House Bill 22-1391 Severance Tax Working Group

Update to Task Force to Legislative Oversight Committee Concerning Tax Policy
8.15.24

Severance Tax on Oil and Gas

Gross Income	Severance Tax Rate
Under $25,000	2%
$25,000 - $99,000	3%
$100,000 - $299,999	4%
$300,000 and above	5%

Ad Valorem Tax Credit

- Taxpayers can claim a severance tax credit equal to a percentage of the property taxes they paid on the value of their production.
- Inferred Purpose from 2020 OSA Evaluation: To equalize the combined severance and property tax liabilities of oil and gas taxpayers for wells located in different parts of the state.

SB 21- 281: 1st Severance Tax Working Group

Goals

Smooth Volatility	Ease Administration	Revenue Neutral
Many factors drive volatility, creating challenges for state administrators and tax beneficiaries	Complex filing, multi-year processes, and lack of transparent data make filing and administration more challenging than other taxes	Solutions that raise or lower revenue over multiple fiscal years were considered out-of-scope

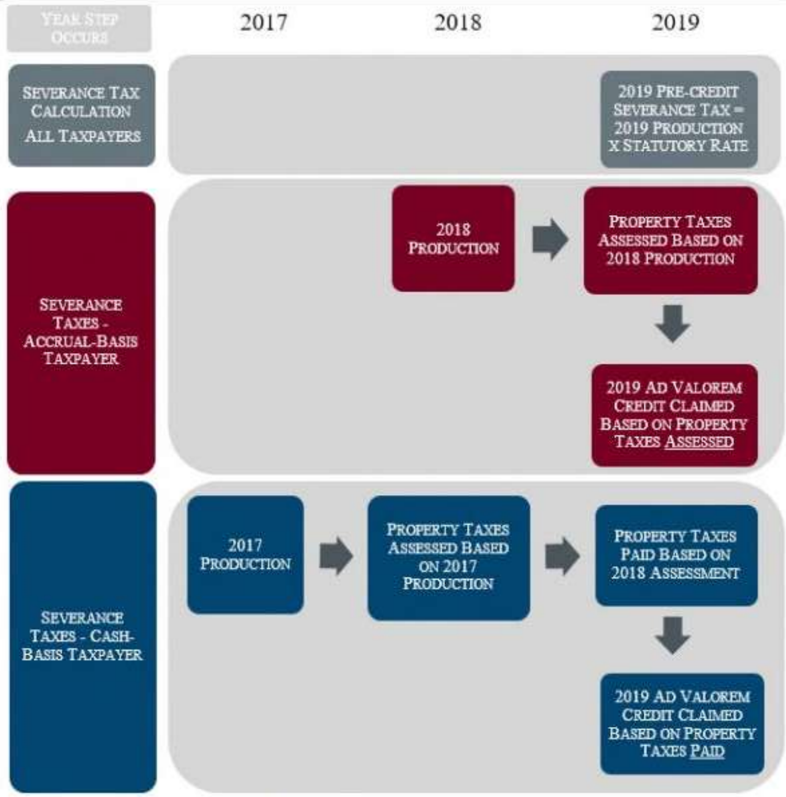
Who: OSPB, DNR, DOLA, DOR, CDE + input from public stakeholder group

Report: https://leg.colorado.gov/sites/default/files/sevtax-02-03-22.pdf

SB21-281 Working Group Recommendations

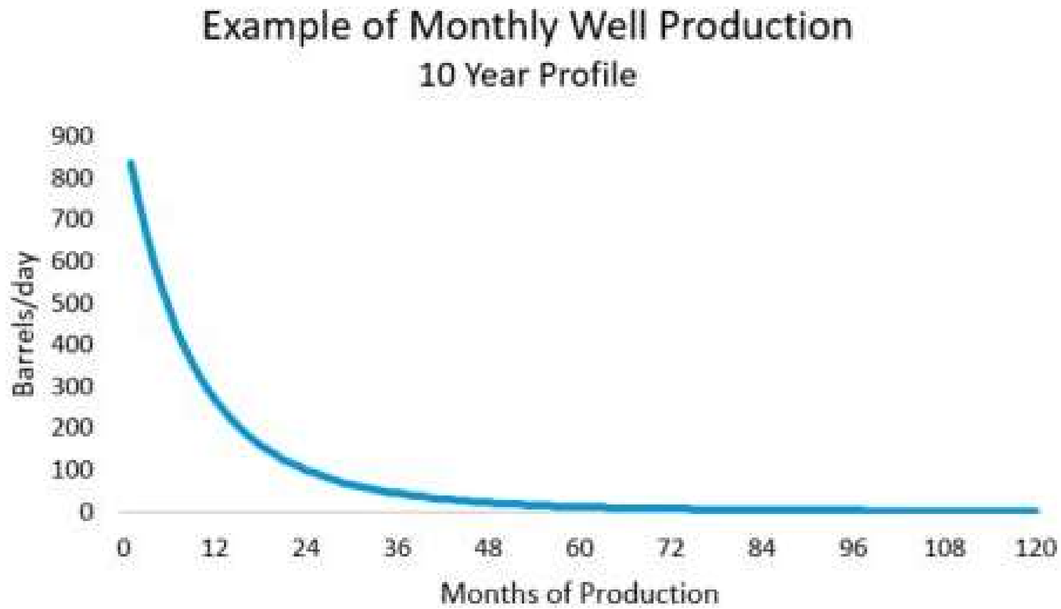
1. Shift from taxing all interest owners to only operators
2. Base the ad valorem tax credit on severance tax year gross income and prior year mill levy rate
3. Implement and require an electronic filing system
4. Require additional reporting
5. Further evaluate SB 21-281 impacts on metropolitan districts and additional considerations for metropolitan district service plan approval
6. Potential shifts in distribution methodology
7. Creation of a constitutional severance tax perpetual trust
8. Evaluate stripper well exemption thresholds

EXHIBIT 1.8. 1- AND 2-YEAR MISALIGNMENTS BETWEEN THE PRODUCTION YEARS USED TO CALCULATE THE AD VALOREM CREDIT AND SEVERANCE TAXES



SOURCE: Office of the State Auditor analysis of property tax and severance tax statutes.

Lag Time = Reduced AV Credits



Change in AV Credit Calculation

- Current: Statewide Credit = Credit % x [Local Property Tax Base] x [Actual Mill Levy Used]
- Future: Per Well Credit = Credit % x [State Severance Tax Base] x [Last Year's Mill Levy]
- Statewide Calc (Current) vs. Per-Well (Future)
- Reduced Lag Time

Effective Ad Valorem Credit Rates

Tax Year	% of Property Taxes That Can Be Used as Ad Valorem Credit
1977 - 2023	87.5%
2024	75%
2025	75%
2026	75%
2027 and future years	87.5%

HB22-1391 Topics

- Working group to develop an “implementation plan” with recommendations to:
  - Change legal incidence of tax from interest owners to operators, including the “legislative and administrative steps necessary to implement the change” (only O&G)
  - Require electronic filing of returns for severance taxes (all sev tax, including mining)
  - Require additional electronic data collection “necessary to ease the administration and enforcement of severance tax, including opportunities for increased data sharing among state and local government agencies” (only O&G)

HB22-1391 Topics (cont.)

- Group to also conduct “quantitative fiscal analysis” of:
  - Shifting the tax incidence to operators & recommendations to “reduce disruption to the state, local governments, and stakeholders” during and after the transition
  - Changes to the calculation of the Ad Valorem Credit
- Plan must make recommendations on how to implement these two changes “while maintaining revenue neutrality”

Who is in the State Workgroup?

- Department of Revenue
- Office of State Planning and Budgeting (Governor's Office)
- Policy Office (Governor's Office)
- Department of Natural Resources
- Department of Local Affairs
- Department of Education

Who are the Public Stakeholders?

So far, we have invited:

- Legislators
- Oil and Gas Industry
- Local Governments
- Special Districts
- Agriculture Groups
- Environmental Groups

Timeline

- Public & Technical Working Group meetings held in July 2022 and March 2023
- Working Group implementation plan must be submitted to JBC by January 15, 2025
- Prior to submission, public stakeholder group "shall have an opportunity to review the draft recommendations and individual stakeholders may provide comments in response to the implementation plan"
- At least 3 more meetings scheduled: 9/11, 9/23, 10/16

Potential Draft Recommendations

1) **Making operators liable for remitting the tax (statutory change)**
   - Not fully changing legal incidence of tax, given challenges
   - This eliminates the need for monthly withholdings, though the requirement for estimated payments remains
   - This would be accompanied by moving from a tiered to a flat sev tax rate (likely somewhere around 4.9% for all taxpayers)

Potential Draft Recommendations

2) Make electronic filing mandatory for operators (administrative change)

- Would have a cost to DOR

Potential Draft Recommendations

3) Require the collection of additional data points on the DR0021D and DR0021PD Form (administrative change)

- Taxpayers are not always submitting this data
- May slightly increase burden for taxpayers, but more addressable given only operators would file
- Opportunities to coordinate with data from ECMC's production report

Potential Draft Recommendations

4) Since overall AV credit changes are revenue negative, recommend adjusting the severance tax rate or eliminating cross-crediting as an offset for revenue neutrality (statutory change)

- There are three main revenue levers here. The credit calc changes the timing of AV credits & uses the state sev tax base rather than the locals' property tax base. These two changes are revenue negative to the State.
- But we can eliminate the "cross-crediting" of unused AV credits from one well to others. Doing so would be revenue positive.
- If an additional lever is needed for revenue neutrality, it could be slightly adjusting the (now flat) sev tax rate.

Additional Work Required

- DOR working on quantitative analysis of AV credit changes
  - Timing change / Using Last Year's Mill Levy = Revenue Negative
  - Switch from Local Property Tax to State Sev Tax Base = Revenue Negative
  - If we potentially eliminated "Cross-Crediting" = Revenue Positive

- Determining whether we can arrive at consensus on State-Local data sharing