>	<u>545,071</u>	<u>551,261</u>	
FTE	3.1	3.0	4.0	4.0	
Cash Funds	350,192	298,923	355,426	361,616	
Federal Funds	276,407	290,945	189,645	189,645	
Blaster Certification Program	<u>127,679</u>	<u>106,654</u>	<u>114,302</u>	<u>120,635</u>	
FTE	1.0	1.0	1.0	1.0	
Cash Funds	23,534	22,280	23,851	28,092	
Federal Funds	104,145	84,374	90,451	92,543	
Indirect Cost Assessment	<u>17,732</u>	<u>12,973</u>	<u>17,762</u>	<u>18,701</u>	
Cash Funds	7,518	5,646	11,496	8,974	
Federal Funds	10,214	7,327	6,266	9,727	
SUBTOTAL - (D) Mines Program	772,010	709,495	677,135	690,597	2.0%
FTE	<u>4.1</u>	<u>4.0</u>	<u>5.0</u>	<u>5.0</u>	0.0%
Cash Funds	381,244	326,849	390,773	398,682	2.0%
Federal Funds	390,766	382,646	286,362	291,915	1.9%
(E) Emergency Response Costs					
Emergency Response Costs	<u>97,558</u>	<u>648</u>	<u>100,000</u>	<u>100,000</u>	
Cash Funds	97,558	648	100,000	100,000	
SUBTOTAL - (E) Emergency Response Costs	97,558	648	100,000	100,000	0.0%
FTE	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	0.0%
Cash Funds	97,558	648	100,000	100,000	0.0%

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	FY 2016-17 Actual	FY 2017-18 Actual	FY 2018-19 Appropriation	FY 2019-20 Request	Request vs. Appropriation
TOTAL - (2) Division of Reclamation, Mining, and Safety	7,835,042	7,087,806	7,894,082	8,073,082	2.3%
<i>FTE</i>	<u>59.9</u>	<u>30.1</u>	<u>65.8</u>	<u>65.8</u>	(0.0%)
Cash Funds	4,549,629	3,746,048	4,502,244	4,595,101	2.1%
Federal Funds	3,285,413	3,341,758	3,391,838	3,477,981	2.5%

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	FY 2016-17 Actual	FY 2017-18 Actual	FY 2018-19 Appropriation	FY 2019-20 Request	Request vs. Appropriation
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(3) OIL AND GAS CONSERVATION COMMISSION

Primary functions: Promoting and regulating development of oil and gas natural resources in a manner consistent with the protection of public health, safety, and welfare. Cash funds are from the Oil and Gas Conservation and Environmental Response Fund and the severance tax.

Program Costs	<u>9,051,684</u>	<u>9,585,122</u>	<u>11,011,418</u>	<u>11,768,432</u> *
FTE	99.5	102.2	114.3	119.3
Cash Funds	9,051,684	9,585,122	11,011,418	11,768,432
Underground Injection Program	<u>77,462</u>	<u>0</u>	<u>96,559</u>	<u>96,559</u>
FTE	2.0	0.0	2.0	2.0
Federal Funds	77,462	0	96,559	96,559
Plugging and Reclaiming Abandoned Wells	<u>441,339</u>	<u>415,003</u>	<u>5,011,000</u>	<u>5,011,000</u>
Cash Funds	441,339	415,003	5,011,000	5,011,000
Environmental Assistance and Complaint Resolution	<u>191,321</u>	<u>245,294</u>	<u>312,033</u>	<u>312,033</u>
Cash Funds	191,321	245,294	312,033	312,033
Emergency Response	<u>0</u>	<u>750,000</u>	<u>750,000</u>	<u>750,000</u>
Cash Funds	0	750,000	750,000	750,000
Special Environmental Protection and Mitigation Studies	<u>163,151</u>	<u>88,462</u>	<u>325,000</u>	<u>325,000</u>
Cash Funds	163,151	88,462	325,000	325,000
Indirect Cost Assessment	<u>497,549</u>	<u>464,426</u>	<u>544,549</u>	<u>513,401</u>
Cash Funds	492,010	464,426	540,819	513,401
Federal Funds	5,539	0	3,730	0

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	FY 2016-17 Actual	FY 2017-18 Actual	FY 2018-19 Appropriation	FY 2019-20 Request	Request vs. Appropriation
TOTAL - (3) Oil and Gas Conservation Commission	10,422,506	11,548,307	18,050,559	18,776,425	4.0%
<i>FTE</i>	<u>101.5</u>	<u>102.2</u>	<u>116.3</u>	<u>121.3</u>	<u>4.3%</u>
Cash Funds	10,339,505	11,548,307	17,950,270	18,679,866	4.1%
Federal Funds	83,001	0	100,289	96,559	(3.7%)

Appendix A: Number Pages

	FY 2016-17 Actual	FY 2017-18 Actual	FY 2018-19 Appropriation	FY 2019-20 Request	Request vs. Appropriation
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(4) STATE BOARD OF LAND COMMISSIONERS

Primary Functions: Manages 2.8 million surface acres and 4.0 million mineral acres of state trust lands for the benefit of 8 public trusts, the largest of which is the K-12 School Trust. Cash Funds are from the Trust Administration Fund. Reappropriated funds are from the Division of Parks and Wildlife.

Program Costs	<u>4,541,297</u>	<u>4,536,948</u>	<u>4,687,474</u>	<u>4,789,376</u> *
FTE	39.0	40.3	42.0	42.0
Cash Funds	4,541,297	4,536,948	4,687,474	4,789,376
Public Access Program Damage and Enhancement Costs	<u>203,840</u>	<u>144,503</u>	<u>225,000</u>	<u>225,000</u>
Reappropriated Funds	203,840	144,503	225,000	225,000
Indirect Cost Assessment	<u>223,835</u>	<u>325,861</u>	<u>268,675</u>	<u>250,190</u>
Cash Funds	223,835	325,861	268,675	250,190

TOTAL - (4) State Board of Land Commissioners	4,968,972	5,007,312	5,181,149	5,264,566	1.6%
FTE	<u>39.0</u>	<u>40.3</u>	<u>42.0</u>	<u>42.0</u>	0.0%
Cash Funds	4,765,132	4,862,809	4,956,149	5,039,566	1.7%
Reappropriated Funds	203,840	144,503	225,000	225,000	0.0%

TOTAL - Department of Natural Resources	23,226,520	23,643,425	31,125,790	32,114,073	3.2%
FTE	<u>200.4</u>	<u>172.6</u>	<u>224.1</u>	<u>229.1</u>	2.2%
Cash Funds	19,654,266	20,157,164	27,408,663	28,314,533	3.3%
Reappropriated Funds	203,840	144,503	225,000	225,000	0.0%
Federal Funds	3,368,414	3,341,758	3,492,127	3,574,540	2.4%

APPENDIX B RECENT LEGISLATION AFFECTING DEPARTMENT BUDGET

2017 SESSION BILLS

S.B. 17-026 (STATE ENGINEER STATUTES CLEANUP): Removes obsolete provisions and modernizes the language of state statutes related to the State Engineer and the Division of Water Resources.

S.B. 17-202 (SPECIES CONSERVATION TRUST FUND PROJECTS): Authorizes the Department of Natural Resources to obligate and expend \$3.9 million from the Species Conservation Trust Fund in FY 2017-18 for programs to conserve native species listed as threatened or endangered under state or federal law, or are likely to become candidate species as determined by the United States Fish and Wildlife Services.

S.B. 17-254 (LONG BILL): General appropriations act for FY 2017-18.

S.B. 17-259 (GENERAL FUND TRANSFERS TO PROTECT NATURAL RESOURCES): Makes transfers totaling \$10.0 million General Fund to support four Severance Tax Tier 2-funded programs as described in the following table:

TRANSFERS OF FUNDS TO SUPPORT SEVERANCE TIER 2 PROGRAMS		
FY 2017-18 TRANSFER ON JUNE 30, 2018	CASH FUNDS	GENERAL FUND
FOREST HEALTH AND WILDFIRE PREVENTION AND MITIGATION PROGRAMS		
Health forest and vibrant communities program	\$1,186,363	(\$1,186,363)
Forest restoration and wildfire risk mitigation grant program	954,545	(954,545)
Wildfire preparedness program	86,364	(86,364)
Wildland-urban interface training program	45,455	(45,455)
SPECIES CONSERVATION TRUST FUND	4,090,909	(4,090,909)
AQUATIC NUISANCE SPECIES		
Division of Wildlife--Aquatic nuisance species	2,452,193	(2,452,193)
Division of Parks--Aquatic nuisance species	1,184,171	(1,184,171)
TOTAL	\$10,000,000	(\$10,000,000)

S.B. 17-260 (SEVERANCE TAX CASH FUND TRANSFER TO GENERAL FUND): Transfers \$45.7 million funds originating as severance tax revenue to the General Fund.

H.B. 17-1030 (UPDATE 1921 IRRIGATION DISTRICT LAW): Updates the 1921 Irrigation District Act. The bill made the following changes: increases the compensation of board members and election judges; clarifies the definitions of agricultural land and landowner; allows an irrigation district to lease its surplus water for any beneficial use permitted by decree or applicable law; clarifies how irrigation district assessments are to be collected, held, and reported; eliminates the bonding requirement for district board members; and modernizes election procedures and procedures for selling surplus property.

H.B. 17-1248 (CWCB CONSTRUCTION FUND PROJECTS): Appropriates \$30,134,000 funds from the CWCB Construction Fund to the Department of Natural Resources in FY 2017-18 for various water-related projects. Authorizes the following transfers:

- \$30,000,000 from the Severance Tax Perpetual Base Fund to the Loan Guarantee Fund for repayment of loans made for water projects;
- \$20,000,000 from the Severance Tax Perpetual Base Fund to the CWCB Construction Fund to support appropriations made in other sections of the bill;
- \$10,000,000 from the Severance Tax Perpetual Base Fund to the Water Supply Reserve Fund to support water basin roundtable approved projects;
- \$1,500,000 from the CWCB Construction Fund to replenish the continuously-appropriated Fish and Wildlife Resources Fund;
- \$1,300,000 from the CWCB Construction Fund to replenish the continuously-appropriated Litigation Fund;
- \$500,000 from the CWCB Construction Fund to replenish the continuously-appropriated Flood and Drought Response Fund;
- \$300,000 from the CWCB Construction Fund to replenish the continuously-appropriated Feasibility Study Small Grant Fund; and
- \$260,000 from the CWCB Construction Fund to the Public and Private Utilities Sector Fund to support appropriations made in other sections of the bill.

H.B. 17-1250 (RENEW AND EXPAND TAX CHECK-OFF TO BENEFIT WILDLIFE): Extends and modifies the Colorado Nongame Conservation and Wildlife Restoration voluntary checkoff program and establishes the Colorado Nongame Conservation and Wildlife Restoration Cash Fund Authority that is overseen by a board of directors. The bill also creates the Nongame Conservation and Wildlife Restoration Cash Fund. Money in the fund is used by the Division of Parks and Wildlife to support a variety of activities that aid nongame and endangered species work. In addition, a percentage of the checkoff revenue may be given in the form of grants for wildlife rehabilitation in Colorado. Grants will be overseen by the board of directors.

H.B. 17-1289 (STATE ENGINEER RULES HISTORICAL CONSUMPTIVE USE): Directs the State Engineer in the Department of Natural Resources (DNR) to adopt rules taking into account local conditions that an applicant can use to calculate the historical consumptive use of a water right. The use of the methodology, approach, or local factors developed by the State Engineer is voluntary, and the resulting calculation of historical consumptive use carries no presumptive effect in the determination by the State Engineer, water referee, or water judge.

2018 SESSION BILLS

S.B. 18-143 (PARKS AND WILDLIFE MEASURES TO INCREASE REVENUE): Increases fees for the Colorado Parks and Wildlife Division (CPW) for certain hunting and fishing licenses and park passes. In addition, the bill:

- Authorizes CPW to apply a consumer price index to hunting and fishing licenses;
- Creates a new annual resident youth fishing license;
- Authorizes CPW to create a license for young adult hunters and anglers;
- Requires CPW to prepare an annual report on the impact of the fee increases by March 1, 2022; and
- Requires CPW to require individuals entering state parks by means other than motor vehicles to purchase an entrance pass.

S.B. 18-170 (RESERVOIR RELEASES FOR FISH AND WILDLIFE MITIGATION): Establishes a water court process by which a storage water right owner may dedicate releases from new capacity in a reservoir to the CWCB in order to reasonably avoid, minimize, or mitigate impacts on fish and wildlife within a qualifying stream reach, if certain conditions are met.

S.B. 18-218 (CWCB CONSTRUCTION FUND PROJECTS): Appropriates \$24,716,894 cash funds from the CWCB Construction Fund in FY 2018-19 for various water-related projects. The bill also authorizes the following transfers:

- \$30,000,000 from the Loan Guarantee Fund to the Severance Tax Perpetual Base Fund;
- \$4,000,000 from the Severance Tax Perpetual Base Fund to the CWCB Construction Fund to support appropriations made in other sections of the bill;
- \$2,000,000 from the CWCB Construction Fund to the Water Supply Reserve Fund to support water basin roundtable approved projects;
- \$2,000,000 from the CWCB Construction Fund to replenish the continuously-appropriated Litigation Fund;
- \$500,000 from the CWCB Construction Fund to replenish the continuously-appropriated Flood and Drought Response Fund; and
- \$500,000 from the CWCB Construction Fund to replenish the continuously-appropriated Feasibility Study Small Grant Fund.

H.B. 18-1008 (MUSSEL-FREE COLORADO ACT): Creates new financing mechanisms for the Aquatic Nuisance Species (ANS) Program and increases cash fund revenue to the program beginning January 1, 2019, and thereafter from fees on boats. Combines the balances of two existing ANS cash funds.

H.B. 18-1322 (LONG BILL): General appropriations act for FY 2018-19.

H.B. 18-1338 (MEASURES TO ADDRESS REDUCED REVENUE SEVERANCE TAX REVENUES): Makes a number of transfers to support programs historically funded with Tier 1 or Tier 2 severance tax revenue from the Severance Tax Operational Fund. General descriptions of each transfer are provided below. The fiscal impact of the bill is dependent upon revenue forecasts. The fiscal impact in this bill summary is based on the Governor's Office of Planning and Budgeting March Revenue Forecast, which estimated severance tax revenue in FY 2018-19 will total \$113.0 million. The bill contains the following provisions.

- Transfers a total of \$2,973,869 out of Tier 2 cash funds administered by the Department of Natural Resources back into the Severance Tax Operational Fund, effective upon enactment. This reverses or "claws back" the transfers made to the Department's Tier 2 programs in July 2017. These transfers were based on the June 2017 LCS Forecast which did not fully account for the state's outstanding refund liability associated with *BP America* Supreme Court of Colorado decision. The transfers would not have occurred without the favorable forecast and the revenue would have been allocated to Tier 1 agencies.
- Eliminates the statutory transfer of \$11.4 million required by S.B. 17-260 (Section 39-29-109.3 (1.7), C.R.S.). A transfer of this magnitude would guarantee the Operational Fund would go bankrupt at the end of FY 2017-18.

- Accounts for severance tax refunds attributable to the operational account by diverting income tax revenue to a reserve used to pay these refunds. Refunds count as a reduction in state revenue (thus not fiscal year spending).
- Transfers General Fund into the Operational Fund on July 1, 2018, in an amount equal to total Tier 1 appropriations in FY 2018-19 Long Bill.
- Transfers General Fund into the Operational Fund on January 1 and July 1, 2019, in an amount equal to total Tier 1 appropriations in FY 2019-20 to fulfill the Tier 1 reserve requirement. The transfer on July 1, 2019, is estimated to total \$14,214,854 but is dependent on funding decisions made for Tier 1 programs in the 2019 Long Bill. This estimated figure also serves as the maximum amount that may be transferred for this purpose.
- Transfers General Fund into specific cash funds continuously appropriated to Tier 2 severance tax programs:

TIER 2 PROGRAMS TARGETED WITH TRANSFERS	
TIER 2 PROGRAM	TRANSFER INCLUDED
Aquatic Nuisance Species	\$3,636,364
Species Conservation Trust Fund	3,000,000
Forestry and Wildfire Grants	2,272,727
Soil Conservation Districts Matching Grants	450,000
Forfeited Mine Site Reclamation	127,000
TOTAL TIER 2 TRANSFERS	\$9,486,091

- Diverts all severance tax revenue that would otherwise be distributed to the Operational Fund between February 1, 2018, and June 30, 2019, to the General Fund up to a cap of just under \$41.0 million. If revenue exceeds the cap during the period specified, the excess should be directed back to the Operational Fund. This functions as a "repayment" mechanism to minimize the impact of the legislation on the General Fund. Some severance tax revenue will be realized but it is unclear how much or the timing of it.
- Includes authorizations for species conservation projects submitted by the Director of the Department of Natural Resources that are designed to conserve native species that have been listed as threatened or endangered under state or federal law, or are likely to become candidate species as determined by the United States Fish and Wildlife Service. The funds appropriated are available in FY 2018-19 and remain available for the designated purposes until they are fully expended.

APPENDIX C FOOTNOTES AND INFORMATION REQUESTS

UPDATE ON LONG BILL FOOTNOTES

- 1 Department of Natural Resources, Executive Director's Office, Administration -- In addition to the transfer authority provided in Section 24-75-108, C.R.S., the Department may transfer up to 5.0 percent of the total appropriation between the line items for Personal Services and Operating Expenses.

COMMENT: This Long Bill footnote will be addressed during the Briefing for the Executive Director's Office on December 17, 2018.

- 2 Department of Natural Resources, Division of Reclamation, Mining, and Safety, Inactive Mines, Legacy Mine Hydrology Projects -- This appropriation remains available until the completion of the project or the close of FY 2020-21, whichever comes first. At project completion or the end of the three-year period, any unexpended balance reverts to the Severance Tax Operational Fund, from which this appropriation was made.

COMMENT: This footnote sets forth the purpose, conditions, and limitations of the line item and provides flexibility for projects that often span multiple fiscal years.

- 3 Department of Natural Resources, Division of Reclamation, Mining, and Safety, Inactive Mines, Reclamation of Forfeited Mine Sites -- This appropriation remains available until the completion of the project or the close of FY 2020-21, whichever comes first. At project completion or the end of the three-year period, any unexpended balance reverts to the Severance Tax Operational Fund, from which the transfer to the special account in the General Fund created in Section 34-32-122 (1)(a), C.R.S., was made.

COMMENT: This footnote sets forth the purpose, conditions, and limitations of the line item and provides flexibility for projects that often span multiple fiscal years.

- 4 Department of Natural Resources, Oil and Gas Conservation Commission, Plugging and Reclaiming Orphaned Wells -- This appropriation remains available until fully expended or the close of FY2019-20, whichever comes first.

COMMENT: This footnote sets forth the purpose, conditions, and limitations of the line item and provides flexibility for projects that often span multiple fiscal years.

- 5 Department of Natural Resources, Oil and Gas Conservation Commission, Emergency Response -- It the General Assembly's intent that this appropriation be expended if there is an oil and gas related emergency under the jurisdiction of the Oil and Gas Conservation Commission. The purpose of this appropriation is to fund investigation, prevention,

monitoring, and mitigation of circumstances caused by or that are alleged to be associated with oil and gas activities and that call for immediate action by the Oil and Gas Conservation Commission.

COMMENT: This footnote sets forth the purpose, conditions, and limitations of the line item.

- 6 Department of Natural Resources, Oil and Gas Conservation Commission, Special Environmental Protection and Mitigation Studies -- It is the General Assembly's intent that funding for this line item be used for special environmental protection and mitigation studies including, but not limited to, gas seepage mitigation studies, outcrop monitoring studies, soil gas surveys in the vicinity of plugged orphaned wells, and baseline water quality and subsequent studies.

COMMENT: This footnote sets forth the purpose, conditions, and limitations of the line item.

- 7 Department of Natural Resources, Division of Parks and Wildlife, Special Purpose, Off-highway Vehicle Direct Services -- The appropriation for this line item remains available until the completion of the project or the close of FY 2020-21, whichever comes first.

COMMENT: This information request will be addressed during the Briefing for the Division of Parks and Wildlife on December 17, 2018.

- 8 Department of Natural Resources, Division of Parks and Wildlife, Special Purpose, Grants and Habitat Partnerships -- The appropriation for this line item remains available until the completion of the project or the close of FY2020-21, whichever comes first.

COMMENT: This information request will be addressed during the Briefing for the Division of Parks and Wildlife on December 17, 2018.

- 9 Department of Natural Resources, Division of Parks and Wildlife, Special Purpose, Asset Maintenance and Repairs -- The appropriation for this line item remains available until the completion of the project or the close of FY 2020-21, whichever comes first.

COMMENT: This information request will be addressed during the Briefing for the Division of Parks and Wildlife on December 17, 2018.

- 10 Department of Revenue, Taxation Business Group – It is the General Assembly’s intent that the Department review its existing resources dedicated to severance tax and provide the Joint Budget Committee with the information requested in the requests for information letter submitted in conjunction with the 2018 Long Bill.

COMMENT: The Department included a response to this request, which has been provided in Appendix J. There is also an issue brief that discusses statutory changes included in the Department’s submission. It is included for its impact of severance tax policy generally.

UPDATE ON REQUESTS FOR INFORMATION

- 1 Department of Natural Resources, Oil and Gas Conservation Commission, Plugging and Reclaiming Abandoned Wells -- The Oil and Gas Conservation Commission is requested to include in its annual budget request a report detailing all expenditures made in the previous year from this line item.

COMMENT: The Department included a response to this request, which has been provided in Appendix E.

- 2 Department of Natural Resources, Division of Reclamation Mining and Safety, Emergency Response Costs -- The Division of Reclamation, Mining, and Safety is requested to include in its annual budget request a report detailing all expenditures made in the previous year from this line item.

COMMENT: The Department included a response to this request, which has been provided in Appendix F.

- 3 Department of Natural Resources, Oil and Gas Conservation Commission, Emergency Response -- The Oil and Gas Conservation Commission is requested to include in its annual budget request a report detailing all expenditures made in the previous year from this line item.

COMMENT: The Department included a response to this request, which has been provided in Appendix G.

- 4 Department of Natural Resources, Oil and Gas Conservation Commission, Special Environmental Protection and Mitigation Studies -- The Oil and Gas Conservation Commission is requested to include in its annual budget request a report detailing all expenditures made in the previous year from this line item.

COMMENT: The Department included a response to this request, which has been provided in Appendix H.

- 5 Department of Natural Resources, Oil and Gas Conservation Commission, Program Costs -- The Department of Natural Resources is requested to include in its annual budget request a report on the performance of the risk-based inspection program. The report should provide information on the activities of the Facilities Integrity group, the inspection process for piping and flowlines, and the metrics used to measure the performance and effectiveness of the Facilities Integrity program.

COMMENT: The Department included a response to this request, which has been provided in Appendix I.

- 6 Department of Natural Resources, Division of Parks and Wildlife -- The Division of Parks and Wildlife is requested to provide the Joint Budget Committee with a report on Parks and

Outdoor Recreation and Wildlife sources of revenue, as well as the expenditures of revenues by revenue type. The report should provide an analysis of lottery funds Great Outdoors Colorado Board Grants used for operations and capital projects. The report is requested to be submitted by November 1, 2018.

COMMENT: This information request will be addressed during the Briefing for the Division of Parks and Wildlife on December 17, 2018.

- 7 Department of Revenue, Taxation Business Group -- The Department is requested to submit to the Joint Budget Committee by November 1, 2018, an assessment of the additional resources it would need to provide the General Assembly with more specific information related to severance tax and tax credits, exemptions, and deductions taken by severance tax filers for decision making purposes. Additional resources may include, but is not limited to: statutory changes, additional personnel, additional software modules, or software adjustments to GenTax.

COMMENT: This item is included in this document because of its impact on overall severance tax policy. The Department included a response to this request, which has been provided in Appendix J. There is also an issue brief that discusses statutory changes included in the Department's submission.

APPENDIX D DEPARTMENT ANNUAL PERFORMANCE REPORT

Pursuant to Section 2-7-205 (1)(b), C.R.S., the Department of Natural Resources is required to publish an **Annual Performance Report** for the *previous fiscal year* by November 1 of each year. This report is to include a summary of the Department's performance plan and most recent performance evaluation for the designated fiscal year. In addition, pursuant to Section 2-7-204 (3)(a)(I), C.R.S., the Department is required to develop a **Performance Plan** and submit the plan for the *current fiscal year* to the Joint Budget Committee and appropriate Joint Committee of Reference by July 1 of each year.

For consideration by the Joint Budget Committee in prioritizing the Department's FY 2018-19 budget request, the FY 2017-18 Annual Performance Report dated June 2018 and the FY 2018-19 Performance Plan dated November 2018 can be found at the following link:

<https://www.colorado.gov/pacific/performancemanagement/department-performance-plans>

APPENDIX E WRCC BILL AND FISCAL NOTE

Seventy-second General Assembly STATE OF COLORADO

BILL B

LLS NO. 19-0138.02 Ed DeCecco x4216

SENATE BILL

SENATE SPONSORSHIP

Donovan and Coram,

HOUSE SPONSORSHIP

Esgar and Saine, Roberts, Arndt, Catlin

Senate Committees

House Committees

A BILL FOR AN ACT

101 **CONCERNING THE METHODOLOGY TO DISTRIBUTE MONEY IN THE**
102 **SEVERANCE TAX OPERATIONAL FUND AFTER CORE**
103 **DEPARTMENTAL PROGRAMS ARE FUNDED WITHOUT CHANGING**
104 **THE TRANSFERS TO THE NATURAL RESOURCES AND ENERGY**
105 **GRANT PROGRAMS.**

Bill Summary

(Note: This summary applies to this bill as introduced and does not reflect any amendments that may be subsequently adopted. If this bill passes third reading in the house of introduction, a bill summary that applies to the reengrossed version of this bill will be available at <http://leg.colorado.gov/>.)

Water Resources Review Committee. Money in the severance tax operational fund (operational fund) is primarily used for 2 purposes.

The general assembly annually appropriates money from the operational fund for several core departmental programs, which were previously described as "tier-one programs". If money remains after these appropriations and after a reserve requirement for the core departmental programs is satisfied, then the state treasurer transfers money to an array of funds that support natural resources and energy grant programs, which were previously described as "tier-two programs".

There is also a requirement that the reserve include an amount equal to 15% of the maximum transfers to natural resources and energy grant programs required by law, and this reserve is used for the transfers, if necessary.

The bill changes the distribution of the money in the operational fund as follows:

- Separates the reserve into the core reserve and the grant program reserve, while maintaining the overall purpose of each reserve;
- Increases the maximum grant program reserve to 100% of the maximum transfers to the natural resources and energy grant programs required by law, which currently is equal to \$36,378,072;
- Requires the state treasurer to make the transfers to the natural resources and energy grant programs on August 15 after a fiscal year and to base the transfers on actual revenue as opposed to estimated revenue. Money from the grant program reserve may be used for these transfers; and
- If all of the appropriations and transfers have been made and both reserves are full, then the state treasurer is required to transfer any money remaining in the operational fund to the severance tax perpetual base fund.

1 *Be it enacted by the General Assembly of the State of Colorado:*

2 **SECTION 1.** In Colorado Revised Statutes, 39-29-109.3, **amend**
3 (2) introductory portion, (3)(a), and (7)(c); **repeal** (4) and (5); and **add**
4 (3.5) and (8) as follows:

5 **39-29-109.3. Severance tax operational fund - core reserve -**
6 **grant program reserve - definitions - repeal.** (2) Subject to the
7 requirements of subsections (3) and ~~(4)~~ (3.5) of this section, if the general
8 assembly chooses not to spend up to one hundred percent of the money

1 in the operational fund ~~as specified in subsection (1) of this section~~ ON
2 CORE DEPARTMENTAL PROGRAMS, the state treasurer shall transfer the
3 following amounts: ~~with the exception of the fiscal year commencing on~~
4 ~~July 1, 2018:~~

5 (3) (a) (I) ~~Except as provided in paragraph (b) of this subsection~~
6 ~~(3);~~ It is the intent of the general assembly that the operational fund
7 maintain a reserve equal to the current state fiscal year's operating
8 appropriations for the CORE DEPARTMENTAL programs, ~~specified in~~
9 ~~subsection (1) of this section plus fifteen percent of the current fiscal~~
10 ~~year's transfers specified in subsection (2) of this section. Moneys may be~~
11 ~~transferred from~~ WHICH RESERVE IS REFERRED TO IN THIS SECTION AS THE
12 "CORE RESERVE". IF SEVERANCE TAX REVENUES ARE LESS THAN
13 ANTICIPATED, THEN MONEY IN THE CORE RESERVE IS AVAILABLE TO
14 SUPPORT THE CORE DEPARTMENTAL PROGRAMS, BUT THE CORE RESERVE
15 IS NOT AVAILABLE FOR THE TRANSFERS TO THE NATURAL RESOURCES AND
16 ENERGY GRANT PROGRAMS.

17 (II) IT IS THE INTENT OF THE GENERAL ASSEMBLY THAT THE
18 OPERATIONAL FUND MAINTAIN A SECOND RESERVE THAT IS EQUAL TO THE
19 MAXIMUM AMOUNT OF THE TRANSFERS TO THE NATURAL RESOURCES AND
20 ENERGY GRANT PROGRAMS UNDER THIS SECTION, WHICH RESERVE IS
21 REFERRED TO IN THIS SECTION AS THE "GRANT PROGRAM RESERVE".
22 MONEY IN THE GRANT PROGRAM reserve MAY BE USED to offset temporary
23 revenue reductions in the CORE DEPARTMENTAL programs ~~specified in~~
24 ~~subsection (1) of this section and to offset reductions~~ for TRANSFERS TO
25 NATURAL RESOURCES AND ENERGY GRANT programs; ~~specified in~~
26 ~~subsection (2) of this section, up to fifteen percent of the current fiscal~~
27 ~~year's transfers specified in subsection (2) of this section;~~ except that, if

1 the general assembly determines that transfers of moneys from the GRANT
2 PROGRAM reserve are needed during a state revenue crisis, the transfers
3 shall be a loan from the GRANT PROGRAM reserve to be repaid as soon as
4 ~~moneys are~~ MONEY IS available.

5 (III) ~~This provision is~~ THE RESERVES CREATED IN THIS
6 SUBSECTION (3) ARE intended to mitigate the impact of fluctuations in the
7 amount of revenue credited to the fund from year to year so as to maintain
8 current levels of service for the CORE DEPARTMENTAL programs ~~specified~~
9 ~~in subsection (1) of this section~~ AND THE NATURAL RESOURCES AND
10 ENERGY GRANT PROGRAMS.

11 (3.5) (a) IF, AT THE END OF A FISCAL YEAR, THE CORE RESERVE
12 REQUIREMENT IS FULLY SATISFIED, THEN, ON AUGUST 15 FOLLOWING THE
13 END OF THE FISCAL YEAR, THE STATE TREASURER SHALL MAKE THE
14 TRANSFERS TO THE NATURAL RESOURCES AND ENERGY GRANT PROGRAMS
15 IN THE AMOUNTS SPECIFIED IN SUBSECTION (2) OF THIS SECTION. IF
16 NECESSARY, THE STATE TREASURER MAY USE MONEY IN THE GRANT
17 PROGRAM RESERVE TO SUPPLEMENT THE MONEY OTHERWISE AVAILBLE TO
18 MAKE THE TRANSFERS. IF THERE IS INSUFFICIENT MONEY IN THE
19 OPERATIONAL FUND FOR THE FULL TRANSFERS SPECIFIED IN SUBSECTION
20 (2) OF THIS SECTION, THEN THE STATE TREASURER SHALL
21 PROPORTIONALLY REDUCE THE TRANSFERS.

22 (b) IF THE GRANT PROGRAM RESERVE REQUIREMENT IS FULLY
23 SATISFIED AND THERE IS STILL MONEY IN THE OPERATIONAL FUND AS OF
24 THE END OF THE FISCAL YEAR, THEN, ON AUGUST 15 FOLLOWING THE END
25 OF THE FISCAL YEAR, THE STATE TREASURER SHALL TRANSFER THE
26 REMAINDER TO THE SEVERANCE TAX PERPETUAL BASE FUND CREATED IN
27 SECTION 39-29-109 (2)(a).

1 (c) (I) NOTWITHSTANDING SUBSECTION (3.5)(a) OF THIS SECTION,
2 THE STATE TREASURER SHALL NOT MAKE ANY TRANSFERS ON AUGUST 15,
3 2019, UNLESS SEVERANCE TAX RECEIPTS ARE DEPOSITED IN THE
4 SEVERANCE TAX OPERATIONAL FUND DURING THE PRIOR FISCAL YEAR AND
5 THERE WAS SUFFICIENT MONEY IN THE CORE RESERVE SO THAT NO
6 TRANSFER WAS REQUIRED UNDER SUBSECTION (7)(c) OF THIS SECTION.

7 (II) THIS SUBSECTION (3.5)(c) IS REPEALED, EFFECTIVE JULY 1,
8 2020.

9 ~~(4) (a) Except as provided in subsections (4)(b) and (4)(c) of this~~
10 ~~section, all transfers specified in subsection (2) of this section shall be~~
11 ~~made by the state treasurer in three installments, as follows:~~

12 ~~(I) Forty percent on July 1;~~

13 ~~(II) Thirty percent on January 4;~~

14 ~~(III) Thirty percent on April 1.~~

15 ~~(b) (I) If the revenue estimate prepared by the staff of the~~
16 ~~legislative council in June of any fiscal year indicates that the amount of~~
17 ~~severance tax revenues to be credited to the operational fund in the next~~
18 ~~fiscal year as specified in section 39-29-109 (2)(b) is insufficient for the~~
19 ~~state treasurer to make the transfers set forth in subsection (2) of this~~
20 ~~section and to meet the reserve requirement specified in subsection (3) of~~
21 ~~this section, all transfers scheduled to be made on July 1 shall be~~
22 ~~proportionally reduced. The July 1 proportional reduction shall be~~
23 ~~calculated based on the size of the annual transfers as specified in~~
24 ~~subsection (2) of this section and shall be made to the extent necessary to~~
25 ~~cover forty percent of the projected shortfall between total moneys~~
26 ~~available in the operational fund and the sum of the total operating~~
27 ~~appropriations for the programs specified in subsection (1) of this section;~~

1 the total fiscal year's transfers specified in subsection (2) of this section;
2 and the reserve requirement specified in subsection (3) of this section;
3 except that up to one-third of the fifteen percent of the current fiscal
4 year's transfers specified as part of the reserve set forth in subsection (3)
5 of this section shall be used to offset any proportional reduction required
6 by this subparagraph (I) in any fiscal year.

7 (H) If the revenue estimate prepared by the staff of the legislative
8 council in December of any fiscal year indicates that the amount of
9 severance tax revenues credited to the operational fund as specified in
10 section 39-29-109 (2)(b) is insufficient for the state treasurer to make the
11 transfers set forth in subsection (2) of this section and to meet the reserve
12 requirement specified in subsection (3) of this section, all transfers
13 scheduled to be made on January 4 of the fiscal year shall be
14 proportionally reduced. The January 4 proportional reduction shall be
15 calculated based on the size of the annual transfers as specified in
16 subsection (2) of this section and shall be made to the extent necessary to
17 cover seventy percent of the projected shortfall between total moneys
18 available in the operational fund and the sum of the total operating
19 appropriations for the programs specified in subsection (1) of this section;
20 the total fiscal year's transfers specified in subsection (2) of this section;
21 and the reserve requirement specified in subsection (3) of this section;
22 except that up to one-third of the fifteen percent of the current fiscal
23 year's transfers specified as part of the reserve set forth in subsection (3)
24 of this section shall be used to offset any proportional reduction required
25 by this subparagraph (H) in any fiscal year.

26 (HH) If the revenue estimate prepared by the staff of the legislative
27 council in March of any fiscal year indicates that the amount of severance

1 tax revenues credited to the operational fund as specified in section
2 39-29-109 (2)(b) is insufficient for the state treasurer to make the
3 transfers set forth in subsection (2) of this section and to meet the reserve
4 requirement specified in subsection (3) of this section, all transfers
5 scheduled to be made on April 1 of the fiscal year shall be proportionally
6 reduced. The April 1 proportional reduction shall be calculated based on
7 the size of the annual transfers as specified in subsection (2) of this
8 section and shall be made to the extent necessary to cover the projected
9 shortfall between total moneys available in the operational fund and the
10 sum of the total operating appropriations for the programs specified in
11 subsection (1) of this section, the total fiscal year's transfers specified in
12 subsection (2) of this section, and the reserve requirement specified in
13 subsection (3) of this section; except that any moneys remaining of the
14 fifteen percent of the current fiscal year's transfers specified as part of the
15 reserve set forth in subsection (3) of this section shall be used to offset
16 any proportional reduction required by this subparagraph (III) in any
17 fiscal year.

18 (IV) If proportional reductions are made to either the July 1 or
19 January 4 installments, the April 1 installment may be increased to offset
20 proportional reductions made earlier in the current fiscal year to the
21 maximum extent allowable under the revenue estimate prepared by the
22 staff of the legislative council in March of any fiscal year. The April 1
23 installment shall only be increased if the revenue estimate indicates that
24 the amount of severance tax revenues credited to the operational fund as
25 specified in section 39-29-109 (2)(b) is sufficient to fund the increased
26 installments and still meet the reserve requirement specified in subsection
27 (3) of this section.

1 (c) ~~Repealed.~~

2 (d) ~~Due to decreases in state severance tax revenue, the state~~
3 ~~treasurer shall not make any transfers specified in subsection (2) of this~~
4 ~~section for the fiscal year commencing on July 1, 2018, unless severance~~
5 ~~tax receipts are deposited in the severance tax operational fund during the~~
6 ~~fiscal year and there is sufficient money in the operational fund reserve~~
7 ~~so that no transfer is required under subsection (7)(c) of this section.~~

8 (5) ~~In addition to the distributions specified in paragraph (a) of~~
9 ~~subsection (4) of this section, if there were any proportional reductions~~
10 ~~required in a fiscal year as specified in paragraph (b) of said subsection~~
11 ~~(4), after the reserve specified in subsection (3) of this section is made~~
12 ~~whole if any portion of the reserve was used as specified in paragraph (b)~~
13 ~~of subsection (4) of this section to offset any proportional reduction~~
14 ~~required by said paragraph (b) of subsection (4), the state treasurer shall~~
15 ~~make proportional distributions on August 20 of the following fiscal year~~
16 ~~to the programs specified in subsection (2) of this section if the revenues~~
17 ~~actually received in the operational fund for the previous fiscal year were~~
18 ~~sufficient for the state treasurer to more fully make the transfers set forth~~
19 ~~in subsection (2) of this section and to fully meet the reserve requirement~~
20 ~~specified in subsection (3) of this section.~~

21 (7) The state treasurer shall transfer the following amounts from
22 the general fund to the operational fund:

23 (c) On July 1, 2019, an amount equal to the ~~portion of the~~
24 ~~operational fund CORE reserve required by subsection (3)(a) of this~~
25 ~~section~~ for the operating appropriations for the fiscal year commencing
26 on July 1, 2019, for the programs specified in subsection (1) of this
27 section or fourteen million two hundred fourteen thousand eight hundred

1 fifty-four dollars, whichever amount is less.

2 (8) AS USED IN THIS SECTION:

3 (a) "CORE DEPARTMENTAL PROGRAMS" MEANS THE PROGRAMS
4 SPECIFIED IN SUBSECTION (1) OF THIS SECTION.

5 (b) "TRANSFERS TO THE NATURAL RESOURCES AND ENERGY GRANT
6 PROGRAMS" MEANS THE TRANSFERS SPECIFIED IN SUBSECTION (2) OF THIS
7 SECTION.

8 **SECTION 2. Safety clause.** The general assembly hereby finds,
9 determines, and declares that this act is necessary for the immediate
10 preservation of the public peace, health, and safety.



Legislative Council Staff

Nonpartisan Services for Colorado's Legislature

FISCAL NOTE

Drafting Number: LLS 19-0138
Prime Sponsors:

Date: September 20, 2018
Bill Status: Water Resources Review Committee Bill Request
Fiscal Analyst: Larson Silbaugh | 303-866-4720 Larson.Silbaugh@state.co.us

Bill Topic: SEVERANCE TAX OPERATIONAL FUND DISTRIBUTION METHODOLOGY

- Summary of Fiscal Impact: State Revenue, State Expenditure, State Transfer, TABOR Refund, Local Government, Statutory Public Entity

This bill changes the timing and budgeting of severance tax revenue to several grant programs administered by the Department of Natural Resources. The bill does not change the funding amount for individual programs over time but delays the transfers until severance taxes have been collected for the previous fiscal year. The impacts are ongoing.

Appropriation Summary: None required.

Fiscal Note Status: The fiscal note reflects the bill draft requested by the Water Resources Review Committee.

Table 1
State Fiscal Impacts Under Bill 2

Table with 5 columns: Category, Description, FY 2018-19 (Current Year), FY 2019-20, FY 2020-21. Rows include Revenue, Expenditures, Transfers (Natural Resources and Energy Grant Programs), and TABOR Refund (General Fund).

Summary of Legislation

Under current law, the operational fund of the Severance Tax Trust Fund receives 25 percent of severance tax receipts. The fund is used for Tier 1 and Tier 2 programs in the Department of Natural Resources. Tier 1 programs are prioritized in the fund and include operations for the Oil and Gas Conservation Commission; the Geological Survey; the Avalanche Information Center; the Division of Reclamation, Mining, and Safety; the Water Conservation Board; the Division of Parks and Wildlife; and the fund's statutory reserve. Tier 2 programs include water-related programs, agriculture-related programs, clean and renewable energy development, soil conservation, the control of invasive species, the Species Conservation Trust Fund, and low-income energy assistance programs. The bill formally names Tier 1 programs as Core Departmental Programs and Tier 2 programs as Natural Resources and Energy Grant Programs.

The bill also changes the timing and number of payments made to the Natural Resources and Energy Grant Programs. Current law provides a mechanism for balancing spending from the operational fund by making proportional reductions to all Natural Resources and Energy Grant Programs (Tier 2) when insufficient funds exist to fully fund those programs and still meet the fund's statutory reserve requirement. This includes providing three transfers each year based on the forecasted severance tax revenue, prior transfers, and the statutory reserve.

The bill consolidates three transfers made to Natural Resources and Energy Grant Programs on July 1, January 4, and April 1 of each fiscal year into a single transfer made annually on August 15. The current transfers are based on the forecasted revenue for current fiscal year severance tax collections. This bill transfers revenue to Natural Resource and Energy Grant Programs in arrears as a single transfer is made based on the severance tax collections from the previous fiscal year.

Finally, the bill raises the statutory reserve for the Natural Resources and Energy Grant Programs from 15 percent of authorized distributions to 100 percent of authorized distributions and transfers any unspent revenue to the Severance Tax Perpetual Base Fund.

State Transfers

The bill reduces transfers from the operational fund of the Severance Tax Trust Fund to Natural Resources and Energy Grant Programs by \$27.6 million in FY 2018-19 and \$0.9 million in FY 2019-20.

Under current law, Natural Resources and Energy Grant Programs receive three transfers in a fiscal year based on the most recent forecast of severance tax revenue. Each fiscal year, the following transfers are scheduled:

- on July 1, 40 percent of authorized grant amounts are transferred;
- on January 4, 30 percent of authorized grant amounts are transferred; and
- on April 1, the final 30 percent of authorized grant amounts are transferred.

Individual transfer amounts are adjusted based on the statutory reserve and the latest forecast. The July 1, 2018 transfers were not made because there is not sufficient revenue to make the transfer and meet other statutory requirements pursuant to House Bill 18-1338. Severance tax revenue in the September 2018 Legislative Council Staff forecast anticipates that there will be sufficient revenue for full transfers to Natural Resources and Energy Grant Programs in FY 2018-19, however these transfers will occur in the second half of the fiscal year. The current

amounts authorized for FY 2018-19 and projected for FY 2019-20 are shown in the top half of Table 2. This fiscal note assumes that the bill will become law before any transfers are made to Natural Resources and Energy Grant Programs in FY 2018-19 on April 1, 2019.

The bill does not change the authorization of Natural Resource and Energy Grant Programs, but the transfer will occur on August 15 in the year following when the severance tax collections occur. Transfers under Bill 2 are shown in the bottom half of Table 2.

Table 2
Transfers Made Under Current Law and Under Bill 2

	FY 2018-19 (Current Year)	FY 2019-20	FY 2020-21
Current Law Distributions of Severance Tax Revenue to Tier 2 Programs			
(a) Water Supply Reserve Fund	7,585,513	9,086,027	9,086,027
(b) Soil Conservation District Grants	341,348	408,871	408,871
(c) Water Efficiency Grant Program	417,203	499,731	499,731
(e) Species Conservation Trust Fund	3,792,757	-	-
(f) LEAP - Low-income Energy Assistance	9,861,167	11,811,833	11,811,833
(i) Interbasin Compact Committee	565,172	676,970	676,970
(k) and (n) Forestry Grants	1,896,378	2,271,506	2,271,506
(m) Aquatic Nuisance Species	3,038,760	3,639,866	3,639,866
(n) Abandoned Mine Reclamation	96,336	115,393	115,393
Tier 2 Program Total Distributions Under Current Law	\$27,594,635	\$28,510,197	\$28,510,197
Distributions Under Bill of Severance Tax Revenue to Natural Resources Energy Grant Programs			
(a) Water Supply Reserve Fund	-	7,585,513	9,086,027
(b) Soil Conservation District Grants	-	341,348	408,871
(c) Water Efficiency Grant Program	-	417,203	499,731
(e) Species Conservation Trust Fund	-	3,792,757	-
(f) LEAP - Low-income Energy Assistance	-	9,861,167	11,811,833
(i) Interbasin Compact Committee	-	565,172	676,970
(k) and (n) Forestry Grants	-	1,896,378	2,271,506
(m) Aquatic Nuisance Species	-	3,038,760	3,639,866
(n) Abandoned Mine Reclamation	-	96,336	115,393
NREG Program Total Distributions Under Current Law	-	27,594,635	28,510,197
Change in Transfers Under Bill 2	(\$27,594,635)	(\$915,562)	-

Effective Date

The bill takes effect upon signature of the Governor, or upon becoming law without his signature.

State Appropriations

No appropriation is required.

State and Local Government Contacts

Counties
Natural Resources

Local Affairs
Revenue

Municipalities

APPENDIX F RFI 1 PLUGGING AND RECLAIMING ORPHANED WELLS

Department of Natural Resources - Colorado Oil and Gas Conservation Commission Plugging and Reclaiming Orphaned Wells Line Item DNR RFI #1 - Annual Report of Expenditures

Orphaned Well Program Project Name	Project Type(s)	County(ies)	FY 2017-18 Expenditures*
Arco Sindt #4 Lease	Field Operations	Logan	\$3,549
CM Production	Engineering, Environmental, Reclamation	Jackson, Washington	\$71,560
DeBeque Orphan #8	Engineering, Environmental	Mesa	\$13,027
Florence - Canon City Field	Engineering	Fremont	\$13,485
General Resources Ltd.	Reclamation	Weld	\$948
Hodges Pool Unit #1	Field Operations	La Plata	\$632
Juhl #1	Engineering	Boulder	\$78
Lloyd and Lowell #1	Engineering	Mesa	\$76,610
McCullough #4	Environmental	La Plata	\$3,007
Pilcher #1	Environmental	Montezuma	\$1,074
Ranchers Retta J	Reclamation	Larimer	\$3,537
Ranchers River West #2	Reclamation	Larimer	\$1,953
Red Mesa Holdings	Field Operations, Engineering, Environmental, Reclamation	La Plata	\$60,840
Redwine	Reclamation	Montrose	\$3,638
Tatonka	Reclamation	Moffat	\$350
Texas Tea	Engineering, Reclamation	Adams, Weld	\$159,987
Wolcott #1	Reclamation	Montezuma	\$407
Wosley Oil State #1-36	Reclamation	Montezuma	\$322
Total Expenditures			\$415,003

*Many of these projects also have FY18 funding from bonds claimed by the Commission. Bond funding is not shown here.

Project Type Definitions

Field Operations: includes site security, equipment intervention (draining, cleaning, and fluid management), and equipment removal.

Engineering: includes design (site access for heavy equipment), mechanical integrity tests or other well work, well plugging, and flowline abandonment.

Environmental: includes sampling and analysis, remediation of spills/releases, and pit closure.

Reclamation: includes grading, contouring, stormwater controls, seeding, and weed control.

**APPENDIX G RFI 2 DRMS EMERGENCY RESPONSE
EXPENDITURE REPORT**

**Department of Natural Resources – Division of Reclamation, Mining, and Safety (DRMS)
Emergency Response Costs Line Item
DNR RFI #2 - Annual Report of Expenditures**

Project Name	Description of FY 2017-18 Activity	FY 2017-18 Expenditures
S Bar C Pit Farms	Following the revocation of the S Bar C Pit Farms 112c Permit by the Mined Land Reclamation Board and the subsequent construction work in FY 2016-17, these personal services expenses cover project management for conclusion of the reclamation activities at this permit location.	\$648.00
Total Expenditures		\$648.00

APPENDIX H RFI OGCC RISK-BASED INSPECTION PROGRAM REPORT

Department of Natural Resources - Colorado Oil and Gas Conservation Commission (COGCC) Emergency Response Line Item DNR RFI #3 - Annual Report of Expenditures

Project Name	Description of FY 2017-18 Activity	FY 2017-18 Expenditures
Saulcy 4-1 Well	<p>On October 31, 2017, near Berthoud, a landowner reported fluids discharging from an old well, the Saulcy 4-1. The fluids were traveling north to the Hwy 60 road ditch. This was occurring while nearby new horizontal wells were being stimulated. The operator of the new wells, with assistance from Wild Well Control, was able to get the Saulcy well under control but not before large amounts of grayish fluids resembling drilling mud, along with some oil, were spilled onto the surface. After a subsequent investigation, the OGCC determined that the well had been inadequately plugged in 1984 by an OGCC contractor and was, therefore, unable to withstand the pressures incurred during the well stimulation activities about 3000 feet away. Because the Saulcy well had been plugged with OGCC oversight, costs associated with responding to the emergency situation, re-entering, plugging, capping, and abandoning the old well were the responsibility of the state.</p> <p>Total costs associated with the Saulcy well event were \$926,123. Of this amount, \$750,000 was expended from the Emergency Response line item, while the remaining \$176,123 was paid out of the Plugging and Reclaiming Orphaned Wells and the Environmental Assistance and Complaint Response line items.</p>	\$750,000
Total Expenditures		\$750,000

APPENDIX I RFI SPECIAL ENVIRONMENTAL PROTECTION AND MITIGATION STUDIES

Department of Natural Resources - Colorado Oil and Gas Conservation Commission (OGCC) Special Environmental Protection and Mitigation Studies Line Item DNR RFI #4 - Annual Report of Expenditures

Special Study/ Project Name	Description of FY 2017-18 Activity	FY 2017-18 Expenditures
<p>3M-4M <i>(ongoing project)</i></p>	<p>Between 2001 and 2010, the OGCC installed 17 monitoring wells at 11 locations along the Fruitland Outcrop in La Plata and Archuleta Counties to monitor gas pressure changes in the Fruitland Coal Formation. The wells are equipped with downhole pressure transducers that report data via a satellite telemetry system to a central data center. In 2008 and 2009, the OGCC and its contractor also designed and installed methane seep mitigation systems at two locations in La Plata County.</p> <p>The OGCC retained third-party contractors knowledgeable in the monitoring and mitigation systems to provide ongoing operations and maintenance (O&M) support to ensure the systems stay in working order and continue to relay data as designed. In FY 2017-18, these contractors provided the following services:</p> <ul style="list-style-type: none"> ● Conducted routine operations and maintenance activities of all system locations; ● Reviewed gas quality measurements stored in all data loggers; ● Collected weather station data; ● Conducted a system-wide field inspection tour; ● Collected well pressure measurements from a central data center; and ● Analyzed data and prepared the annual report. <p>To retrieve the FY 2017-18 Annual Report from the OGCC website (http://cogcc.state.co.us), navigate online to Library / Area Reports / San Juan Basin / 4M Project / 2017 4M Monitoring Report (2018 June).</p>	<p>\$35,931</p>

<p>Geophysical Survey of East Stewart Creek Pipeline Spill <i>(new for FY 2017-18)</i></p>	<p>In June 2016, approximately 5000 barrels of gas condensate were released from a pipeline in the Piceance Basin. Due to topography and the terrain, the subsurface investigation and remediation efforts have been challenging. Therefore, in FY 2017-18, the OGCC conducted a geophysical survey to aid in the evaluation of the subsurface and to better understand the distribution of the condensate in the subsurface. The survey results showed anomalies indicative of increased fracture density and potential flow paths. While survey data does not trace actual contaminant flow, the potential groundwater flows revealed by the study will assist the OGCC in characterizing the subsurface for future remediation efforts.</p>	<p>\$19,971</p>
<p>Exploration and Production Waste Facilities – Environmental Remediation Costs <i>(ongoing project)</i></p>	<p>Centralized Exploration & Production (CE&P) Waste Management Facilities, which receive produced water, drilling fluids, and completion fluids for aggregation, and any other exempt exploration and production (E&P) waste for treatment, temporary storage, and/or disposal, require the operator to seek a permit from the OGCC and post financial assurance that represents the full cost of decommissioning, dismantling, remediation and reclamation. These facilities include land farms, water processing facilities, E&P waste storage pits, soil/cutting processing facilities, and drilling mud processing and management facilities.</p> <p>To better protect the state from financial liability, the OGCC retains a consultant to provide third party reviews and cost estimates of the environmental remediation procedures the OGCC would use in the event of operator financial default and OGCC management of the cleanup. The unbiased information obtained from this project is used to set the appropriate levels of financial assurance, which is typically somewhere between \$500,000 and \$4 million.</p>	<p>\$17,070</p>

<p>Exploration and Production Waste Facilities – Environmental Remediation Costs, cont. <i>(ongoing project)</i></p>	<p>During FY 2017-18, the consultant prepared four cost estimates for CE&P facilities in Garfield and Mesa Counties, and are working on five cost estimates for facilities in Garfield, Mesa, Moffat, and Weld Counties.</p>	
<p>Naturally Occurring Radioactive Material Analysis in Produced Water <i>(ongoing project)</i></p>	<p>The “Naturally Occurring Radioactive Materials (NORM) in Produced Water” study is a follow up to the 2014 “Analysis of NORM in Drill Cuttings, Greater Wattenberg Field, Weld County.” This Special Project is also responsive to the October 2011 State Review of Oil and Natural Gas Environmental Regulations’ (STRONGER) review of OGCC regulations. The results of this study will determine if NORM is present in produced fluids tested as part of the study’s sampling program.</p> <p>For the follow up study in FY 2018, the OGCC collected 11 produced water samples for laboratory analysis (ten new sample locations and one resampling of a site sampled in FY 2017 for verification purposes). Including prior years, the OGCC has collected a total of 51 produced water samples, including 6 duplicate water samples, and five natural gas samples from 45 individual sites statewide as part of this project. The OGCC collected samples from wells targeting various geological formations producing oil and gas throughout Colorado, including the Sussex, Codell, Niobrara, Dakota, Mesa Verde (Williams Fork), Mancos, Leadville, J and D sands, Vermejo/Raton, Fruitland, Osage, Topeka, and Cherokee Formations.</p> <p>The OGCC also collected samples of both source water used for hydraulic fracturing along with “flowback” fluids following hydraulic fracturing. Preparation of the report with results is underway, and the report’s publication and posting online for public access is expected in FY 2018-19.</p>	<p>\$14,830</p>

<p>Upper Pierre Aquifer Water Quality Study <i>(ongoing project)</i></p>	<p>Several water court applications have been submitted to Colorado’s Division of Water Resources requesting designation of the Upper Cretaceous Pierre Shale in eastern Weld, Morgan, and Logan Counties as nontributary groundwater. The Upper Pierre Shale consists of shale with intervals of sandstone and silty sandstone that contain economic quantities of ground water. The water bearing sandstone intervals have collectively become known as the Upper Pierre Aquifer.</p> <p>Water well permit applications continue to be submitted in eastern Weld County for agricultural, commercial, and industrial uses, including applications for uses such as stock water and oil and gas drilling and completion. In response to this higher level of interest in the Upper Pierre Aquifer, the OGCC undertook a water quality study of the aquifer. The study’s objective was to document current water quality conditions and the presence and origin of methane in the aquifer. No evidence of oil- and gas-related impacts were found.</p> <p>In FY 2018, the OGCC finalized the report and posted it for public access in the agency’s online library. To retrieve the report, go to the OGCC website (http://cogcc.state.co.us), navigate online to Library / Area Reports / Denver Basin / Water Quality and the Presence and Origin of Methane in the Upper Pierre Aquifer in Northeastern Weld County, Morgan County and Logan County, Colorado, COGCC Special Project 2141 (October 2017). Staff also provided a presentation on the results of the study to the Commission at its January 2018 Hearing.</p>	<p>\$660</p>
<p>Total Expenditures</p>		<p>\$88,462</p>

APPENDIX J RFI OGCC RISK BASED INSPECTIONS



COLORADO

Department of Natural Resources

Executive Director's Office
1313 Sherman Street, Room 718
Denver, CO 80203

November 1, 2018

The Honorable Millie Hamner
Chair, Joint Budget Committee
Colorado General Assembly
200 E. 14th Avenue, Third Floor
Legislative Services Building
Denver, CO 80203

RE: Department of Natural Resources FY 2018-19 RFI #5

Dear Representative Hamner:

The Joint Budget Committee requested the Department of Natural Resources to include in its annual budget request a report on the performance of the risk-based inspection program, including information on the development of the facilities integrity group, the inspection of process piping and flowlines, and the metrics used to measure the performance and effectiveness of the facilities integrity program. This Request for Information was made in conjunction with the approval of the Colorado Oil and Gas Conservation Commission's FY 2015-16 request for the 12.0 FTE recommended by the Governor's Task Force on Oil and Gas. The following is the Department's two-part response to your request.

Risk Based Inspection Program

The Colorado Oil and Gas Conservation Commission (COGCC) uses a risk-based strategy for inspecting oil and gas locations that targets the operational phases that are most likely to experience spills, excess emissions, and other types of violations and that prioritizes more in-depth inspections. To achieve this goal, the COGCC first conducted a study to determine the operational phases of oil and gas activity that resulted in relatively higher occurrences of adverse impacts to public health, safety and welfare, or the environment, including wildlife. This study developed four recommendations for priority inspections: 1) review flowline and facility integrity at production facilities more frequently; 2) increase inspections during facility closures; 3) increase inspections during site construction; and 4) increase inspections during hydraulic fracturing and flowback. Additionally, the COGCC developed a geographic information system (GIS) model that is used in conjunction with existing agency systems to prioritize field inspections.



This GIS model is a systematic, automated, statistical tool that relies on statewide environmental and demographic data from the COGCC, Colorado Division of Water Resources, Colorado Parks and Wildlife, Colorado Department of Local Affairs, and U.S. Census Bureau. The model uses the data to calculate a relative risk level (RRL), between 15 and 75, for each well in the state. The risk level is automatically updated as the factors affecting it change over time. Therefore, COGCC's database provides nearly real-time data for analysis, tracking, and spatial display on the COGCC's interactive map. Wells with a RRL of 45-75 are considered high priority; and the COGCC's goal is to inspect 100% of them on an annual basis, which currently aligns with the employees' performance review cycle (*i.e.* April 1 through March 31). On April 1, 2018 there were 3,163 wells with a "high" RRL. As of October 14, 2018, 56% of them had been inspected.

Corrective actions related to environmental and community protection that are issued to high priority wells are closely tracked to ensure 80% are re-inspected and that issues are resolved within 30 days. If corrective actions were not implemented by the operator within the scheduled time, the issue is referred to the COGCC's enforcement team. As of October 14, 2018, 77% of high priority wells with corrective actions had been re-inspected to confirm resolution or pursue enforcement action.

Field staff, including inspectors, environmental specialists and engineers, statewide, use the calculated risk levels as an additional factor to consider when prioritizing inspections.

Facilities Integrity Program

The COGCC's integrity group, formed in FY 2015-16, has designed and implemented a risk-based program focused on the installation and maintenance of flowlines. Flowlines are the network of pipelines connecting oil and gas wells to tanks, separators, and other vessels, and include the pipelines connecting these facilities to the point of sale. During the third year of the program, FY 2017-18, the facilities integrity group accomplished the following:

Operator Guidance and Outreach:

- Prepared "Frequently Asked Questions" documents pertaining to the new Flowline rules of February 2018.
- Issued a statement on use and precautions for Production Facilities with Groove-Lock Coupling and Sealing Systems.
- Conducted trainings on use of the new Form 44 Flowline Report.
- Conducted outreach at events across Colorado, including Colorado Oil and Gas Association meetings in Denver, the Northwest Forum and Energy Advisory Board in Rifle, Society of Petroleum Engineers student chapter at Colorado School of Mines, and Small Operator Outreach in Sterling and Lamar.

Integrity Inspections:

- Performed field inspections of flowlines at over 200 sites. Inspections are conducted during flowline construction, repair, and abandonment, and include the observation of pressure testing methods. Non-compliance issues are immediately addressed with the operator; the most serious resulting in formal enforcement actions.



Instrument Based Technologies for Detecting and Preventing Leaks and Spills from Flowlines:

- Engaged the Energy Institute at Colorado State University to conduct a review of instruments currently available or under development that could prevent and detect leaks. This work is expected to be completed in FY 2018-19.

Probabilistic Models for Flowline Integrity:

- Engaged the Colorado School of Mines to review probabilistic models for flowlines. This study, expected to be completed in FY 2018-19, will help the COGCC improve upon the existing risk-based model for monitoring the integrity of upstream flowline systems in Colorado.

Flowline Audits:

- Conducted audits of 16 operators – reviewed integrity programs and pressure testing records for flowlines associated with over 1,200 wells. Audits are prioritized based on a data-driven flowline ranking model and are designed to help ensure operators have systems in place to prevent damage to flowlines, prevent failures that cause spills and releases, identify systemic flowline issues, and identify and address instances of non-compliance. The number of audits conducted were lower than the previous year as attention was focused on the new rulemaking and Form 44, along with reviewing the flowline data received as a result of the May 2017 Notice to Operators.

Flowline-Related Spill Monitoring:

- Reviewed over 202 flowline and facility related spills to determine root causes, when possible, and the mitigations needed to prevent future releases. The largest percentages of flowline spills have been caused by corrosion. Fusion failures in polyethylene plastic pipe have also caused a significant portion of the flowline spills, along with freezing-related issues.

Review of Data Related to May 2017 Notice to Operators:

- The COGCC completed the review of approximately 120,000 rows of data received from operators pursuant to the May 2017 Notice to Operators, which required operators to inspect, ensure, and document the integrity of all flowlines within 1,000 feet of a building unit. It also required them to abandon any flowlines not actively operated, regardless of distance from a building unit. A cease and desist order for non-compliance was issued to an operator of nine wells. These wells were ultimately added to the orphan well program.

Update of Flowline Rules.

- New requirements include:
 - The registration of off-location flowlines, domestic taps, crude oil transfer lines, and produced water transfer systems.
 - The use of international technical engineering standards.
 - Tier 1 membership in the Utility Notification Center of Colorado and participation in One Call.
 - The addition of isolation valves to certain existing systems.
 - Gas leak reporting.
 - Bonding for produced water transfer systems.
- The updated rules also expanded the requirements related to the abandonment of flowlines.

New Flowline Form:

- The New Flowline Form 44 was developed and put into service. It allows operators to register, report realignment, report removal from service, and report abandonment of off-location



flowlines, domestic taps, crude oil transfer systems, and produced water transfer systems. It also covers the reporting of Grade 1 gas leaks, which are considered a hazard to persons or property.

Revisions to Existing Forms:

- Revised five regulatory forms to accommodate the new flowline rules and associated rule revisions.

Facility Engineering:

- Added Alternative Measurement Method standard to tank gauging rules.

Please contact me if you require additional information on the COGCC's risk-based inspection program or the development and progress of its new facilities integrity group.

Sincerely,



William H. Levine
Budget Director, Department of Natural Resources





APPENDIX K DOR RFI ON RESOURCES FOR ENHANCED SEVERANCE TAX REPORTING

Executive Summary

<i>Summary of Additional Resources Required to Provide Severance Tax Filing Data¹</i>			
<i>Category of Expenditure</i>	<i>FY 1*</i>	<i>FY 2</i>	<i>FY 3 and Ongoing</i>
Vendor Development and Testing Costs (Fast for GenTax Progaming)	\$73,750	\$73,750	\$-
Mineral Audit	\$43,321	\$86,641	\$86,641
Office of Research and Analysis	\$19,200	\$3,200	\$320
System Support Office (Personal Services Dollars to Backfill Testing and Project Management Functions)	\$51,215	\$51,215	\$-
Total	\$187,486	\$214,806	\$86,961

*Fiscal Year Ending During the Impacted Tax Filing Year

Note: For a more detailed explanation of costs and methodologies, review the “Additional Resources Required to Implement” section of the report.

As a result of this request for information, the Colorado Department of Revenue (CDOR) convened a working group of audit, taxpayer service, business analyst, reporting, and policy staff to discuss current limitations and identify areas of opportunity to modify severance tax administration to improve the systematic intake and output of taxpayer data. CDOR made several assumptions about what constitutes “more specific information” about the data in question that are outlined in the “Problem Statement” section of the report. Potential solutions developed by the team are grouped by solutions that would be facilitated by statutory changes or by solutions that could be addressed through return and/or system updates alone.

Colorado’s severance tax was enacted in 1977 and portions of statute have not been substantially updated or revisited since the 1980’s and 90’s. This document summarizes

¹ For purposes of estimating costs to respond to this RFI, the Department assumes that the implementation timeline for statutory and system changes would begin January 1 of the impacted tax filing year. For example, if the changes are effective for the tax year beginning January 1, 2019, the project would be initiated, planned and developed beginning January 1, 2019 (or as soon as possible thereafter) in order to ensure that the returns, data sharing processes, and filing and billing systems are fully updated by January 1, 2020 when taxpayers may begin filing for the 2019 tax year.



several statutory changes the Department recommends including but not limited to: mandate e-filing; mandate centralized collection and sharing of NERF data electronically with CDOR, CDOLA, and the counties; exempt severance tax from refund interest statutes in certain cases; and add an option for the Department to assess a penalty for failure to report and file correctly to ensure correct information is collected.

In addition to providing the General Assembly with more reporting capacity, the adoption and funding of the solutions suggested in this report simplify severance tax filing for taxpayers and reduce manual work and errors for CDOR, improving the integrity and accountability of the tax system. Historically, conflicting and higher impact demands on CDOR development resources have superseded opportunities to automate the severance tax or to drive the systematic collection of data for reporting of the tax. While modernizing these processes would result in more efficient administration of the tax, the cost of the modernization has exceeded the benefit given the Department's budget allocations in the past.

For general information, currently there are no cases waiting in the Department's conferee section to be resolved as a result of BP Am. v. Colo. Dept. of Revenue decision. There is projected to be \$16 M of refunds issued for returns that are currently under audit. These refunds are related to the BP Am. v. Colo. Dept. of Revenue decision ruling. These refunds are expected to be processed and paid by the end of this fiscal year, June 30, 2019. Additionally, there is anticipation that amended returns may be filed for the eligible time period of tax year 2014 through 2016 for an estimated total of up to \$29 M².

Without an electronic filing mandate, the costs to collect and prepare the data for reporting manually by staff increase exponentially above what is presented in this RFI response. The adoption of any single solution alone is not enough to address the request for additional reporting for the general assembly and the suggestions provided should be considered as a package.³

² This estimate is based on a representative group of the largest taxpayers and the limited information that is known at this time. This total is only an estimate, as the decision to file amended returns is left to the business. The Department of Revenue has no advance notice of taxpayer intent until such time as the business files tax information with the Department.

³ Any changes made as a result of suggestions from this RFI will only be effective going forward; what data the Department does have available for back years and current years is limited and can only be retrieved through manual information gathering, which means copying information from images of paper forms (if provided and available) by hand into a spreadsheet or other data collection tool.

Also, reporting data from tax filings includes an inherent lag. For example, if taxpayer requirements were changed effective for the 2019 filing period (which is due beginning April 15, 2020), the earliest that reporting could be completed would be January 2021 to include fiscal year taxpayers and extension filers in a "full tax year". In addition, reporting on return-based information does not predict the potentially substantial revenue adjustments that happen as a result of late filings, amendments, or audits. Filing data should only be used to inform decisions about long-term trends and patterns and cannot reasonably be used to forecast short term effects.



Introduction

1.1 Problem Statement:

“The Department is requested to submit to the Joint Budget Committee (JBC) by November 1, 2018, an assessment of the additional resources it would need to provide the General Assembly with more specific information related to severance tax and tax credits, exemptions, and deductions taken by severance tax filers for decision making purposes. Additional resources may include, but is not limited to: statutory changes, additional personnel, additional software modules, or software adjustments to GenTax.”

In order to complete the request for information (RFI), the Department makes the following assumptions:

- The JBC believes that historical data on the use of specific credits, exemptions, and deductions allowed under statute against severance tax will allow for more accurate forecasts of severance tax revenues in the future.
- The “more specific” information includes a breakout of credit, exemption, and deduction amounts claimed that is consistent and comparable to the information that is collected by property tax administrators in the netback expense (NERF) forms.
- Collecting and reporting data systematically is facilitated by receiving data electronically.
- Without an electronic filing mandate, the costs to collect and prepare the data for reporting manually by staff increase exponentially above what is presented in this RFI response.

CDOR is currently unable to provide reporting on the specific information requested related to severance. Prior to 2008, all CDOR administered taxes were housed by a patchwork of systems in a mainframe environment developed decades before. The legacy system presented a number of limitations on data, processing, and information collection that set a foundation of manual processing and little integration. The severance taxes were among the first taxes that were migrated to the new system in 2008. As one of the first taxes implemented in the system, the priorities for severance tax migration were (1) proof-of-concept to transfer relatively smaller taxes to a more integrated new system and (2) maintaining existing processes with minimal business disruption for taxpayers and for Department staff. The severance tax roll out was not designed include significant enhancements or changes. Since the initial roll out and over the past ten years, other conflicting and higher impact demands on CDOR resources have superseded many opportunities to improve the administration of the severance tax or to increase the systematic collection and reporting of the tax data.



The data desired by the GA is return data. This data can be used to inform some policy decisions about the severance tax landscape, but even if made available, limitations on the usefulness of the data should be considered and understood by decision makers. Returns are reports that rely on voluntary compliance and taxpayer knowledge that may be audited and corrected by the Department. Not every return received is audited. Return information can be changed at any time (within reason and within a statute of limitations) through amendment, review adjustment, audit findings, administrative hearing settlement, or court process. While return data (which is specified by tax year/filing period) largely tracks collection data (which is specified by revenue period) it will not match exactly and cannot be easily linked to collection data because substantial revenue adjustments can happen as a result of late filings, amendments, or audits.

Tax policy--such as providing deductions or credits--has an effect on severance tax collections, however larger economic and political forces on oil and gas prices such as global supply and demand, other federal and state exploration and production regulations, and industry profitability and technology contribute more to drive business decisions and ultimately production and tax revenue from producers than tax policy directly. These forces, as well as the results of any potential future litigation create variations from forecasts that are outside of the control of the state and the impacts of these forces are not mitigated or predicted by additional data reported on returns.

The majority of the suggestions included in the report are focused on changes to oil and gas reporting specifically, however each of the changes recommended are also applicable to other severance taxes (metallic minerals, coal, molybdenum, etc.) Much of the statute governing the administration of severance taxes applies to all severance tax types so the associated costs for updates also consider severance tax as an inclusive package. The costs to make changes could be reduced marginally if the suggested statutory and administrative changes were adapted to fully separate the administration of oil and gas severance from all other severance taxes; however the reduction in development costs would be marginal and would decrease consistency in administration between the various types of severance tax.

Finally, the members of the working group discussed ideas outside of the scope of reporting that could have a stabilizing impact on the state revenue stream generated by severance taxes to improve the General Assembly's ability to budget and expend severance tax revenues.⁴ Ultimately, these ideas were not addressed in detail in the RFI response due to

⁴ These ideas were to (1) change the way distributions are allocated from the severance tax funds in the state budget based on collections from the prior fiscal year rather than the current fiscal year, (2) raise the tax rates, (3) change the point of taxation to producers only rather than require a withholding and liability sharing with other taxpayers by taxing the production directly rather than the gross income from the production, (4) remove, reduce, or modify the ad valorem credit since taxpayers receive reductions and credits against the ad valorem tax based on several netback expense (NERF) deductions, and (5) remove or reduce the threshold for consideration of "stripper" well exemption status.



the fact that they were more significant tax policy changes or budget decisions rather than collection of information and had the potential to result in net revenue increases for the state.

1.2 Statutory Construction of Severance Tax

The current statutory framework authorizing severance tax contains grey areas and does not provide statutory authority for the Department to enact or enforce administrative changes that only serve the purpose of increasing the amount of reportable data. To the extent the Department determines that additional information is required on a return for the purpose of tax administration the Department has statutory support to require that information. However, depending on the quantity, type, and scope of changes to returns and systems to accommodate the information the Department must defend and budget for the changes or forgo other maintenance and support work to pay for the development. In addition, the results of the *BP Am. v. Colo. Dept. of Revenue* decision mean that the Department has little room to make any regulatory adjustments regarding deductions without supporting legislative changes to the underlying statute. In order to support the request for additional reporting and return information from taxpayers, the Department recommends several statutory changes in the “Statutory Solutions” section of this report.

1.3 Return and System Limitations on Data Collection

The general assembly request pertains to “more specific information related to severance tax and tax credits, exemptions, and deductions taken by severance filers.” Information regarding deductions is not reported on the Form DR 0021 and associated Form DR 0021D which are the minimum required components to administer oil and gas severance tax return processing. Deduction is reported, if at all, on Form DR 0021PD, a form that was not designed to reflect the degree of detail contemplated by the RFI, that CDOR is not able to require taxpayers to submit, and, if taxpayers do submit, CDOR does not have the current system capacity to data capture and store the information.

The decisions regarding the collection and capture of this information at any level in the past have been largely driven by resource constraints (costs to key or data capture information from paper, costs to store data in the Department’s system of record, etc.) and the relatively small populations of impacted filers compared to the historic audit coverage of the industry, which has in some years been as much as 75% of the collected amount and covers the majority of wells in the state. Additional data that is captured and stored systematically could in some cases improve the ease of administration of the tax, however due to costs for system changes as well as the requirement of taxpayers to “keep and preserve books, accounts, and records as may be necessary to determine the amount of liability”, capturing additional data on the return has remained a “nice to have” rather than a “necessary” consideration. Additional reporting requirements from the taxpayer also increase taxpayer



costs of compliance to report and file correctly and requiring redundant information from CDOR that the taxpayer files and reports elsewhere places additional burden on the industry and costs on the businesses. In order to support the request for additional reporting and return information from taxpayers, the Department recommends funding several administrative and system changes in the “Return and System Solutions” section of this report.

Potential Solutions and Resources Needed

Statutory Solutions

This section outlines CDOR’s recommendations for statutory changes that would enable more current, accurate and accessible data for decision makers, a more streamlined severance tax filing experience, as well as more automated administration of the severance tax.

Suggestions and Rationale for Statutory Changes	
<i>Suggested Section in C.R.S.</i>	<i>Description of change and rationale for the suggestion</i>
#1 39-7-101(4)	Mandate sharing of NERF data electronically from the counties with CDOR to (a) centralize the information and (b) help improve the correct assessment of tax and (c) streamline audit efficiency. Or consider centralized reporting from all the producers to CDOLA or DOR into a database system all of the assessors could access (and then share from CDOLA to CDOR if necessary.) This suggestion represents an opportunity (like a state managed GIS for sales tax boundaries) to invest in a centralized data repository that could be used by state and local agencies, as well as a repository for more complete deduction information.
#2 39-21-110	The fact that the original due date of a filing rather than the timely filing drives the payment of refund interest could result in variations in collection that are unexpected and difficult to budget for. CDOR has 90 days from the return due date to process returns prior to having to pay refund interest. This is a very large task in and of itself. Additionally, there is no clear guidance on how to treat taxpayers who file late (after the due date) or upon extension. The Income Tax refund interest statute is subject to different rules, one of which is that the state does not have to pay refund interest if a return has been selected for review and one which begins any interest calculations at the date of the receipt of the



Suggestions and Rationale for Statutory Changes	
<i>Suggested Section in C.R.S.</i>	<i>Description of change and rationale for the suggestion</i>
	<p>filing or return rather than the original due date of the return. Some severance tax returns are in excess of 200+ pages and often are more lengthy reviews. A change to this statute would result in less chance for variations in collections that are a result of interest being paid on late or amended filings.</p>
<p>#3 39-29-102(3)(a)</p>	<ul style="list-style-type: none"> • Clarify in statute the General Assembly’s intent, scope, and definition of deductions allowed against “gross income”. • Consider statutory changes regarding “related parties” and provide specific direction on what can be allowed to be considered an arm’s length transaction vs. a related party transaction, statute allows CDOR to define in rule however the Department had to modify the regulation as a result of the court decision. Statutory clarification defining related parties could allow the Department more direction to prevent related party pricing to avoid tax.
<p>#4 39-29-103(2) AND 39-29-105(2)</p>	<p>Eliminate the option to use cash or accrual methods to determine the credit allowed and just follow the federal rule for most taxes of cash accounting for purposes of establishing the credit. This change would avoid taxpayers who use accrual accounting getting the value of the credit before the payment that generates the credit is actually made in some cases. This nuance in filing, reporting, and qualifying for the credit complicates filing and can result in audit adjustments that make predicting the revenue flow of severance taxes challenging.</p>
<p>#5 39-29-111</p>	<ul style="list-style-type: none"> • Codify the requirement that producers or first purchasers must file their withholding statements with the Department in addition to sending copies of withholding statements to the interest holder. This reporting requirement provides a check and balance system for refund claims by interest holders and reinforces the Department with a systematic tool rather than selection for audit to ensure that producers are withholding correctly. • Consider conforming producer withholding requirements to similar standards as wage withholding requirements to include a penalty for failure to correct withholding documents and provide corrected documents to taxpayers.



Suggestions and Rationale for Statutory Changes	
<i>Suggested Section in C.R.S.</i>	<i>Description of change and rationale for the suggestion</i>
	<ul style="list-style-type: none"> Consider moving the requirement to complete 4th quarter withholding and annual reconciliation earlier than March 1 to improve the filing timelines and correct information. If taxpayers do not receive withholding statements until the first or second week of March and annual filing is due by April 15 there is little time to file correctly. Additionally, if there are delays in producers providing withholding reconciliations to CDOR the Department is unable to verify withholding for interest holders who file earlier. Producers or first purchasers who have employees are accustomed to providing employment withholding statements and reconciliations to the IRS, SSA and the state by January 31 for the prior year.
#6 39-29-112(1)	Mandate electronic filing of severance tax returns with CDOR (and fund and complete the subsequent development to create an electronic filing method). If all of the requisite data for reporting is provided by taxpayers in an electronic format directly to the Department, the significant reporting barrier of manual data entry costs and errors is removed.
#7 39-29-112(7)	If the general assembly needs complete information related to severance tax in order to make decisions, statute currently does not include reporting from individuals with less than \$250 withheld from all unit operators and for whom the \$250 minimum meets or exceeds the tax obligation. As a result, there are a large number of rent/royalty taxpayers who never file an actual return. When this exclusion from filing is combined with the previous bullet, it is likely that a large number of interest holders are not only not filing, and if they all submitted returns for prior periods be eligible for refunds of over withholding that is not currently captured or anticipated. To the extent that the producer or first purchaser submits DR 0021Ws to the Department, the Department has this information, just from a different source. If the submission and collection of data from DR 0021W's provided by producers or first purchasers were addressed (as in suggestion #5 above) this exclusion would not necessarily need changed.



Suggestions and Rationale for Statutory Changes	
<i>Suggested Section in C.R.S.</i>	<i>Description of change and rationale for the suggestion</i>
<p>#8 39-29-115(2)</p>	<p>Modify or add a penalty provision for failure to report to CDOR correctly. Even minor changes to tax reporting are adopted with varying rates of success and the suggested changes are substantial. Most taxpayers will voluntarily comply with the new reporting requirements however CDOR has no recourse to compel any serious standouts to report correctly on the filing. Consider borrowing language from 39-26-118(2) re: failure to “correctly account” for the tax. Include a requirement that if errors are discovered during an audit, the taxpayer is required to file an amended return to correct the errors. Taxpayers have similar requirements for federal severance audits.</p>
<p><i>For consideration, a simplification of the tax structure overall in order to create the easiest structure for filing and for reporting on information:</i></p>	
<p>#9 39-29-102(3) AND 39-29-111</p>	<p>Significant changes to reporting and liability structure of the tax so that the incidence of the tax is entirely on the producer and not interest or royalty holders at all. The withholding scheme convolutes where the tax liability ultimately rests, complicates reporting and filing significantly, and benefits the producers over the royalty holders by reducing overall the tax that is due on severance throughout the state at the current rates. Since a change like this has the potential to implicate TABOR by resulting in a revenue increase, this type of change is not included in the resource costs of this analysis. Careful review and potentially an adjustment and decrease in rates to account for an increase in taxable gross income could mitigate overall revenue increases, however that analysis has not been conducted by CDOR at this time.</p>



Return and System Solutions

Suggestions and Rationale for Return and System Changes	
<i>Corresponding Statutory Updates for Support (if applicable)</i>	<i>Description of change and rationale for the suggestion</i>
See #1 & #6 in the “Statutory Solutions” section	Modify the DR 0021 and the DR 0021PD to enumerate taxpayer reporting of more of the NERF deductions that statute and the court decision allow for more granular reporting data to be collected on the filings. Require and capture (electronically) the DR 0021PD and use the data from that form to feed into the DR 0021 at an aggregate level.
See #1, #4, & #6 in the “Statutory Solutions” section	Make updates to the audit working papers (audit program functionality) in GenTax to operate more like the retail marijuana tax working papers and have a number of fields from the DR 0021 that are updated upon audit adjustments in the RETURN document in addition to the financials that post on the account for billing. If the return document is not updated by audit adjustments, reporting for accounts that have been audited and adjusted will not accurately represent credit, exemption, or deduction information as requested in the RFI.
See #5, #6, & #7 in the “Statutory Solutions” section	Make changes to the annual withholding reconciliation for OGW to behave more like the DR 1093 for wages and adjust annual reporting requirements and rules to align that process more closely with the wage withholding process. Withholding functions best in a system of checks and balances, where the withholder is compelled to correctly report withholding against filing or claims for refund from the party withheld.
See #1, #5, #6, & #7 in the “Statutory Solutions” section	The only data currently electronically captured and stored in GenTax for oil and gas severance is from the DR 0021 and the DR 0021D, and limited fields from those return forms. Expand the data stored and collected as indicated in the table above, including mapping the data to return tables and supporting tables to allow for reporting out of the system.
See #3, #5, & #6 in the “Statutory Solutions” section	<ul style="list-style-type: none"> Adding verbiage that DR 21D is required with the return and modify the form to include a column to report withholding. Require that each DR 21W should be separately listed on the DR 21D. Capture the additional withholding data and complete any



Suggestions and Rationale for Return and System Changes	
<i>Corresponding Statutory Updates for Support (if applicable)</i>	<i>Description of change and rationale for the suggestion</i>
	<p>math rule changes that should be completed as a result of the extra step to automate withholding comparisons. This way, if discrepancies occur, CDOR can identify and correct specific withholding statements. Poor tracking could cause allowance of ad valorem when no income may have been present on any given DR 21W due to limited information.</p> <ul style="list-style-type: none"> • Require the DR 21AS with any severance tax filing (when applicable.) This information helps CDOR identify parent/subsidiary entities that are required to file a combined severance return.



Additional Resources Required to Implement Suggested Solutions

Additional Vendor System Development and Testing Cost Resources:

The suggestions presented in this document require a number of changes and modifications to the severance tax returns, filing processes, and audit processes in order for CDOR to systematically collect and report the information requested as part of this RFI. The review team developed requirements and a scoping document⁵ for changes and modifications based on the suggested solutions and CDOR’s software vendor Fast Enterprises provided a level of effort estimate for the vendor development costs to update the Department’s GenTax system for the new return functionality and processes.

Activity	Hours/Cost
Design/Analysis	40
Development	450
Unit Testing	80
Change Management	20
Total Hours	590
Hourly Rate	\$250
Total Cost	\$147,500

Additional Staff Resources:

The workload estimates for additional staff resources in this RFI response are developed consistently with the workload methodologies that are used by CDOR to estimate workload for fiscal note purposes.

Mineral Audit

The changes suggested require the mineral audit section to make adjustments to returns on a much more detailed (well by well) basis in the system. Current audit practices involve a detailed investigation of taxpayer activity and statements; however return data is not updated upon completion of an audit. Rather, financial adjustments are made to the

⁵ The scoping document and vendor response detail can be provided, but is not included in this RFI response for brevity and readability.



“bottom line” only in order to reflect the net adjustments made to the taxpayer’s liability. To complete an overhaul of the audit working paper and increase the data points that are corrected after a taxpayer audit to reflect accurately in reporting, the mineral audit section would require some staffing changes to reflect the additional work.

The mineral audit section’s current work consists of work that is focused on audit of the state severance tax, in addition to staff that performs joint audit work with the federal government using federal funding on federal severance. The work of each group is different, and both are currently managed by a single level of management. In order to develop the updated audit program and protocols to track and report the information at the level of detail required to report credits and exemptions, the internal controls and reviews for the additional level of complexity exceeds the capacity of the existing team and management structure. In order to implement the next level of reporting, the mineral audit section has developed the following staffing recommendations:

- Add one new Admin Assistant II position to assist with the data entry and input of detailed, well-by-well adjustments into the reporting database to ensure correct information about credits and deductions and to research reporting question from the Office of Research and Analysis
- Upgrade a current Auditor III position that acts as a team lead for the state mineral audit program to an Auditor IV to allow for additional management responsibilities of the new admin position and for the additional job responsibilities of developing the enhancements to the state audit program.
- Upgrade a current Auditor III position that acts as a team lead for the federal severance program to an Auditor IV to shift and adjust the supervisory workload of the remainder of section and to balance the supervisory responsibilities of each group’s work.
- Upgrade the existing mineral audit section manager position from an Auditor IV level position to an Auditor V position to accommodate appropriate levels of supervision because of the necessary upgrades of the other two positions.

Mineral Audit Staffing Adjustment Plan

Description	Position Number	Current Classification	New Classification	Current per month	New per month	Fiscal Year '19 Impact
Reclassification	279	AUDITOR IV	AUDITOR V	\$9,090	\$9,999	\$10,908
Reclassification	1989	AUDITOR III	AUDITOR IV	\$7,307	\$8,038	\$8,768
Reclassification	153	AUDITOR III	AUDITOR IV	\$6,352	\$7,082	\$8,760
New Position	N/A	N/A	ADMIN ASSISTANT II	\$0	\$2,839	\$34,068
			Total Salary	\$22,749	\$27,958	\$62,504



Mineral Audit Staffing Adjustment Plan

PERA	10.40%	\$2,366	\$2,908	\$6,500
AED	5.00%	\$1,137	\$1,398	\$3,125
SAED	5.00%	\$1,137	\$1,398	\$3,125
Medicare	1.45%	\$330	\$405	\$906
STD	0.19%	\$43	\$53	\$119
Health-Life-Dental	\$780	\$2,340	\$3,120	\$9,360
Total Benefits		\$7,354	\$9,282	\$23,136
Operating for New Position		\$0	\$83	\$1,000

Office of Research and Analysis

In order to provide reporting support on the new data that would be collected by CDOR, the Office of Research and Analysis (ORA) has estimated the following hours of new workload based upon assumptions for level of effort using historical tracking of staff time for new reporting. All ORA expenditure costs are based on a Statistical Analyst III salary (\$40/hr). ORA assumes that an annual report is adequate for purposes of providing additional information to the General Assembly, however if more frequent or ad hoc reporting is anticipated, ongoing costs increase proportionally for report preparation and analysis.

Initial Fiscal Year (Fiscal year ending during the first tax year affected):

- \$19,200 - 480 hours for setting up the data mapping tickets and testing the data mapping and configuration of the database:
 - 40 hours for planning, meetings, and initial set up of tickets and mapping structure
 - 120 hours (8 hours per field for approximately 15 fields) for testing the mapping of fields on DR 0021PD
 - 80 hours (8 hours per field for approximately 10 fields) for testing the mapping of newly captured and added fields on DR 0021D
 - 40 hours (8 hours per field for approximately 5 fields) for testing the mapping of new aggregate fields on DR 0021
 - 200 hours (8 hours per field for approximately 25 fields) for miscellaneous fields on other severance forms that may need to be mapped (DR 0021S, DR 00020, DR 0020A, DR 0022, DR 0456, DR 0461, DR 0020E).

Second Fiscal Year:

- \$3,200 - 80 hours to initially set up the reporting methodology and produce the first report

Ongoing:



- \$320 - 8 hours per year to produce annual reports

Systems Support Office - Business Analyst and Business Testing Resources

The changes recommended in the RFI to generate new data for reporting will require GenTax programming (noted above) to be tested by Department personnel in several divisions to ensure the system is functioning properly. Every change to GenTax requires some amount of end user acceptance testing to ensure that the changes are made correctly and that all transactions and account activities post correctly. The changes recommended in the RFI are one-time changes and there is no ongoing cost for testing. Any future testing needs would be a result of other changes to severance tax law.

The Systems Support Office estimated both business analyst workload and end-user workload for testing and documentation as a result of changes based on the requirements developed in the scoping document.

Business Analyst workload typically includes meeting with the end-users and developers, developing formal scope of work, analyzing proposed changes for integration needs with existing system modules, planning/developing/creating test scenarios and packages, managing user acceptance testing, creating change log documentation, and creating end-user training materials. End-User testing workload typically includes meeting with the business analysts and developers to establish details for processes and scope of work, testing and retesting scenarios and documenting results, opening tickets for issues discovered during testing, affirming successful end-user testing, and receiving training on the system updates.

For fiscal note purposes, the Department typically categorizes end-user and business analyst resource hours in corresponding personal services dollars in order to hire temporary staff to back-fill the more standardized duties of existing staff when they are assigned legislative project implementations.

Total Business Analyst Hours	2,139	Total End-User Testing Hours	1,996	Total Hours	4,135
Business Analyst Temporary Rate (\$25.50/hour)	\$54,545	End-User Temporary Rate (\$23.99/hour)	\$47,884	Total Personal Services Dollars	\$102,429