



SB21-281

# Severance Tax Work Group

February 3rd, 2022

# SB21-281 Severance Tax Work Group

- SB21-281 directed Executive Branch Departments to work with stakeholders to evaluate and make recommendations to the JBC on various aspects of the severance tax system.
  - OSPB, DOR, DNR, DOLA, and CDE participated
- Governor Polis further directed the Working Group to focus particularly on revenue-neutral adjustments that would smooth year over year volatility and ease administration of the tax.

# Executive Branch working group

## DOR-led group

- Tax Structure
- Data Collection
- Tax Filings
- Process Efficiency

## DOLA-led group

- Taxes paid by industry to special districts

## OSPB-led group

- Tax expenditures
- Allocation of tax revenues

# Goals

## Smooth volatility

Many factors drive volatility, creating challenges for state administrators and tax beneficiaries

## Ease administration

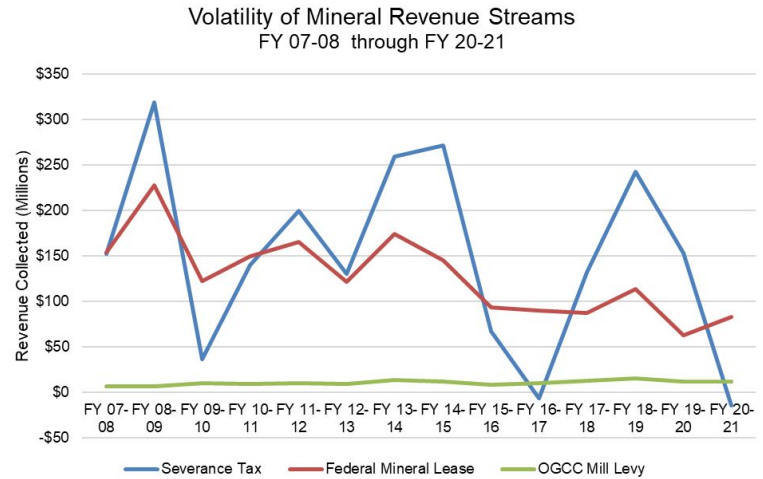
Complex filing, multi-year processes, and lack of transparent data make filing and administration more challenging than other taxes

## Revenue neutral

Solutions that raise or lower revenue over multiple fiscal years were considered out-of-scope

# Revenue Volatility

- The inherent volatility of mineral commodity prices is not solely to blame for the volatility of severance tax revenue.
- While all Colorado revenue sources derived from extracted minerals demonstrate volatility, severance tax displays by far the most volatility.
- The volatility displayed in year over year revenue collections presents significant challenges to tax beneficiaries.



# Tax Administration

- The complexity of the state severance tax filing structure puts strain on both administrators and taxpayers.
- Numerous tax rates, credits, deductions, and exemptions exist for each commodity type subject to severance tax.
- Variation in tax periods for different taxpayers and the interaction with local property taxes also complicate administration.

# Stakeholder Group

## Representatives:

- Industry
- Royalty owners
- Local Governments
- Environmental advocates
- Legislative partners
- Beneficiaries

## Process:

- Two open public meetings (virtual)
- Significant direct outreach and discussions with stakeholders
- Two formal comment letters submitted

# Recommendations

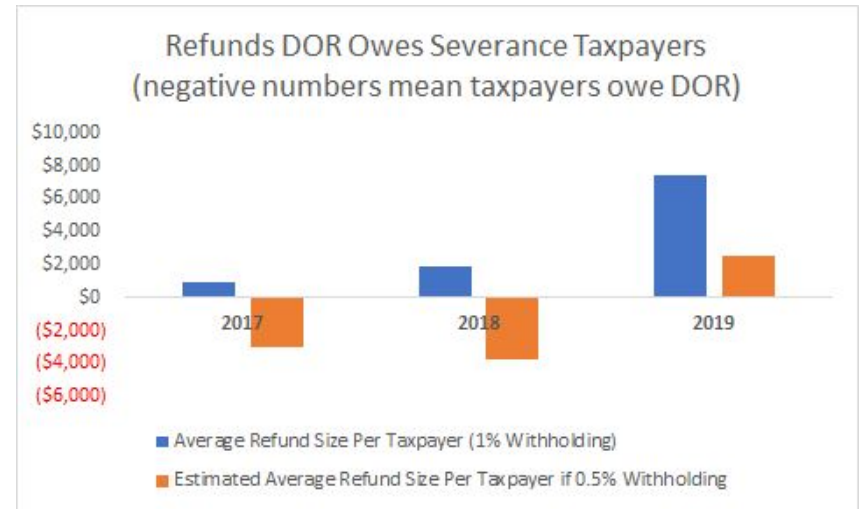
The following recommendations will require continued engagement with legislators and stakeholders prior to adoption.

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# #1: Shift from taxing all royalty owners to only operators

- This change would substantially consolidate the taxpayer base and could realize concomitant filing and process efficiencies.
- Concurrent changes in the tax period could improve the predictability of the revenue stream and could even eliminate most refund claims.
- The operator would be solely liable for the severance tax imposed upon gross income.

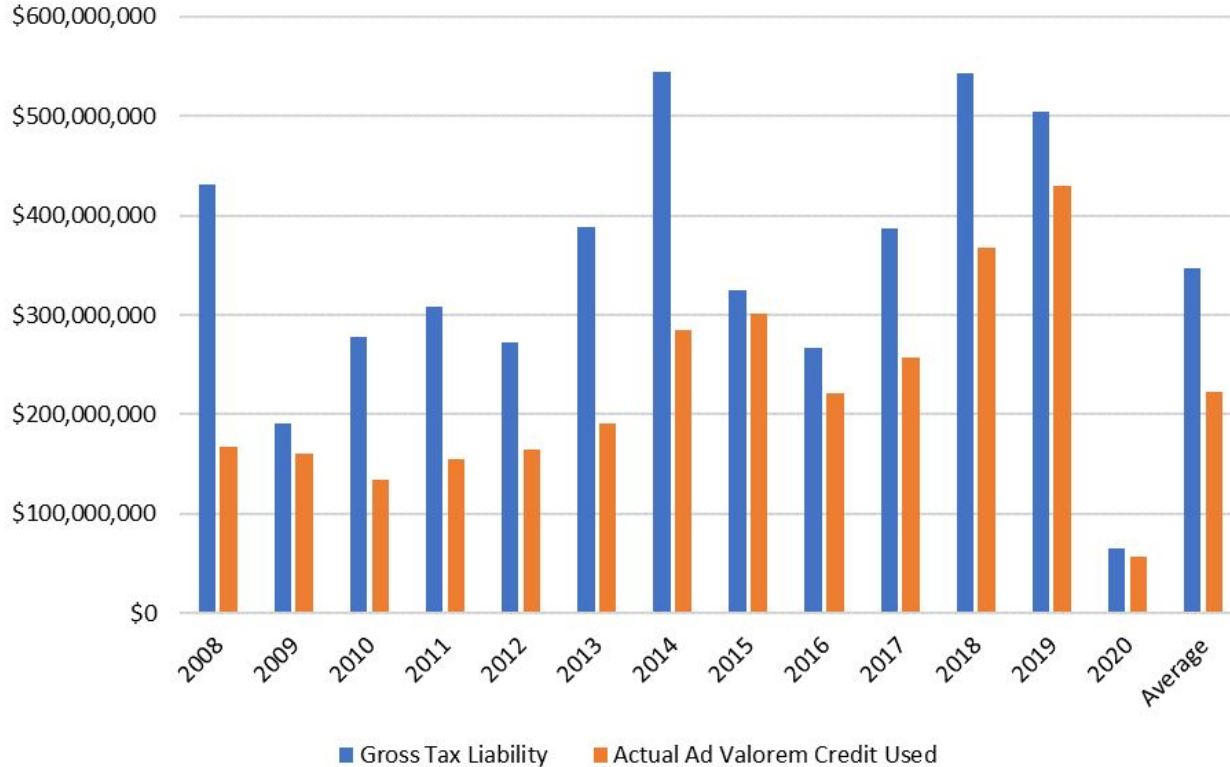


## #2: Base ad valorem credit on proxy mill levy rate

- The gap between production, payment of ad valorem taxes, and payment of severance tax is a major contributor to volatility.
- Ad valorem tax credits lag production by at least a full year. This exacerbates swings in commodity prices.
- Under this proposal, taxpayers would calculate their ad valorem credit by applying the prior year's mill levy to their current year's gross income multiplied by the assessment rate of 87.5%, effectively closing the 1-2 year gap.

# Ad Valorem Credits

Gross Tax Liability vs. Actual Ad Valorem Credit Used  
2008-2020



## #3: Implement electronic filing system

- The severance tax return filing process is currently a paper-based process and the data that is captured for reporting is limited.
- Shifting to an electronic filing system would ease the filing and administration process for all involved.
- E-filing would also allow for more granular reporting (discussed below).
- Also provides an opportunity to link data with DOLA and OGCC

## #4: Additional reporting requirements

- The work group recommends the collection and reporting of additional data during the tax filing process.
- Such reporting will allow for more granular analysis of the tax and give decisionmakers more information when making policy decisions.

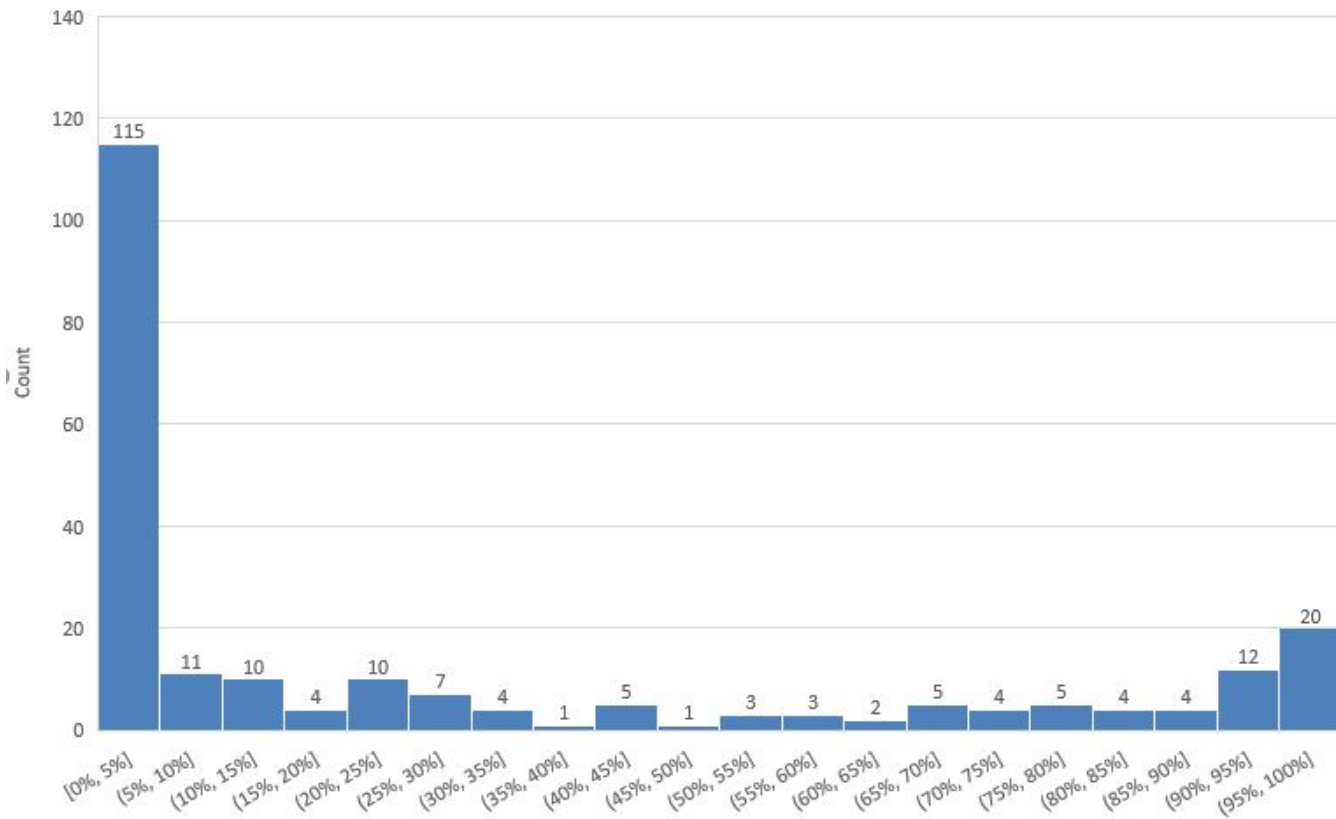
### Additional reporting:

- NERF data; per-well reporting of gross income and ad valorem credit; include well API # on all tax forms w/ well information listed; Stripper well informational return; Make all of the above searchable and reportable in Gentax

## #5: Further evaluate impact of metropolitan districts

- Evaluate the financial impacts of SB21-281 provisions at least one full reporting year.
- Add language to 32-1-203 requiring counties/municipalities to consider impacts on all taxpayers, including mineral interest owners, during the review of metro district service plans.
- Add language to 32-1-107 requiring metro districts to submit evidence that no other district within their boundaries provides or is intended to provide the same services.

Property Taxes from Severed Minerals (metro districts with levy and severed minerals valuation)



## #6: Consider shifts in distribution methodology

- Multiple potential distribution methodologies were considered:
  - Quarterly distributions model could help smooth monthly revenue fluctuations and “clawbacks”, but could also result in cash flow issues for state agencies.
  - An arrears funding model could increase certainty of allocations for beneficiaries, but would require significant one-time funds to make shift.
- Neither option would address the inherent volatility of the tax.



## #7: Create perpetual trust

- Colorado has historically allocated almost all severance tax revenues in the year in which it is collected. Other Western states have created permanent funds:
  - Wyoming and New Mexico's trusts have current market values of \$9.2B and \$6.3B, respectively
- The creation of a trust would allow Colorado to save during big revenue years to distribute during downturns
- Likely requires a revenue cap, above which dollars flow into fund
- Distribution methodology would need to be carefully considered
- Unless created constitutionally, future Legislatures could tap funds.

## #8: Evaluate stripper well exemption

- Exemption is understood to encourage production from low producing wells that might otherwise be plugged, abandoned, or shut in.
- Stripper wells are not exempt from local property taxation
- The thresholds for stripper wells have not been examined since 2000
- Other states' stripper well exemptions depend on commodity values
- Changes to the stripper well exemption could lead to more orphaned wells for the state to plug and reclaim, as well as a loss of local property tax revenue from that production.

# Which recommendations will be most effective in mitigating volatility?

## Revenue Collection

1. Ad valorem credit
  - a. Cash > accrual
  - b. Reduce lag
2. Reduce withholding rate from 1% to 0.5%

## Revenue Distribution

1. Arrears annual distribution model
2. Constitutional severance tax perpetual trust



# **SB21-281 Severance Tax Work Group**

## **Recommendations**

December 2021

**Prepared by:**

The Governor's Office of State Planning and Budgeting  
The Colorado Department of Natural Resources  
The Colorado Department of Local Affairs  
The Colorado Department of Revenue  
The Colorado Department of Education

## **Executive Summary:**

### ***SB21-281:***

SB21-281 directed a team of Executive Branch Departments to work with severance tax stakeholders to evaluate and make recommendations to the Joint Budget Committee on various aspects of the severance tax system.

Governor Polis further directed the Working Group to focus particularly on revenue-neutral adjustments that would smooth year over year volatility and ease administration of the tax.

### ***Background:***

Severance tax is imposed on nonrenewable natural resources that are removed from the earth. Royalty owners in extraction activities are taxed at various rates utilizing various tax bases depending on the value and/or volume of the commodity extracted.

Various credits, deductions, and exemptions are available to taxpayers.

Severance tax revenue is distributed to various local and state government programs on a monthly basis as revenue is collected.

Market conditions and credits, deductions, and exemptions lead to extreme revenue volatility, which harms beneficiaries.

### ***Recommendations:***

As the result of significant research, stakeholder outreach, and consideration, the Working Group recommends that the Joint Budget Committee work with stakeholders and impacted Departments to consider the following adjustments to the severance tax code.

Recommendations are discussed in greater detail below.

1. Shift from taxing all interest owners to only operators
2. Base the ad valorem 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 SB21-281 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

## **Senate Bill 21-281:**

SB21-281 (Severance Tax Trust Fund Allocation) directed a team of Executive Branch Departments to evaluate and make recommendations to the Joint Budget Committee on:

- tax structure
- data collection
- tax expenditures
- taxes paid by industry to special districts
- tax filings and process efficiencies
- the allocation of the tax revenues

This team included members from the Governor's Office of State Planning and Budgeting (OSPB), the Department of Revenue (DOR), the Department of Local Affairs (DOLA), the Department of Natural Resources (DNR), and the Department of Education (CDE). Given the collective expertise of severance tax stakeholders, the bill also directed our team to bring together a group of impacted stakeholders to assist in our analysis. The working group convened two public meetings and conducted significant direct outreach to impacted stakeholders. Stakeholders engaged include representatives from extractive industries, royalty owners in extractive activities, local governments, environmental advocates, and beneficiaries of tax revenues. The working group extends its gratitude to the stakeholders engaged for their significant input and effort in this process. Finally, the bill presented an opportunity for stakeholders to review the draft recommendations and provide comments prior to their submission to the Joint Budget Committee on December 15th, 2021.

In addition to the goals laid out in SB21-281, Governor Polis directed the Executive Branch team to specifically evaluate and recommend revenue neutral adjustments to the severance tax code and processes that aim to reduce year over year revenue volatility and ease administration of the tax. This was intended to ensure meaningful improvements to the operation of our severance tax system without an overall increase to the state tax burden of oil and gas producers. In order to accomplish this, our team divided into three small groups of subject matter experts. One group, led by DOR, evaluated improvements to data collection, tax structure, and tax filings and process efficiencies. The second group, led by DOLA, evaluated taxes paid by industry to special districts. The third and final group, led by OSPB, evaluated tax expenditures and the allocation of tax revenues.

## **Background:**

### ***Taxation:***

The severance tax, enacted in 1977, is imposed on nonrenewable natural resources that are removed from the earth, such as metallic minerals, molybdenum/ore, oil, gas, and coal. Anyone who receives income from oil and gas production and mining must file a severance tax return, even if the producer is unsure they will have a net profit. Revenue collected pursuant to oil and gas production make up the vast majority of gross collections each year (96% in FY20-21). Taxes are remitted to the Department of Revenue (DOR) on a monthly, quarterly, or

annual basis, depending on the commodity being taxed and the overall tax liability. The year-end filing deadline is April 15th. Numerous tax rates, credits, deductions, and exemptions exist for each commodity type subject to severance tax.

It is important to note that Internal Revenue Code Section 164(a) allows businesses (including any person operating a trade or business) to deduct most state and local taxes they pay on their income tax returns, including severance tax. As a result, any increase or decrease in effective severance taxes they pay will to some extent be offset by a decreased/increased income tax liability. Those businesses with insufficient income tax liability in a given year to use their full deduction can “carry it forward” to future tax years as a net operating loss deduction.

### **Tax Rates:**

- Colorado is one of two states, the other being Idaho, that assesses severance tax on the basis of gross income<sup>1</sup>:
  - 2% for gross income under \$25,000
  - 3% for gross income between \$25,000 and \$99,999
  - 4% for gross income between 100,000 and \$299,999
  - 5% for gross income over \$300,000
  - Note: because gross income is the basis for the tax, any product extracted but not used (e.g. flaring and venting activities) is not taxed.
- Coal tax rates are assessed on the basis of per ton production of coal:
  - Currently \$0.824 per ton above statutory exemption amounts, though adjusted each month (detailed below)
- Metallic mineral tax rates are assessed on the basis of gross income:
  - 2.25% at all levels of gross income
- Molybdenum tax rates are assessed on the basis of per ton production of molybdenum:
  - \$0.05 per ton above statutory exemption amount (detailed below)
- Oil shale tax rates are assessed on the basis of gross income, depending on the year of commercial production:
  - 1% in the first year of commercial production
  - 2% in the second year of commercial production
  - 3% in the third year of commercial production
  - 4% in the fifth year of commercial production and beyond

### **Credits, Deductions, and Exemptions:**

- **Oil and Gas:**
  - Up to 15 barrels per day of oil is exempt from taxation
  - Up to 90,000 cubic feet of gas per producing day is exempt from taxation
  - All costs related to transportation, processing, and manufacturing - including personal property taxes on property/equipment used to transport, process, and manufacture the oil and gas - are deductible from calculations of gross income (these are known as “netback deductions”)

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<sup>1</sup><https://www.ncsl.org/research/energy/oil-and-gas-severance-taxes.aspx>

- A tax credit is allowed equal to 87.5% of all property taxes paid to local governments and special districts on oil and gas leaseholds and lands, except for those imposed on equipment and facilities used for production, transportation, and storage.
- Gross income accruing to federal, state, and tribal governments is exempt from taxation
- **Coal:**
  - Tonnage exemption:
    - In the 2021 tax year, the first 300,000 tons per quarter were exempt from taxation
    - In the 2022 tax year, the first 240,000 tons per quarter are exempt from taxation
    - In the 2023 tax year, the first 180,000 tons per quarter will be exempt from taxation
    - In the 2024 tax year, the first 120,000 tons per quarter will be exempt from taxation
    - In the 2025 tax year, the first 60,000 tons per quarter will be exempt from taxation
    - In the 2026 tax year, zero tons per quarter will be exempt from taxation
  - Underground and/or lignitic coal credit:
    - In the 2021 tax year, 50% of the severance tax liability for coal produced by underground mines or for lignitic coal was credited to taxpayers
    - In the 2022 tax year, 40% of the severance tax liability for coal produced by underground mines or for lignitic coal will be credited to taxpayers
    - In the 2023 tax year, 30% of the severance tax liability for coal produced by underground mines or for lignitic coal will be credited to taxpayers
    - In the 2024 tax year, 20% of the severance tax liability for coal produced by underground mines or for lignitic coal will be credited to taxpayers
    - In the 2025 tax year, 10% of the severance tax liability for coal produced by underground mines or for lignitic coal will be credited to taxpayers
    - In the 2026 tax year, no severance tax liability for coal produced by underground mines or for lignitic coal will be credited to taxpayers
- **Metallic Minerals:**
  - The first \$19 million in gross income is exempt from taxation
  - A tax credit is allowed equal to 50% of the property taxes paid to local governments or special districts on producing mines
- **Molybdenum:**
  - The first 625,000 tons of production are exempt from taxation
- **Oil shale:**
  - The greater of the first 15,000 tons per day or the first 10,000 barrels per day are exempt from taxation



### ***Distribution of Revenues:***

Section 39-29-108, C.R.S. directs that 50% of severance tax revenue be deposited into the State Severance Tax Trust Fund and 50% be deposited into the Local Government Severance Tax Trust Fund.

#### **Local Government Severance Tax Trust Fund**

- The Local Government Severance Tax Trust Fund is administered by the Department of Local Affairs (DOLA) to assist local governments.
- 70% of DOLA allocations are used in local impact grant and loan funds to provide discretionary loans and grants to local governments socially or economically impacted by the mineral extraction industry for planning, construction, and maintenance of public facilities, as well as the provision of public services. This funding also supports Department operations and administration (\$3.9M) and an annual transfer to CDPHE for uranium mill tailings remediation action program (\$0.3M).
- The remaining 30% of DOLA funds are directly distributed by statutory formula to local governments impacted by oil, gas, and mining activities.

The Department of Natural Resources (DNR) receives the other half of severance tax revenues. Of this amount, one half is deposited into the Perpetual Base Account and is used by the Colorado Water Conservation Board for water projects.

#### **Severance Tax Perpetual Base Fund**

- The Perpetual Base Fund finances loans for state water projects administered by the Colorado Water Conservation Board to construct or improve flood control, water supply, hydroelectric energy, and recreational facilities. The Fund was also authorized by SB21-281 to fund three former Operational Fund Grant Programs: the Water Supply Reserve Fund, Water Efficiency Grants, and the Interbasin Compact Committees.

#### **Severance Tax Operational Fund**

- The other half of DNR's severance tax revenue is deposited into the Severance Tax Operational Fund.
- Revenue is first spent on Core Programs. Core programs include programs administered by:
  - the Colorado Oil and Gas Commission
  - the Avalanche Information Center
  - the Colorado Geological Survey
  - the Division of Reclamation, Mining, and Safety
  - the Colorado Water Conservation Board
  - the Division of Parks and Wildlife
  - Revenue is next used to fund the Species Conservation Trust Fund (SCTF), the Aquatic Nuisance Species (ANS) program, and Soil Conservation Grants.
  - Finally, funds are used to ensure there is a full reserve in place to protect those Core Programs (excluding SCTF, ANS, and Soil Conservation grants). The

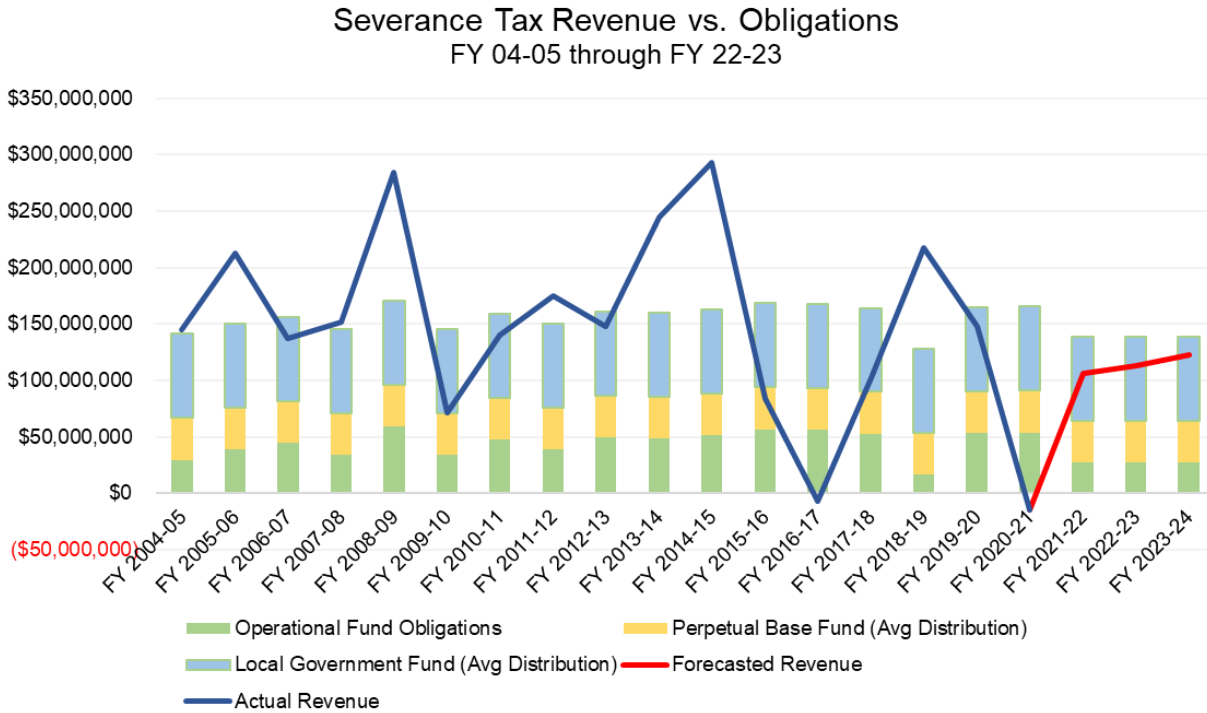
current Core Program reserve is 200% of annual appropriations, as established by SB21-281.

- Excess money is then spent on Natural Resource and Energy Grant Programs, including:
  - clean energy development
  - wildlife conservation (CPW)

**Revenue History/Volatility:**

Table 1, below, shows year over year severance tax collections since FY04-05 (blue line actuals; red line projections) set against severance tax liabilities (annual appropriations for Operational Fund programs; 15-year average Perpetual Base Fund allocations; 15-year average Local Government Fund allocations).

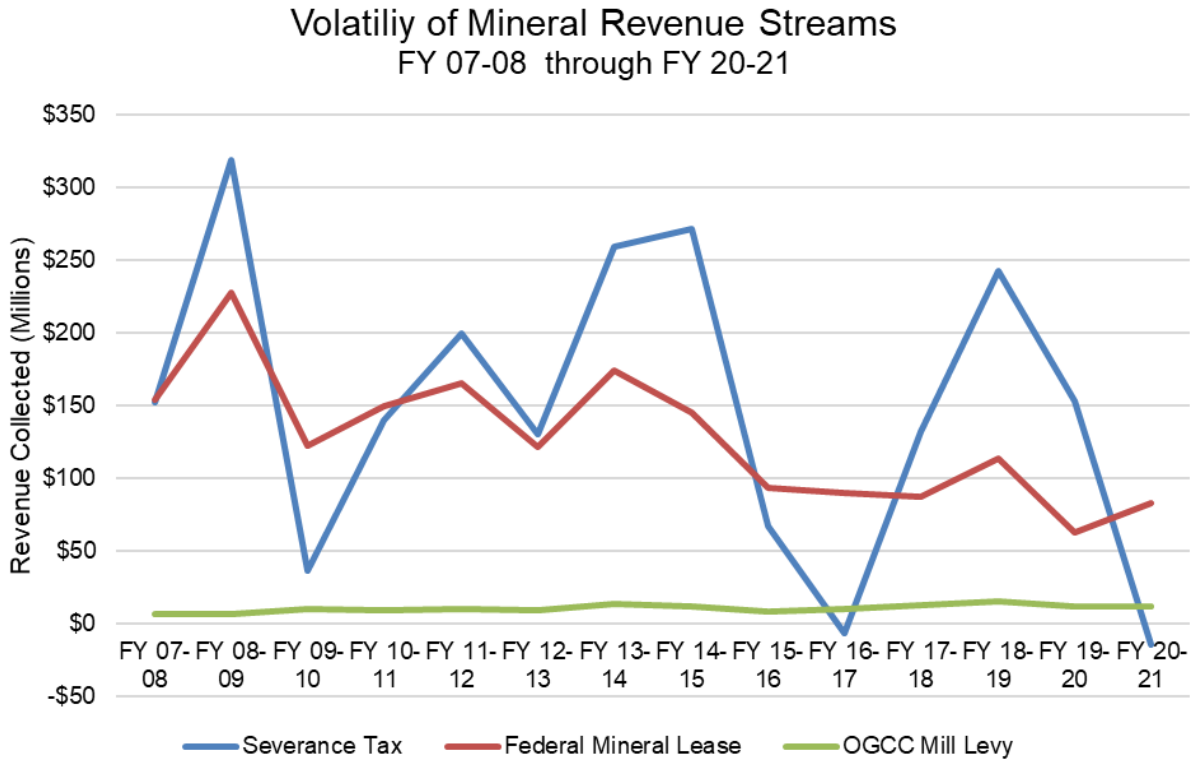
Table 1: Severance Tax Revenue vs. Obligations [FY 04-05 through FY 22-23]



The inherent volatility of mineral commodity prices is not solely to blame for the volatility of severance tax revenue. Indeed, Colorado benefits from three revenue streams based on the value of extracted minerals: severance tax, Federal Mineral Lease revenue, and the Oil and Gas Conservation Commission (OGCC) mill levy. While all three demonstrate volatility, severance tax displays by far the most volatility. The relative standard deviation (RSD) of severance tax revenue on a yearly basis is ~70%. Meanwhile, the RSD of Federal Mineral Lease revenue and OGCC mill levy revenue is 35% and 25%, respectively. Table 2, below,

demonstrates this dynamic<sup>2</sup>. The volatility displayed in year over year revenue collections presents significant challenges to tax beneficiaries.

Table 2: Volatility of Mineral Revenue Streams [FY 07-08 through FY 20-21]



<sup>2</sup> Federal Mineral Lease data from Legislative Council Staff, Severance Tax Revenue data from the Department of Revenue, and OGCC mill levy data from the OGCC

## **Recommendations:**

As the result of significant research, stakeholder outreach, and consideration, the Working Group recommends that the Joint Budget Committee work with stakeholders and impacted Departments to consider the following adjustments to the severance tax code.

### **1. Shift from taxing all interest owners to only operators**

Currently, the tax is imposed upon the interest owner.<sup>3</sup> The operator generally has an obligation to withhold 1% of the amount owed to the interest owner to cover the severance tax.<sup>4</sup> The interest owner then claims a credit for the amount withheld when making their annual severance tax return, either paying or obtaining a refund of the difference.<sup>5</sup> Corporate severance taxpayers also have an obligation to make estimated payments in the same manner as the income tax, to the extent the withholdings will be insufficient to cover the tax.<sup>6</sup>

In a January 2020 report, the Office of the State Auditor found this structure to be inconsistent with several principles of good tax policy, namely efficient and effective administration, certainty, and simplicity.<sup>7</sup> The report cited a number reasons for this finding:

- Taxing at the interest owner level significantly increases the number of taxpayers required to make a return.<sup>8</sup>
- If operators do not provide DOR with detailed withholding statements, DOR may be unable to determine whether all taxpayers have filed required returns.<sup>9</sup>
- The statutory requirements for who is legally responsible when the interests are owned by one or more members of a combined group, or by an entity taxed as a partnership for federal income tax purposes, are unclear.<sup>10</sup>

The working group suggests that policy makers consider shifting the tax from the interest owner to the operator. Significantly, this would be a change in the legal incidence of the tax, not just the reporting structure. The operator would be solely liable for the severance tax imposed upon gross income attributable to the sale of oil and gas produced from wells operated by such operator.

Changing the legal incidence of the tax has several advantages. First, it would consolidate the taxpayer base. There are currently over 13,000 active oil and gas severance accounts. DOR estimates that figure could be reduced to as few as 200. Because operators often own interests in their wells, these remaining taxpayers are likely already filing severance

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<sup>3</sup> 1 CCR 201-10, Rule 39-29-105–1(1).

<sup>4</sup> Section 39-29-111(1), C.R.S.

<sup>5</sup> *Id.* at (2).

<sup>6</sup> Section 39-29-112(2), C.R.S.

<sup>7</sup> Office of the State Auditor, Colorado General Assembly, Report No. 1928P, *Severance Taxes* 49 (Jan. 2020) (*hereinafter* “OSA Report”).

<sup>8</sup> *Id.*

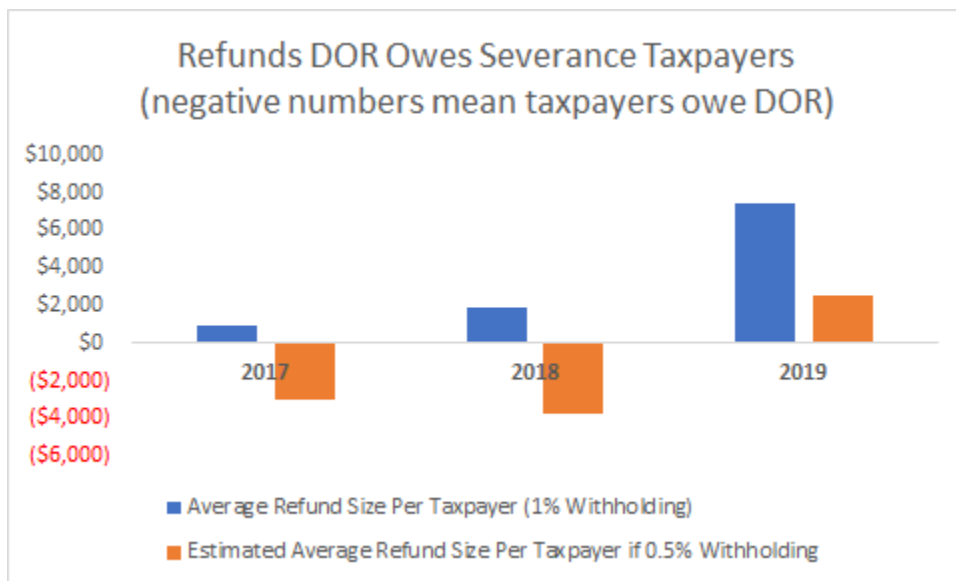
<sup>9</sup> *Id.* at 50. Requiring these statements was also an audit finding, which DOR has remedied. See recommendation 4 starting at page 42 of the OSA Report.

<sup>10</sup> OSA Report at 51.

tax returns and are familiar with the process. Furthermore, these taxpayers are likely to have greater resources for tax compliance, as they are often filing similar tax returns in multiple states. Kansas and Montana, for example, currently tax and collect solely from the operator.<sup>11</sup> Finally, operators have greater access to the information necessary to complete the return, as they are the parties incurring processing and transportation costs. Operators also handle the property tax reporting and payment, which is essential to computing the ad valorem credit.

In addition to reducing the number of taxpayers, the withholding system could be eliminated. Like other withholding requirements, the requirement to withhold severance taxes from payments to interest owners is intended to increase compliance and avoid creating collection issues by collecting the tax before the taxable base is in the hands of the taxpayer. If the tax is imposed upon operators, there is not a need to withhold from interest owners who no longer have a liability. Even without a withholding requirement, policy makers should continue requiring estimated payments from operators to spread the payment out over the tax year and avoid collection issues. Table 3, below, estimates refund amounts per taxpayer under the current 1% withholding rate against a potential withholding rate of 0.5%.

Table 3: Refunds Owed by DOR to Severance Tax Payers



Alternatively, the tax period could be changed to a shorter period and payment could be required on an actual basis. For example, returns could be required on a monthly or quarterly basis, rather than the current annual return. Because of the withholding and estimated payment requirements, the current annual return is a reconciliation mechanism where the difference between the actual liability and the tax-year prepayments and withholding amounts are settled up. Conversely, with a more frequent reporting and actual payment requirement, taxpayers could compute and pay the actual liability with the return, limiting refunds to cases of mistaken overpayment and amended returns. The severance tax on molybdenum ore currently functions this way, as does the sales tax and various excise taxes. Depending upon the level of detail

<sup>11</sup> *Id.* at 50.

necessary to meet the data collection goals, monthly filing may be necessary to keep the return to a manageable level of information.

Consolidation of the taxpayer base has some potential drawbacks. For one thing, without careful consideration of rate structure and/or attendant credit structure changes, the change would probably not be revenue neutral. The tax rate is progressive, with marginal rates ranging from 2% to 5% based upon a taxpayer's total gross income. Total gross income would be significantly consolidated, pushing more into the highest tax bracket if the rate is not changed. The rate structure would also need to account for changes to the length and frequency of the tax period, if pursued. These potential revenue impacts might be able to be addressed by creating a new income tax credit for either interest owners or operators.

To maintain revenue neutrality, operators should be allowed to deduct any income paid directly to an exempt entity, such as the federal government. The gross income earned by the United States, the state of Colorado, any political subdivision of the state, the Southern Ute Indian Tribe, and the Mountain Ute Indian Tribe are exempt from the severance tax.<sup>12</sup> Operators are exempt from withholding from these entities.<sup>13</sup>

As with any change, there will be costs for both DOR and for taxpayers to adjust to the new structure. Forms and instructions will need to be redesigned with attendant programming, and taxpayers will have corresponding costs on their end. Rules, guidance publications, and other materials will need to be revised.

There will be transaction costs for operators and interest owners as well. They will have structured their relationship around the existing severance tax regime. DOR does not know the extent of the impact on those agreements. If the operators do not pass on the costs of the tax directly, but rather account for the tax in setting royalty rates, the tax will lose a degree of transparency, which is often a risk when the legal and economic incidence of a tax fall on different parties.<sup>14</sup> Operators will experience similar process costs to restructure their tax compliance systems and processes.

The differing tax years and ad valorem credit years could make the transition challenging. A taxpayer's severance tax year is the same as the taxpayer's income tax year.<sup>15</sup> Most individuals file income taxes on a calendar-year basis. For a variety of reasons, however, businesses may operate on a fiscal-year basis and file their taxes accordingly. This could mean that the operator of the well (usually a business concern) has a different severance tax year than some or all of the interest owners.

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<sup>12</sup> *Id.* at (2).

<sup>13</sup> Section 39-29-111(1), C.R.S.

<sup>14</sup> Transparency is often cited as another principle of sound tax policy. *E.g.* David Brunori, *State Tax Policy: A Primer* 63-64 (4th ed. 2016). It occurs when the "taxpayer" (that is, the person who bears in fact the economic burden of the tax) knows the amount of the tax being paid and can evaluate that payment against the services received from the government in return. *Id.* This evaluation could not occur if the severance tax were incorporated into the royalty payment offered by the operator.

<sup>15</sup> Section 39-29-112(5), C.R.S. A change to this policy could easily coincide with the shift of the incidence, and could improve the predictability of the revenue cycle. Such a change could also accompany a change to the length and frequency of the tax period itself as discussed above.

Not only may the tax years differ among the operator and the interest owners, but the ad valorem credit for a particular property tax period may accrue at different times. This occurs because of the cash- versus accrual-basis distinction in the statute illustrated above. Most operators (being business concerns) keep their books on an accrual basis, whereas most individuals are on a cash basis.

Because calendar-year filing is more common (even among business taxpayers),<sup>16</sup> it would be best to transition as of the end of a calendar year. That would mean short tax years for fiscal-year filers, which would increase the administrative burden. However, a further burden would be imposed either by a second short tax year (beginning January 1 under a new system and ending at the conclusion of each operator's fiscal year). For the transition year, every taxpayer could be offered an ad valorem credit equivalent in the same manner as the credit discussed in the next section.

In addition, an OSA [evaluation](#) indicated that many interest owners are not claiming the netback deductions due to lack of familiarity with the state severance tax system. Some interest owners share in operators' transportation, processing, and manufacturing costs, and so are able to claim the deductions. Shifting the tax incidence to operators, if accompanied by a restructuring of production contracts to reflect the new tax structure, will likely significantly reduce the percentage of allowable netback deductions not claimed, since operators are less likely to fail to claim them. Similarly, 2017-2019 data indicates that, on average, 14% of oil and gas severance tax returns do not include an ad valorem credit claim. While some of these taxpayers are not claiming the credit because they aren't eligible, it might still suggest taxpayers are failing to claim credits they are eligible for, an issue operators are more unlikely to overlook. Indeed, in 2019, 18% of royalty owner taxpayers did not claim an ad valorem credit, while only 8% of operator taxpayers failed to claim it. Royalty owners currently account for about 13% of net oil and gas severance taxpayers, which suggests that revenue impacts from increased deduction and credit claims are likely to be relatively small, but not insignificant.

To summarize, changing the imposition of the tax from interest owners to operators substantially consolidates the taxpayer base and could realize concomitant filing and process efficiencies. Concurrent changes in the tax period could improve the predictability of the revenue stream and could even eliminate most refund claims. Policy makers will need to decide whether the costs of such a transition would outweigh these benefits.

## **2. Base the ad valorem credit on severance-tax-year gross income and prior-year mill levy rate.**

C.R.S 39-29-105 (2)(a) grants each severance taxpayer the ability to claim a credit equal to 87.5% of the ad valorem (property) taxes assessed or paid on oil and gas leaseholds and royalties during the taxpayer's taxable year as an offset to their current year's severance tax liability. Property taxes paid upon equipment and facilities used for production, storage, or transportation of a commodity are not subject to the allowable credit. Neither are property taxes

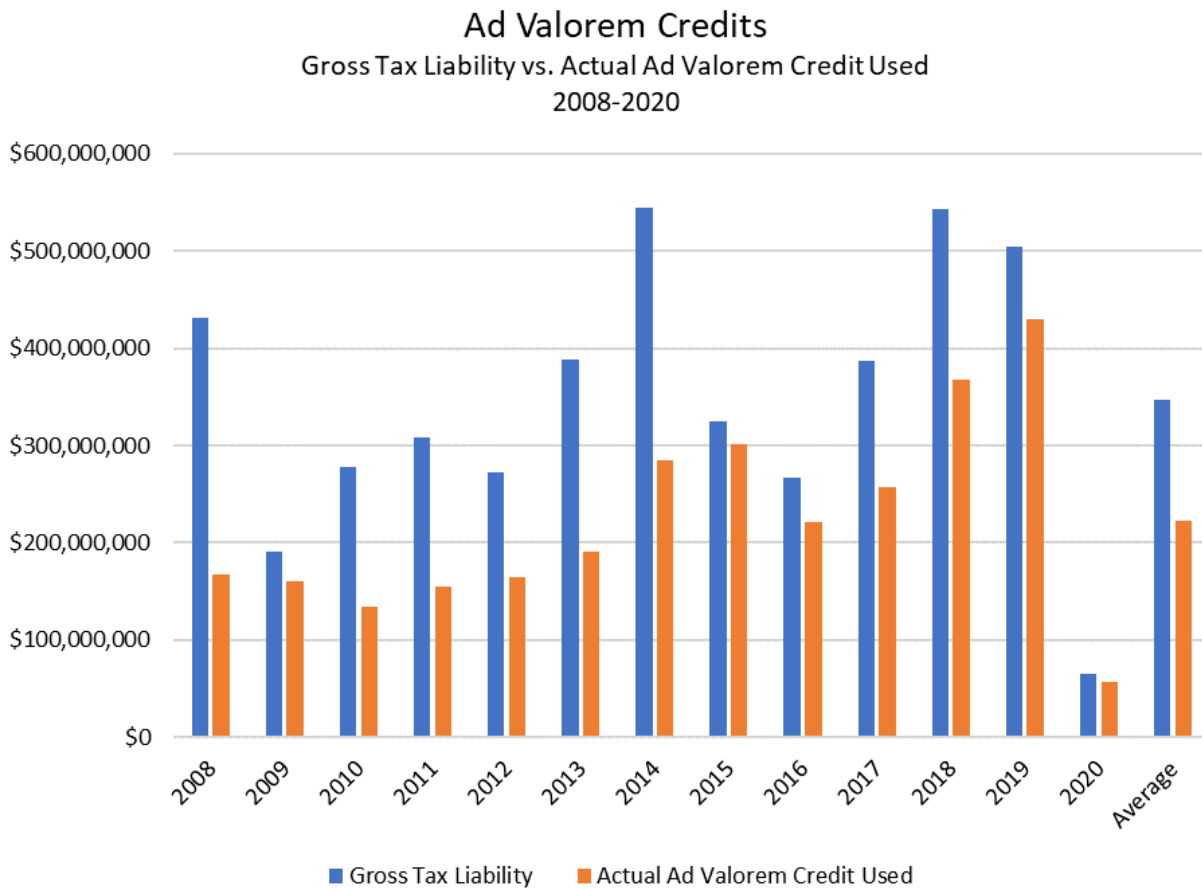
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<sup>16</sup> For reference, there are currently around 100 oil and gas severance tax accounts (out of approximately 13,000 active accounts) registered as fiscal-year filers.

paid on stripper wells (those that produce less than fifteen barrels per day of oil or less than ninety thousand cubic feet of gas per day) subject to the allowable credit. It is also relevant to note that the corresponding credit for metallic minerals is 50%. In addition - just like with severance taxes - Internal Revenue Code Section 164(a) allows businesses to deduct property taxes they pay on their income tax returns.

Since the 2008 tax year, ad valorem credits claimed have averaged \$222.3M per year. This accounts for an average of 67% of taxpayers' gross tax liabilities over this time period, and represents the single largest credit, deduction, or exemption that is claimed on severance taxes each year. Table 4, below, shows actual credits claimed against gross tax liability statewide since 2008<sup>17</sup>.

Table 4: Ad Valorem Credits [Gross Tax Liability vs. Actual Ad Valorem Credit Used]



Using 2020 production data, OSPB estimated the value of the ad valorem credit per well. 27% of credit claims stem from county property tax, 48% from school district property tax, 3% from municipal property tax, and 22% from special district property tax (although in some areas, upwards of 70% stems from special district - mainly metropolitan district - property tax).

<sup>17</sup> DOR Quarterly Ad Valorem Report



The gap between production and payment of ad valorem taxes and payment of severance tax is a major contributor to year over year volatility in state severance tax revenue. Ad valorem taxes are paid on prior year's production, meaning that the mill levy for ad valorem taxes lags production by a full year. Additionally, the filing status of taxpayers can contribute to a further lag between production and claiming of the ad valorem credit on state severance tax. For accrual basis taxpayers, a group that generally consists of operators or large interest-owners, this lag is not significantly increased because they are able to claim the state credit in the year in which the ad valorem taxes are assessed. However, for cash basis taxpayers, a group that generally consists of mineral interest-owners, the lag is increased by at least one year because the credit is claimed only once the ad valorem taxes are paid. Between 2008 and 2019, severance taxpayers have "lost" anywhere between 3% and 24% of their ad valorem credits due to this timing mismatch, with the average annual loss 10%. This lag is illustrated below in Tables 5 and 6.

Table 5: Accrual Basis Taxpayer Example

## Accrual Basis Taxpayer (Calendar-Year Severance Filer)

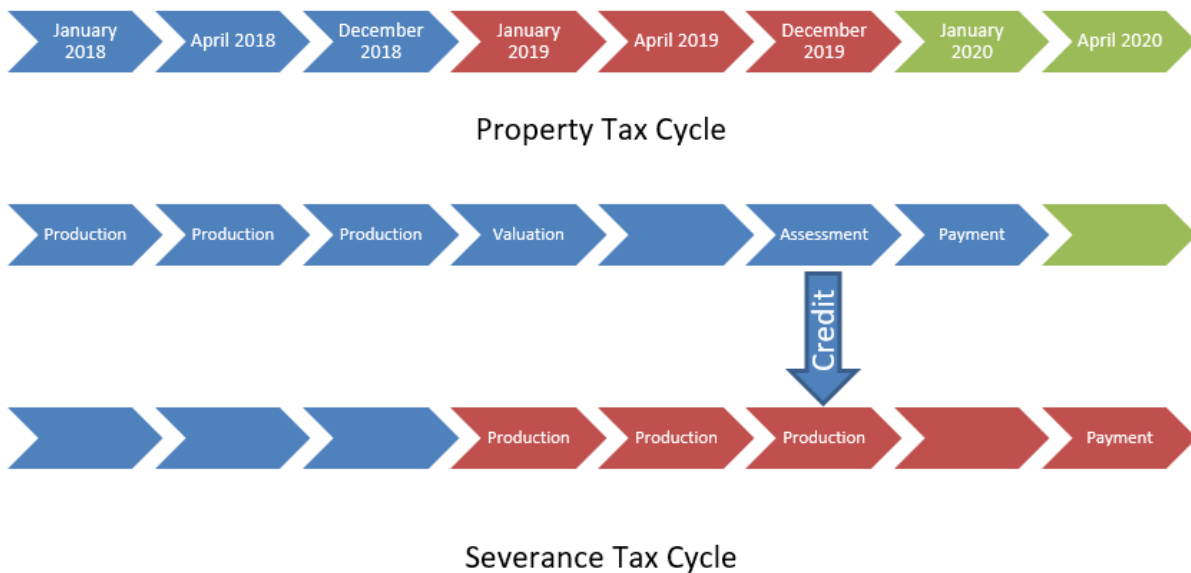
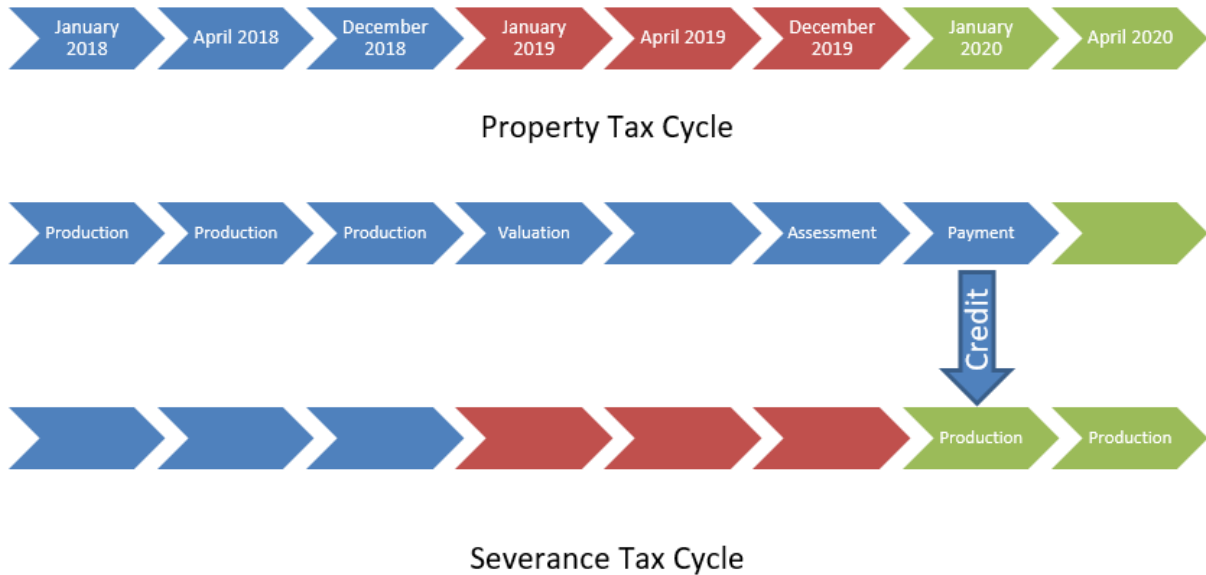


Table 6: Cash Basis Taxpayer Example

# Cash Basis Taxpayer

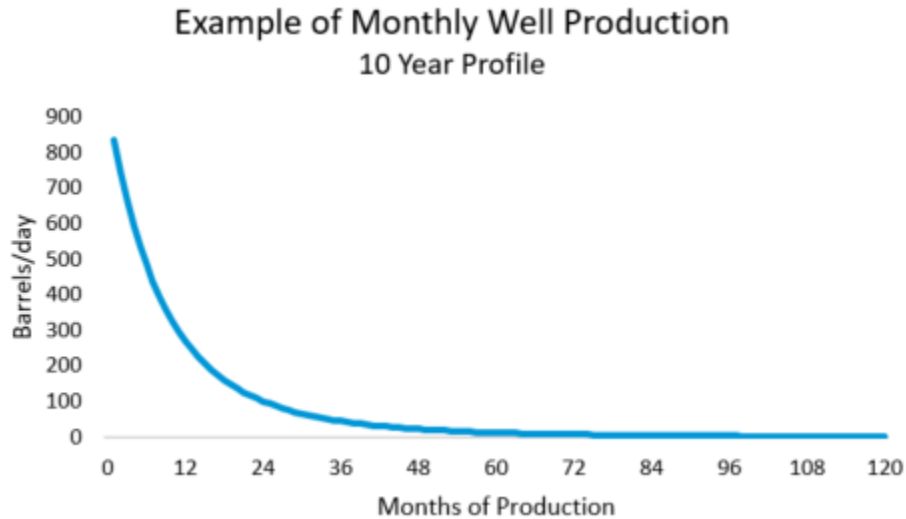
(Calendar-Year Severance Filer)



The lag between the assessment and payment of ad valorem taxes would not contribute to volatility in the size of the ad valorem credits claimed if changes in production value and volume did not occur in the interim period. However, significant changes in both the volume of production and the value of commodities can occur during this period. Below, in Table 7, can be seen an example of a typical production decline curve for oil and natural gas wells<sup>18</sup>.

<sup>18</sup> Estimates of initial production rate and decline are derived from observed well-level production data by the U.S. Energy Information Administration. Data from the U.S. Energy Information Administration: [https://www.eia.gov/analysis/drilling/curve\\_analysis/](https://www.eia.gov/analysis/drilling/curve_analysis/)

Table 7: Example of Monthly Well Production [10 Year Profile]

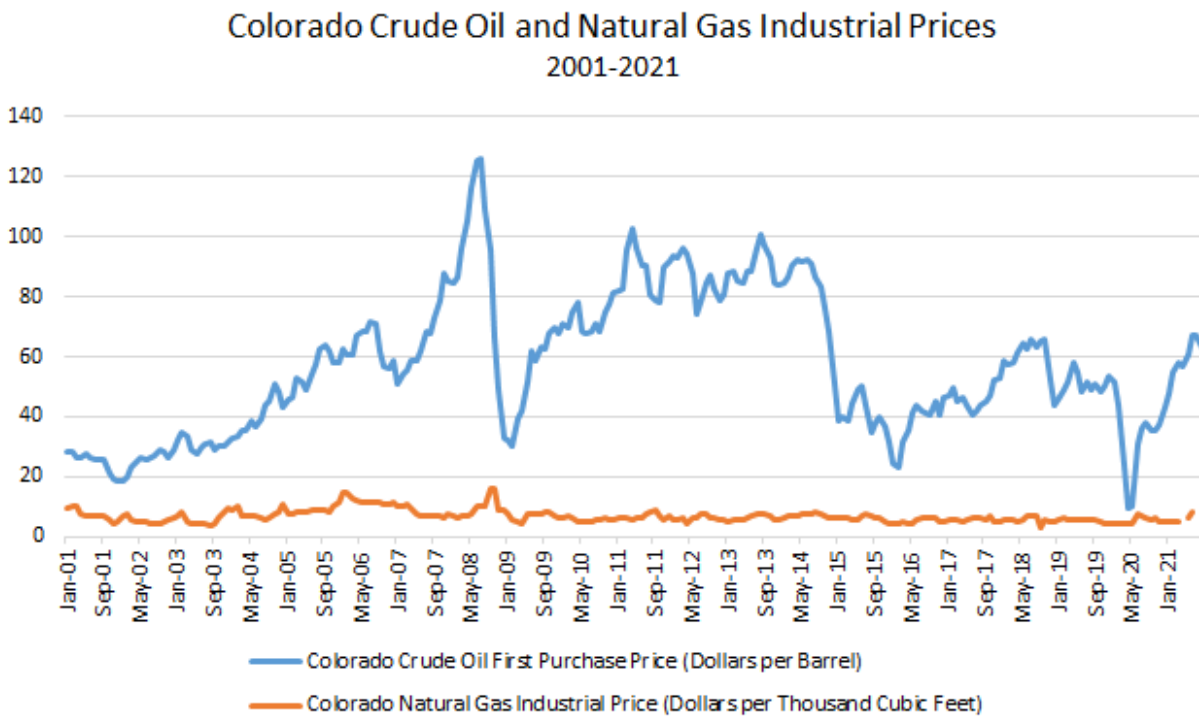


Based on this analysis, roughly 63% of production in the first ten years of a well's lifespan can be expected to occur in the first year of production. In this example, an accrual basis cash payer would be claiming a credit based on the assessed value from Year 1 (63% of ten year production) against the gross income earned on production in Year 2 (which accounts for 20% of ten year production). Alternatively, a cash basis cash payer would be claiming a credit based on the assessed value from Year 1 (63% of ten year production) against the gross income earned on production in Year 3 (which accounts for 8% of ten year production). Thus, in the first few years of production of a given well, taxpayers can be expected to claim comparatively large ad valorem credits against diminishing state severance tax liabilities. This effect increases the volatility of claims and results in taxpayers often not being able to use all of their ad valorem credit in a given year since it frequently reduces their tax liability to zero.

In addition to well-by-well production decline, volatility in global commodity prices also compounds the impact of the lag between production and ad valorem credits. Below, in Table 8, are shown historic prices for Colorado Crude Oil and Natural Gas since 2001<sup>19</sup>.

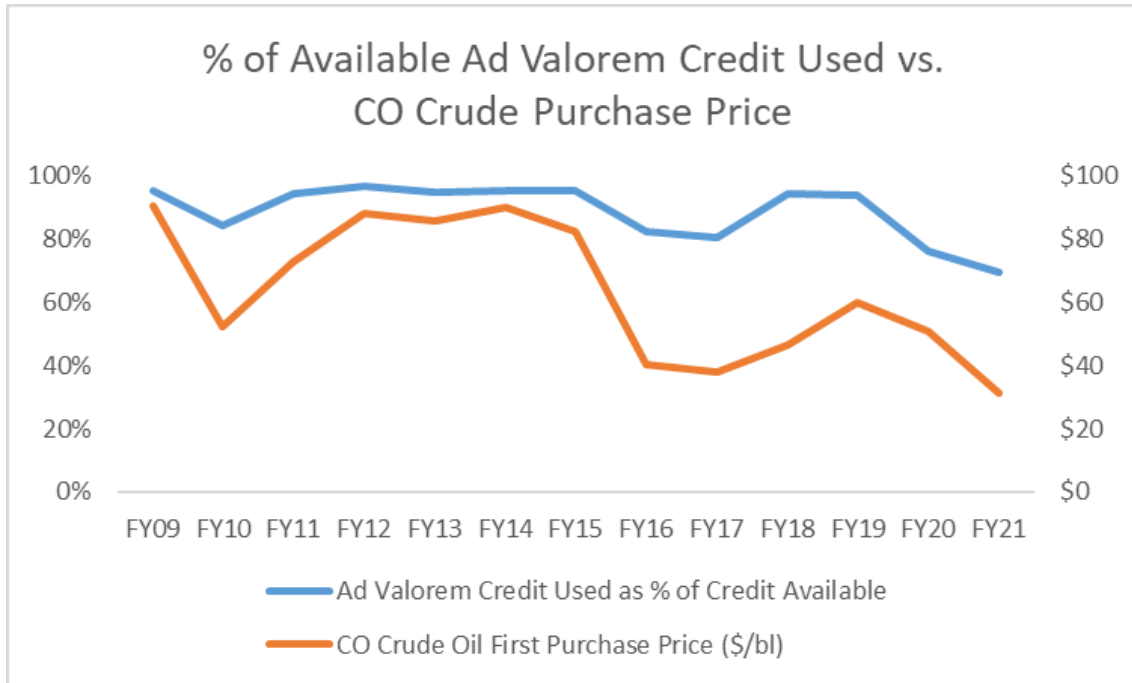
<sup>19</sup> Source: U.S. Energy Information Administration:  
[https://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=F004008\\_\\_3&f=M](https://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=F004008__3&f=M)  
<https://www.eia.gov/dnav/ng/hist/n3035co3m.htm>

Table 8: Colorado Crude Oil and Natural Gas Industrial Prices



Based on an OSPB analysis of 2009-2021 energy market and tax data, oil prices appear to be one of the major predictors of what percentage of their available ad valorem credits taxpayers can actually use in a given year, significantly more so than gas prices, oil production, or gas production. This is shown below in Table 9.

Table 9: Percent of Ad Valorem Credit Used vs. CO Crude Purchase Price



During downturns in commodity prices, taxpayers can be expected to claim large ad valorem credits (based on high production and high prices) against low severance tax liabilities (based on low production and low prices). In contrast, during upswings in commodity prices, taxpayers can be expected to claim comparatively small ad valorem credits against high severance tax liabilities. This has the effect of exacerbating the impacts of swings in commodity prices.

Without adjusting the size of the credit, the solution that the working group feels would most adequately address the revenue volatility caused by the ad valorem credit is to shift from calculating the credit with assessed or paid ad valorem taxes to utilizing estimated ad valorem taxes based on the prior year’s mill levy. While the inherent volatility on mineral commodity markets would continue to drive cyclical ups and downs, the lag between ad valorem taxes being assessed or paid and the credit being claimed would no longer exacerbate these fluctuations. Generally, local property tax rates change infrequently and on a predictable schedule, given that Article X, Section 20 (4)(a) of the Colorado Constitution requires voter approval for “any new tax, tax rate increase, mill levy above that for the prior year, valuation for assessment ratio increase for a property class, or extension of an expiring tax.”

Under this proposal, taxpayers would calculate their ad valorem credit by applying the prior year’s mill levy to their current year’s gross income multiplied by the assessment rate of 87.5%. This proposal would effectively close the gap between ad valorem taxes being assessed and paid and ad valorem credits being claimed, and would better align credits with the

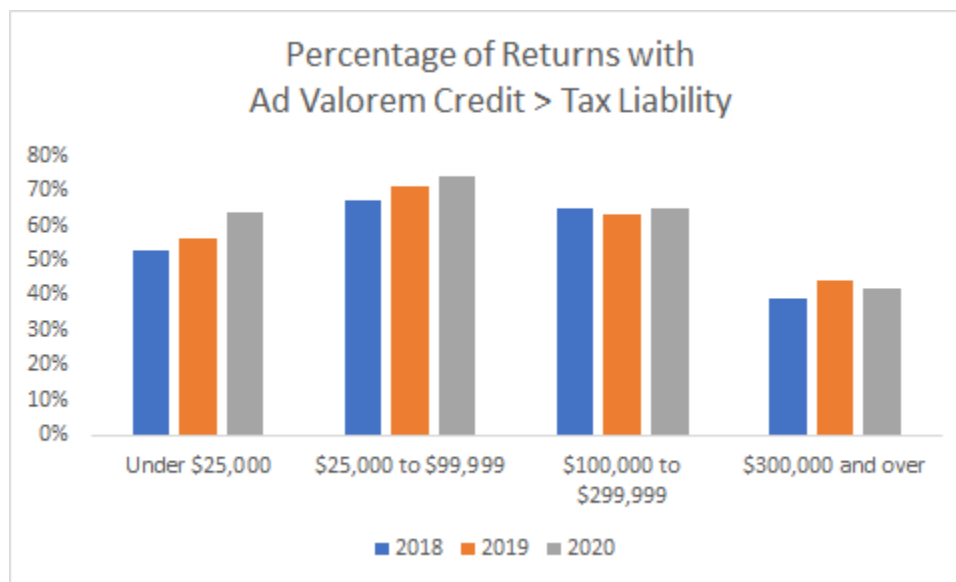
year in which production is occurring. Over time, it can be expected that the volatility associated with the ad valorem credit would smooth. Although other credits, deductions, and exemptions unique to severance tax would likely continue to drive greater fluctuations in revenue than other similar revenue streams, this solution would address the largest single credit available to severance taxpayers.

This solution appears revenue neutral in an environment with significant price volatility, as the oil and gas market often is. However, it may be revenue negative in the long term in a more stable price environment, as reducing the ad valorem credit lag will result in taxpayers being able to claim more credits during the early years of a well's life, which is also when that well's tax liability is at its highest.

Another source of disparity between the current and proposed methods would result from the differences between the property tax and severance tax bases. Specifically, additional expenses are allowable for calculating the wellhead value for property tax purposes, particularly after House Bill 21-1312 amended the definition of "gross income" for severance tax purposes. Using the severance tax definition (which would be easier for DOR to administer on its severance tax return) would reduce the value of the credit thereby increasing revenue.

Finally, it is important to note that even though ad valorem credits are based on each well's property tax liability, taxpayers are allowed to use excess credit from one well against the severance tax liabilities of other wells. Excess credits result from the aforementioned lag time, e.g. a large credit earned in the first year of a well's production is sometimes applied to the taxpayer's severance tax liability two years later, when production, and thus tax liability, is lower. C.R.S. 39-29-105(2)(b) and Regulation 29-105(2)(a) are unclear about whether the General Assembly intended to allow this cross-crediting. However, it primarily benefits operators and large interest owners with interest in many different wells. In Tax Year 2020, 65% of taxpayers with gross income of below \$300,000 had ad valorem credits larger than their gross tax liability (and thus had "wasted" credits), compared to 42% of taxpayers with gross income of \$300,000 and over, who are more likely to benefit from cross-crediting by virtue of having interests in more wells. This is demonstrated below in Table 10.

Table 10: Percentage of Returns with Ad Valorem Credit > Tax Liability



### 3. Implement and require an electronic filing system

As currently situated, the severance tax return filing process is a solely paper-based process and the data that is captured systematically for reporting is limited. It is critical to note that in order to collect additional data, the filing process needs to be modernized and moved to an electronic filing platform. DOR had several opportunities identified for additional information and data elements that could be collected during return filing to provide additional reporting for interested parties if the return process could be modernized to an electronic filing system. These concepts for additional reporting requirements are discussed below. Electronic filing and reporting for severance tax could also be expanded to improve linkages between data held by DOLA and local governments, as well as the COGCC. Such data linkages may improve the accuracy of tax filing, such as helping taxpayers avoid deducting property taxes on stripper wells when claiming ad valorem credits, or assist DOR in flagging leads for audits.

A new electronic filing system will require one-time implementation costs. In the Department of Revenue’s past experience, such a system upgrade could cost in the range of \$250,000-\$500,000, or more, depending on the scope of changes to the existing tax structure adopted prior to or concurrently with the implementation of the new system.

Time to implement would likely be 3-5 months to adjust to any changes and gather requirements in the system. A further 6 months would then likely be required to develop, test, and deploy the software with documentation and training. Based on an existing backlog of legislative changes, current staffing levels, and development needs, the earliest DOR and their vendors would be likely to be able to acquire additional resources would be during the latter half of FY 22-23.

#### 4. Require additional reporting

The Department of Revenue was asked to respond to a Request for Information (Department of Revenue FY 2018-19 RFI #1, or RFI) by the joint budget committee in 2018. The scope of the RFI has overlap with the elements to explore in this study and to the extent any recommendations from the RFI are still relevant, those are included here. To read the entire RFI response, please see the [FY2019-20 Revenue Budget Briefing](#) document, Appendix C. To summarize, the Department of Revenue has recommended:

- mandate e-filing;
- mandate centralized collection and sharing of NERF data electronically with CDOR, DOLA, and the counties;
- exempt severance tax from refund interest statutes in certain cases;
- make small staffing alignment changes to the mineral audit and reporting teams to ensure there is staff and resource support for larger amounts of data and data-driven decision making;
- and add an option for the Department to assess a penalty for failure to report and file correctly to ensure correct information is collected.

Overall, while DOR generally collects enough data to successfully administer the state severance tax, the state as a whole may benefit from the collection and reporting of additional ancillary data using the return filing process as a mechanism to collect the data. Such data collection may facilitate more granular analysis of the tax in the future and allow decision makers to have more detailed information when making severance tax policy decisions. In addition to the above recommendations, the Working Group also recommends that the Committee consider mandating collection of the following data, which will aid in analyzing taxes paid and credits/deductions claimed on a well-by-well basis:

- On [DR 0021D](#), require per-well listing of gross income and ad valorem credit, and make this searchable and reportable in Gentax
- On DR 0021D, add a column for netback deduction claims, and make this searchable and reportable in Gentax
- On DR 0021W, add a column for netback deduction claims (to help interest owners claim them), and make this searchable and reportable in Gentax
- If we keep current tax incidence, require all taxpayers - not just operators - to file [DR 0021 PD](#) at the time of filing, and make this form searchable and reportable in Gentax.
- If we move to operator tax incidence, require all operators to submit DR 0021PD at the time of filing. Fine them if not submitted (DR 0021PD is an informational return operators with well interests are required to submit but mainly only do during audit), and make this form searchable and reportable in Gentax
- On all O&G sev tax forms where per well info is listed, ensure well API # is listed in Gentax and searchable and reportable, so that we can search a well and have all the applicable taxpayers and all of their applicable forms come up.



- Require taxpayers with an interest in stripper wells only to file a simple informational return to DOR with information on each well, and make this searchable and reportable in Gentax
- DOR should capture in Gentax and make available for reporting data on stripper well production that is already submitted on DR 0021D

## **5. Further evaluate SB21-281 impacts on metropolitan districts and additional considerations for metropolitan district service plan approval**

The following discussion and recommendations are broken down into the following component parts:

- Which taxes are paid by industry to special districts?
- Special Districts Background and Formation
- Data Collection
- Scope of Data Analysis
- Special Districts with Property Taxes paid by Industry
- Overlapping Special Districts
- Recommendations and Conclusion

### **Which taxes are paid by industry to special districts?**

Property taxes are the only category of taxes paid by industry directly to special districts. Within the context of property tax, DOLA understands “industry” to mean owners/operators who pay property tax on real property that is classified as natural resources (which includes coal), producing mines, and oil and gas. Therefore, DOLA focused on researching the portion of property taxes that is derived from assessed value of real property for these classifications of severed minerals. In other words, DOLA examined how much property tax comes from severed minerals for individual special districts.

### **Special Districts Background and Formation**

The term “special districts” can refer to a variety of local government types that are formed through various statutory processes. In the broadest sense, special districts could include all local governments that are not counties or municipalities. DOLA attempted to collect property tax information on special districts that fall into this broad category of special districts. In addition to this broad category, “special districts” can also refer more narrowly to local governments whose governing statutes are in Title 32, Article 1. Title 32, Article 1 special district types include fire, health service, health assurance, ambulance, water, sanitation, parks/recreation, and metropolitan districts. Metropolitan districts are defined as special districts that provide two or more services such as fire protection, street improvements, and parks/recreation. For Title 32, Article 1 special districts, the district formation process begins with the special district organizers filing a service plan with the county commissioners. The following process can involve the municipal governing body depending on the proposed district’s

boundaries. Statute then outlines a process for public hearings, notification to property owners, and review by the county commissioners and county/regional planning commission. If approved by the county commissioners, the special district formation process continues in district court, where a petition for organization is filed and further hearings are held. Owners of real property can then file a petition for exclusion, but mineral interest owners have limited participation in Title 32 processes (Bill Barrett Corp. v. Lembke). The district court can then order the organizational election. If approved by the eligible electors, the court then declares the district organized. C.R.S. 32-1-1101(6)(b) limits the mill levy that special districts can levy for debt to 50 mills but there is no statutory limit on mills levied for operations and maintenance.

### Data Collection

DOLA does not routinely collect the assessed value of severed mineral classifications on a special district-specific level and have in no one place useful information on special districts in all counties. Therefore, the Department requested this information from all County Assessors' offices. Some counties were not able to provide the requested information. DOLA obtained responses from 54 out of 64 counties. Because individual severance taxpayer information is confidential, DOLA does not have this level of data to report.

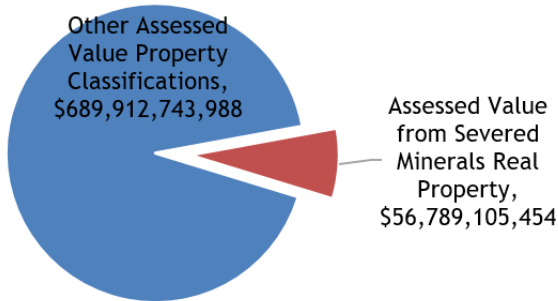
### Scope of Data Analysis

Because only 54 out of 64 counties provided data, the following analysis is only geographically inclusive of the 54 counties that responded. See Appendix A for a list of all counties that responded to the department's request and Appendix B for the entire dataset used in this analysis. The following table summarizes the special district dataset.

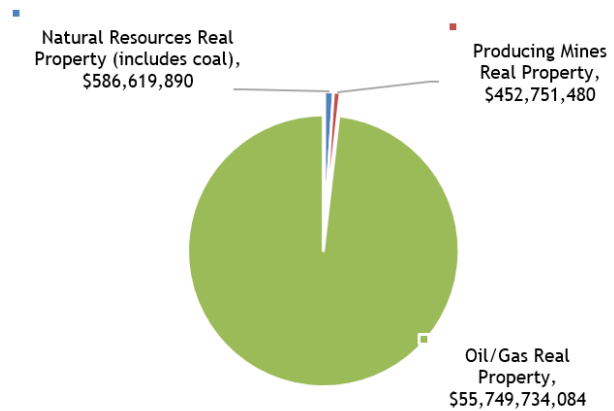
Table 11: Special District Data Summary

<b>Special District Type</b>	<b>Total Entities in Reported Counties</b>	<b>Total Entities with Severed Minerals Assessed Value</b>	<b>Total Entities with Severed Minerals A/V with Levy</b>	<b>Average Portion of Property Tax Revenue from Severed Minerals (Entities w/ Levy and Severed Minerals)</b>
All	3512	868	748	14.50%
Ambulance Districts	8	8	7	3.61%
Cemetery Districts	63	57	57	10.09%
Fire Protection Districts	246	202	202	9.09%
Soil Conservation Districts	94	45	10	18.17%
Hospital Districts	32	29	28	13.65%
Library Districts	49	44	43	7.92%
Metropolitan Districts	1777	264	230	27.77%
Parks & Rec Districts	44	31	30	8.56%
Water/Sewer/W+S Districts	249	79	46	1.32%
Other Local Government Types	950	109	95	8.43%

Total Assessed Value of All Reported Special Districts  
\$746.7 billion



Total Severed Minerals Assessed Value of All Reported Special Districts  
\$56.8 billion

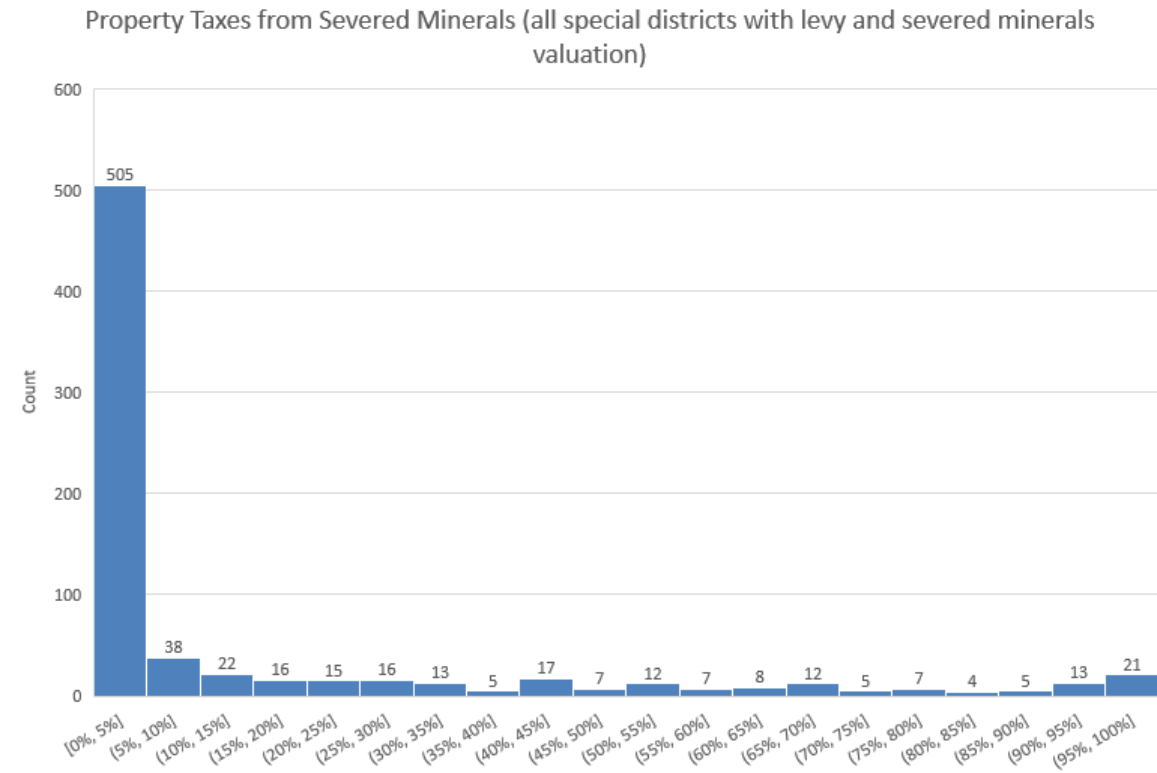


### Special Districts with Property Taxes paid by Industry

This section focuses on special districts who both levy property tax and have severed minerals valuation as part of their tax base. Out of 3,512 special districts in reported counties, 748 special districts levy property tax on severed minerals and, by proxy, industry (21%).

Out of these 748 special districts that levy property tax on industry, DOLA staff were able to estimate the proportion of each special district's property tax revenue that comes from industry. DOLA staff categorized special districts by the portion of each special district's property tax revenue that comes from industry and found that the majority (67.5%) of special districts received less than 5% of their property tax revenue from industry. Within the percentage categories shown below in Tables 12, 13, and 14, there are generally fewer special districts in each category as the percentage of property tax revenue from industry increases, with a notable exception.

**Table 12: Property Taxes from Severed Minerals [All Special Districts]**



**Table 13: Property Taxes from Severed Minerals [Excluding Metro Districts]**

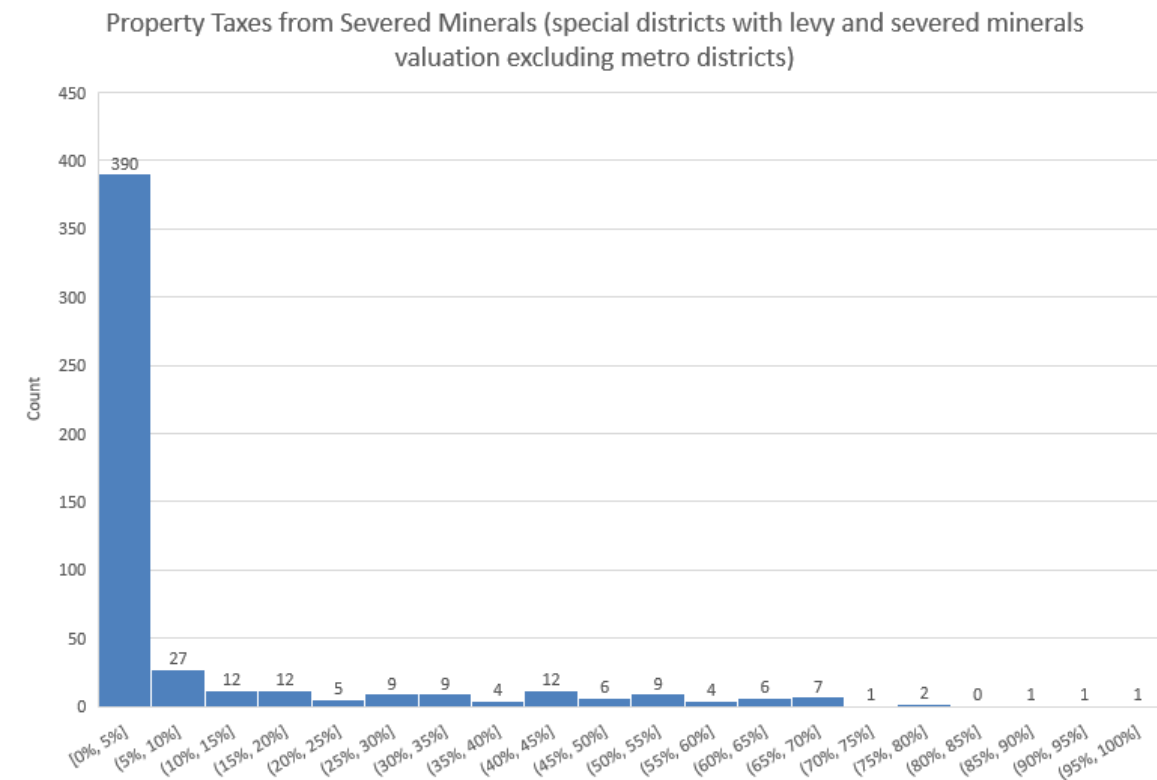
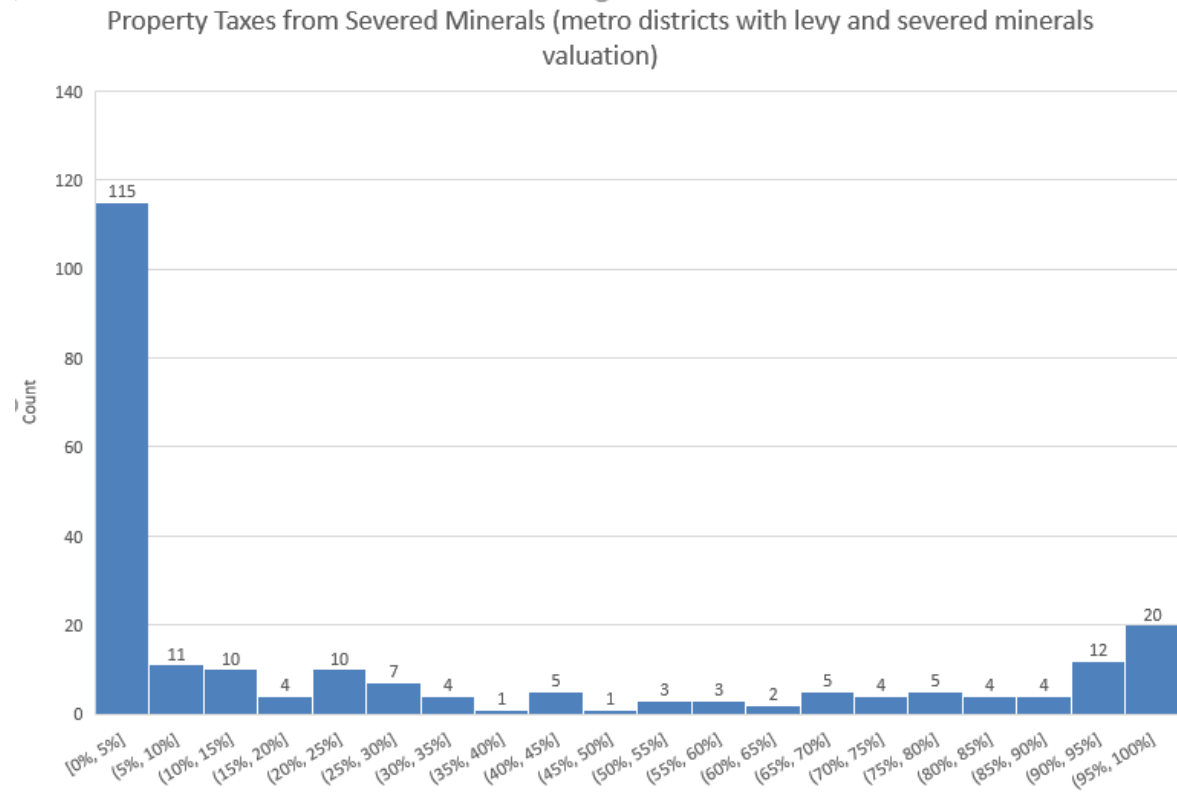


Table 14: Property Taxes from Severance Minerals [Metro Districts Only]



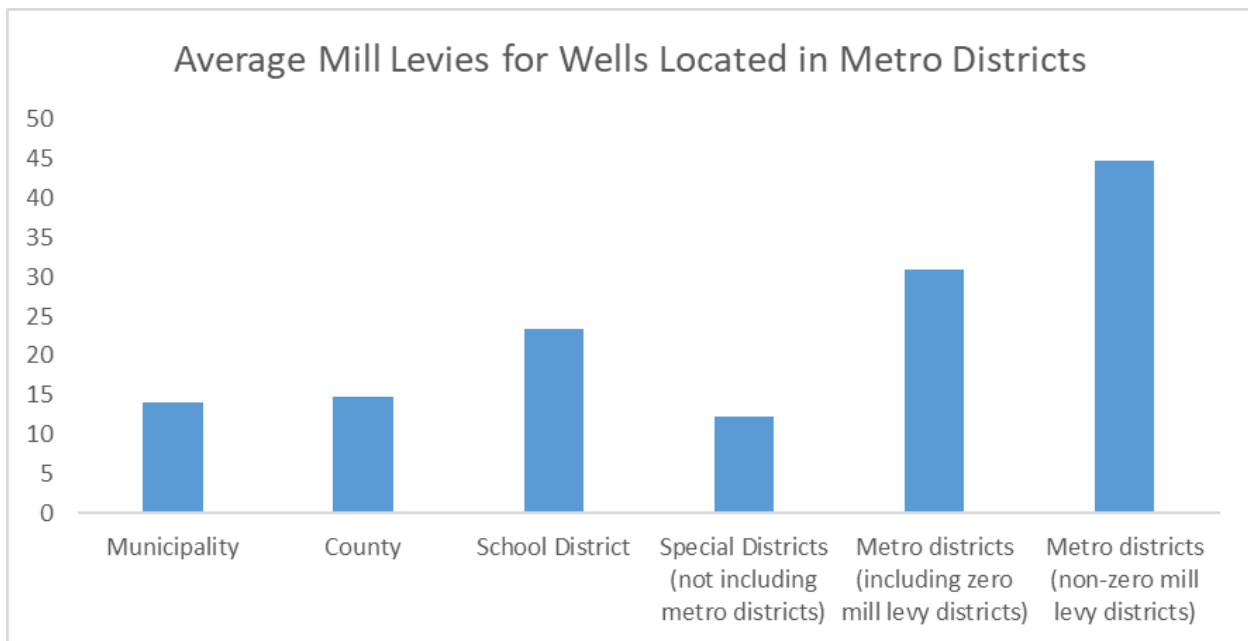
For the 230 metropolitan districts that levy property tax on industry, the distribution of their severed minerals property tax portion appears to be somewhat U-shaped, or bimodal. For special districts that are not metropolitan districts, the distribution appears to decline as fewer special districts receive higher proportions of property tax from industry. DOLA staff identified a cluster of metropolitan districts (approximately 50) that receive a very high proportion (at least 70%) of their property tax revenue from industry. The number of metropolitan districts that receive a very large portion of property tax revenue from industry is small relative to the number of all metropolitan districts. However, this cluster of metropolitan districts is notable because no other special district types (fire districts, water districts, etc.) have a concentration of local governments that rely this heavily on industry for property tax revenue. Even though most metropolitan districts (87.1%) do not receive property tax revenues from industry, the concentration of local governments that receive a very high portion from industry appears to be a notable issue.

For a small but notable portion of metropolitan districts whose property tax base includes severed minerals, industry provides most of the property tax revenue. There are fiscal implications for both these local governments and the state. Because industry property taxes are often assessed based on production, industry property taxes are inherently volatile. For the metropolitan districts that receive most of their property tax revenue from industry, this reliance on a volatile revenue stream could present a fiscal stability issue. For the state, these metropolitan districts likely represent a significant portion of severance tax refunds paid to

industry by the state for the ad valorem credit. OSPB conducted a preliminary analysis which showed that in some areas, upwards of roughly 70% of the ad valorem credit value is attributable to special district mill levies and that metropolitan district mill levies also contributed to a large portion of the ad valorem credit value. These refunds increase the volatility of the state severance tax revenue stream and contribute to the challenge of budgeting state programs funded by State Severance Tax. Because local governments are also beneficiaries of state severance tax, these metropolitan districts also likely increase the volatility of the direct distributions of severance tax to counties and municipalities.

Relatedly, an OSPB well-level analysis using 2020 data showed that of the 758 wells (out of 41,985 total) where special district property tax comprised 50% or more of the total property tax liability, 158 wells were located in metro districts, with an average of 51.1% of these wells' property tax liability stemming from metropolitan districts. As shown in the Table 15 below, mill levies in metropolitan districts with one or more wells were significantly higher than those of the other overlapping jurisdictions in those areas. Still, only 3.2% of wells are in metro districts, which might limit the overall impact of these relatively higher tax burdens on oil and gas taxpayers.

Table 15: Average Mill Levies for Wells Located in Metropolitan Districts



### Overlapping Special Districts

DOLA is aware of industry concerns regarding certain properties that are within the boundaries of several different metropolitan districts and thus subject to “stacked” mill levies. Industry has presented to DOLA staff multiple examples of this overlapping or stacking issue. DOLA recognizes that the inclusion of a single property into multiple metropolitan districts would be confusing for taxpayers, including industry. The Metropolitan District Education Association

communicated to DOLA that they were unable to verify any instances of “stacked” metropolitan district mill levies on wellheads in Weld County. DOLA did not have the resources to extensively study this complex geographic and legal boundary issue, which involves hundreds if not thousands of metropolitan districts.

### **Recommendations and Conclusion**

DOLA’s analysis revealed a small but notable number (approximately 50) of metropolitan districts that receive a high proportion (70% or more) of property tax revenues from industry (as shown by severed minerals assessed value). This issue does not appear widespread among special districts or even metropolitan districts. However, this group of metropolitan districts likely causes increased volatility for the State Severance Tax revenue stream in addition to increased volatility for both the metropolitan districts’ property tax revenue stream and the direct distribution of severance tax to local government beneficiaries.

The Working Group proposes the following recommendations:

- SB21-281 held a provision that requires newly formed metropolitan districts to pay the state for severance tax ad valorem credits claimed for property taxes that are imposed by the metropolitan district. This recent legislation directly addresses the increased volatility caused by high local property taxes on industry. Recommend evaluating the financial impacts to the state after at least one full reporting year.
- Recommend adding language to C.R.S. 32-1-203 (“Action on service plan - criteria”) requiring counties/municipalities to consider the impact on all taxpayers, including mineral interest owners, during the review of metropolitan district service plans. Similarly, recommend encouraging counties to exercise their power to require a special district to file an application for a quinquennial finding of reasonable diligence pursuant to C.R.S. 32-1-1101.5, which allows counties to make a determination on whether “the service plan or financial plan will result in the timely and reasonable discharge of the special district’s general obligation debt” and whether “such implementation will place property owners at risk for excessive tax burdens to support the servicing of such debt”.
- Recommend adding language to C.R.S. 32-1-107 (“Service areas of special districts”) requiring metropolitan districts to submit evidence that no other district within their boundaries provides or is intended to provide the same services.

Because the issue does not appear widespread among special districts nor metropolitan districts, DOLA and the Working Group encourage policymakers to take a measured and targeted approach towards addressing the small but notable portion of metropolitan districts that receive a very high proportion of property tax revenues from industry. Broad action on special districts and industry property tax revenues could negatively impact the ability of special districts (such as fire districts) to provide necessary services to communities.

Furthermore, metropolitan district issues largely go beyond the scope of this analysis and recommendations, which focus on State Severance Tax. However, some issues, such as metropolitan district debt and mill levy increases, do impact industry as well as a large group of stakeholders that include homeowners, real estate developers, and other interested parties. DOLA and the Working Group encourage further stakeholder discussion with regard to metropolitan district issues, particularly in the context of the Special District Act in Title 32 Article 1.

Appendix A: Counties that responded to DOLA data request. Available at:

<https://drive.google.com/file/d/16V0PJITYAIJ1UmsEW5Fn6nFK2Pv7uCW4/view?usp=sharing>

Appendix B: Severed Minerals Assessed Value and 2021 Budget Year Property Tax Mill Levy Data. Available at:

[https://docs.google.com/spreadsheets/d/1k21UZkdVcD\\_mQMI10Nv1rXWIDLDoUIMtjrb97U7ZVLM/edit?usp=sharing](https://docs.google.com/spreadsheets/d/1k21UZkdVcD_mQMI10Nv1rXWIDLDoUIMtjrb97U7ZVLM/edit?usp=sharing)

## **6. Consider potential shifts in distribution methodology**

The working group evaluated multiple alternative distribution models to the existing monthly cash distribution model utilized for severance tax. Currently, when revenue is collected, transfers are made into beneficiary funds as directed by statute.<sup>20</sup> When refunds exceed collections (negative revenue), transfers are not made into beneficiary funds and the negative balance is carried forward. If the following month's revenue exceeds the deficit built up in the previous month(s), the net revenue is transferred into beneficiary funds. However, if the following month's revenue does not exceed the deficit, or if revenue again comes in negative, the balance is carried forward until the end of the fiscal year. In this case, the Department of Revenue is unable to carry the negative balance into the following fiscal year and is required to distribute the negative balance to the beneficiary funds. This means that the Department of Revenue is required to recall previously distributed revenue from the beneficiary funds. These recalls are considered an accounting adjustment to make taxpayers whole for previous overpayments. Despite being an accounting adjustment for taxpayers, many state programs and local governments that rely on severance tax funding may have either expended or obligated all previous distributions. Thus, the effect of revenue recalls can have dire effects on state and local programs alike.

One concept considered to address the accounting of severance tax distributions throughout the year was a shift to quarterly revenue distributions. The working group does not recommend such a shift. Based on a review of the last ten years of monthly distributions Colorado has experienced a total of 26 months "in the red" - months in which no distributions have been made to beneficiary funds<sup>21</sup>. Over this same time period, if Colorado had been utilizing quarterly distributions, there still would have been 24 months in which beneficiary funds went without distributions. In other words, the shift to quarterly distributions would have

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<sup>20</sup> C.R.S. 39-29-108

<sup>21</sup> Department of Revenue monthly severance tax collection report.



contributed to the smoothing of short term volatility on only two occasions. Further, many state programs utilize monthly revenue distributions to cover operating and payroll expenses, especially at the beginning of new fiscal years. If programs were required to wait until the beginning of the second quarter to begin expending resources, operation and staffing challenges could arise.

The second alternative distribution methodology considered is an arrears model for distribution. The working group recommends that the Joint Budget Committee consider an arrears distribution model. Under an arrears distribution model, revenue would be collected monthly through the fiscal year and then distributed in one lump sum transfer to beneficiary funds on either the last day of the fiscal year in which collections occur or the first day of the following fiscal year. An arrears distribution model will not address the year over year volatility associated with severance tax, but it would smooth monthly revenue fluctuations more effectively than a quarterly or even semiannual distribution.

It is important to note that distributions in arrears would be one year removed from the most recent revenue distribution, meaning that the ability for DOR to recall revenue in negative years would be compromised. However, with greater certainty of distributions for the following year, the General Assembly would have the ability to act legislatively prior to a negative or low distribution year, as opposed to engaging and attempting to mitigate negative impacts during the year in which revenue is being collected. State agencies and program beneficiaries would also have the ability to be proactive in the management of their programs and funding when distribution amounts for the entire year are established in advance.

In order to shift to an arrears distribution model, a predetermined amount of funding sufficient to cover Operational Fund liabilities as well as reasonable distributions to the Perpetual Base Fund and Local Government Fund, would likely need to be set aside to fund program operations and grants during the year in which the shift is made. The General Assembly could potentially seize on the availability of one-time General Fund during the 2022 legislative session to facilitate this shift. However, to the extent that one-time General Fund would be utilized to support severance tax-funded programs, the working group would instead recommend that a transfer be made to support a Severance Tax Perpetual Trust, discussed below.

#### **7. Consider the creation of a constitutional severance tax perpetual trust**

Another option considered by the Working Group to smooth year over year severance tax volatility and/or insulate beneficiaries from long term revenue declines is the concept of a perpetual trust. The Working Group recommends that the Joint Budget Committee consider the creation of a perpetual trust, discussed below.

Since the inception of Colorado's severance tax in 1977, revenue collected has largely been allocated to local governments and state government operations in the year in which it is collected. Alternatively, other Western states opted to create permanent mineral trust funds either immediately or shortly after establishing taxation systems for mineral extraction. In both

Wyoming and New Mexico, distributions from constitutionally created permanent funds defray the cost of general government services and depress statewide tax rates for households.

The Wyoming Permanent Mineral Trust Fund (PWMTF) was created in 1975 by a constitutional ballot initiative. The Fund was established six years after the creation of Wyoming's first severance tax on minerals, which was established in 1969<sup>22</sup>. Since that point, various established percentages of total annual severance tax revenue have been deposited into the fund, currently 1.5% of the value of gross product extracted. It is important to note that this tax is levied separately from any other excise, severance, or ad valorem tax in Wyoming and serves the sole purpose of benefiting the PWMTF. Wyoming has an additional severance tax rate of 4.5%, for a total rate of 6%<sup>23</sup>. It is also important to note that the fund was established constitutionally for the expressed purpose of protecting the corpus of the fund from action by future state legislatures. As a constitutional fund, the corpus of the PWMTF is inviolate and not available for expenditure, but is rather invested as prescribed by the Wyoming Legislature. Income from investment earnings are deposited annually into the state's General Fund<sup>24</sup>. Subject to legislative approval, the fund may also be subject to loans to other political subdivisions of Wyoming. As of July 31st, 2021, the market value of the PWMTF was \$9.2B, while interest earnings from the fund facilitated a distribution of \$32.6M to the state General Fund<sup>25</sup>.

The New Mexico Severance Tax Permanent Fund (STPF) was initially created by legislative action in 1973. Later, in 1976, voters approved constitutional protections for the STPF, prohibiting legislative appropriation from the corpus of the fund. The STPF differs from Wyoming's PWMTF in that it does not distribute only interest earnings, but rather a prescribed percentage of its market value. Although severance tax rates are established legislatively, inflows to the STPF include any funds above and beyond debt service requirements in the New Mexico Severance Tax Bonding Fund. Current New Mexico severance tax rates for oil & gas are 3.75% of taxable value<sup>26</sup>. The STPF subsequently distributes 4.7% of its five-year average year-end market values to purposes or funds determined by the Legislature<sup>27</sup>. As of July 31st, 2021, the balance of the STPF was \$6.3B<sup>28</sup>. Average distributions to the state's General Fund are about \$234M per year, as of FY 20-21<sup>29</sup>.

A severance tax perpetual trust fund in Colorado would likely need to differ from both Wyoming and New Mexico's trusts. First, Wyoming and New Mexico's perpetual trust funds are able to make such generous distributions to their respective state General Funds because they are able to harness 45+ years of consistent severance tax revenue and investment growth.

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<sup>22</sup> [https://wyotax.org/wp-content/uploads/2020/08/PWMTF-Combined\\_2015.pdf](https://wyotax.org/wp-content/uploads/2020/08/PWMTF-Combined_2015.pdf)

<sup>23</sup> Wyoming Revised Statute Section 39-14-204

<sup>24</sup> Wyoming State Constitution, Art 15, Section 19

<https://sos.wyo.gov/Forms/Publications/WYConstitution.pdf>

<sup>25</sup> Wyoming State Investment Portfolio Report, July 31st, 2021

<https://statetreasurer.wyo.gov/wp-content/uploads/2021/09/Package-07312021.pdf>

<sup>26</sup> New Mexico Revised Statutes Section 7-29-4

<sup>27</sup> New Mexico State Constitution, Article VIII, Section 10.

<sup>28</sup> <https://www.sic.state.nm.us/wp-content/uploads/2021/09/July-2021-Investment-Holdings-Report-1.pdf>

<sup>29</sup> <https://www.sic.state.nm.us/investments/permanent-funds/severance-tax-permanent-fund/>

Colorado would be establishing a fund from the ground up. As such, in order to provide the short term benefit of smoothing revenue volatility and/or the more long term benefit of insulating beneficiaries from revenue declines, the corpus of the fund would likely need to be able to be utilized, subject to very specific criteria<sup>30</sup>.

Second, while Wyoming and New Mexico's perpetual trusts support their state General Funds, Colorado's severance tax is already established to benefit a very specific group of beneficiaries (discussed in the background section). Any perpetual fund established should continue to support those beneficiaries, many of whom have built program structures that rely on consistent revenue. This could be accomplished by limiting any distributions from a perpetual trust fund to the three cash funds currently established, the Severance Tax Operational Fund, the Severance Tax Perpetual Base Fund, and the Severance Tax Local Government Fund. The proportions currently outlined in statute of 25%, 25%, and 50% distribution, respectively, could be maintained.

Third, an effort to establish a severance tax perpetual trust in Colorado would need to account for the ongoing funding needs for beneficiaries when determining a distribution mechanism. Both the Perpetual Base Fund and the Local Government Fund are structured to provide flexible management of funds based on ebbs and flows in revenue. This is based on the fact that neither supports significant annual appropriations, but instead largely supports grants and loans to local governments and water stakeholders. Alternatively, the Operational Fund supports significant annual appropriations, including staff and operating expenses.

FY 21-22 appropriations from the Severance Tax Operational Fund are approximately \$27M and will grow in future years with growth in employee compensation and other common policies. This appropriation covers all Operational Fund Core Departmental Programs (formerly known as Tier 1 programs). Further, the Operational Fund has a 200% reserve, as established by SB21-281 in statute. SB21-281 and HB21-1105 effectively eliminated Natural Resources and Energy Grant Program (formerly known as Tier 2 programs) from consideration by reprioritizing them above the Core Program reserve requirement (DNR Species Conservation Trust Fund, CPW Aquatic Nuisance Species Fund, and CDA Soil Conservation Grant Fund), adding them to Perpetual Base Fund obligations (Water Supply Reserve Fund, Water Efficiency Grants, and the Interbasin Compact Committees), or shifting them onto new funding streams entirely (Low Income Energy Assistance).

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<sup>30</sup> A Colorado example is available based on SB08-218, which established a Local Government Permanent Fund in the Department of Local Affairs to reserve a portion (50%) of Colorado's Federal Mineral Lease Bonus payments. The fund was established to be tapped by the General Assembly in the event the FML forecasts indicate a drop greater than or equal to 10% in FML revenue in a given fiscal year (based on Legislative Council Staff's December Forecast). In the outlined scenario, the General Assembly may then appropriate an amount up to the projected decline in FML Direct Distributions to augment the next distribution to cities and counties in the following August. The fund has been used for this purpose twice. However, since the fund is reliant upon new federal mineral lease auctions, funds have not accrued as quickly as envisioned. During the 2020 legislative session, HB20-1405 transferred \$2.3M from the fund into the General Fund to support statewide budget balancing.

In order to deposit funds into a severance tax perpetual trust, a cap would likely need to be created, above which revenue would flow into the new fund. When considering a cap, the existing appropriations of the Operational Fund would need to continue to be supported and future growth would need to be accounted for<sup>31</sup>. In addition, a reasonable distribution of funds to the Perpetual Base Fund and the Local Government Fund would need to continue to be supported. Such distributions could be based proportionally off of annual Operational Fund appropriations. In FY21-22, this would result in distributions of \$27M to the Operational Fund, \$27M to the Perpetual Base Fund, and \$54M to the Local Government Fund, pegging total obligations at \$108M prior to distribution into the prospective perpetual trust fund. Based on Legislative Council Staff's September, 2021 forecast<sup>32</sup>, this threshold would not be met in FY21-22 or FY22-23, but would be exceeded by \$6.1M in FY23-24 (without accounting for growth in appropriations). Based on OSPB's September 2021 forecast<sup>33</sup>, this threshold would also not be met in FY21-22, but would be exceeded by \$32.2M in FY22-23 and \$40.7M in FY23-24 (again, not accounting for growth in appropriations). In addition to a potential revenue cap, the Committee could also consider potential seed funding based on the availability of one-time General Fund revenue.

Fourth, when determining how to allocate revenue and/or interest from the prospective trust fund to beneficiaries, there are many factors that the Committee should consider. First, the Committee should consider whether the goal of such a fund would be to smooth revenue volatility or insulate beneficiaries from declining revenues. The fund management strategy would likely differ depending on the goal. In the first scenario, that of a short-term-benefit fund to smooth volatility, funds would likely need to be accessed in the relatively short-term future, possibly during an unforeseen revenue downturn. Such distributions could be triggered if revenue declines below a set threshold, potentially the same threshold above which revenue would flow into the fund. Using this structure, wherein revenue above \$108M is deposited into a trust and revenue below \$108M triggers distributions, over the last 15 years since FY06-07, approximately \$550M would have accrued into a perpetual trust fund above and beyond annual obligations. However, based on long-term forecasted declines in oil and gas demand worldwide<sup>34</sup> it is unclear whether Colorado can expect revenue collections in the next 15 years to be as strong as in the past 15 years. In the second scenario, that of a long-term-benefit fund to insulate against revenue declines, the Committee should consider whether to address the status of the fund after a ten-or-more year pilot period of revenue accrual or determine a date upon which distributions would begin to be made from the fund. A certain percentage decrease in average revenue collections could also be established as a trigger for distributions. In addition

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<sup>31</sup> Although an Operational Fund reserve requirement could become moot if a perpetual trust was created, the Committee should consider whether the critical state operations supported by the Operational Fund merit a continuing reserve requirement. Including enough revenue in distributions to annually ensure that the Operational Fund holds a 16.5% reserve could be a reasonable mechanism to ensure this support if a new fund is created.

<sup>32</sup> [https://leg.colorado.gov/sites/default/files/images/lcs/septforecast\\_1.pdf](https://leg.colorado.gov/sites/default/files/images/lcs/septforecast_1.pdf)

<sup>33</sup> [https://drive.google.com/file/d/1BiV4VvfsNN1Z-kAqkTCnSlr05w8aS\\_8J/view](https://drive.google.com/file/d/1BiV4VvfsNN1Z-kAqkTCnSlr05w8aS_8J/view)

<sup>34</sup>

<https://www.mckinsey.com/~media/mckinsey/industries/oil%20and%20gas/our%20insights/global%20oil%20supply%20and%20demand%20outlook%20to%202040/global-oil-supply-and-demand-outlook-to-2040-online-summary.pdf>

to consideration of a perpetual trust as a long-term support mechanism, the Working Group also recommends that the Committee consider, identify, and/or prioritize alternative long-term sources of funding for critical local government and state government infrastructure and programs.

Finally, the Committee should closely consider a constitutional trust when determining a path forward on a prospective severance tax perpetual trust. In the first scenario outlined above, the prospect of consistent and predictable distributions across fiscal years is likely to appeal to many beneficiaries. By agreeing to limit annual distributions to \$108M (using the same example threshold), beneficiaries would be voluntarily forgoing upside revenue in strong collection years in exchange for the security of consistent distributions. However, the risk of future Legislatures choosing to reallocate funds to other purposes significantly complicates beneficiaries' value proposition. Without the guarantee of consistent revenue distributions, beneficiaries may be loath to limit their annual distributions. Both Wyoming and New Mexico chose to address this issue by establishing constitutional trusts. Colorado should likewise carefully consider this option.

## **8. Evaluate stripper well exemption thresholds**

The OSA evaluation of the stripper well exemption inferred that its purpose was to encourage continued production from low-producing wells that might otherwise be plugged and abandoned, or shut in, particularly given the energy crisis in 1977, the year the exemption was created. Indeed, many stakeholders argue that the exemption is one deterrent against operators abandoning the well, leaving it “orphaned.” While operators are required to deposit funds with OGCC for every well they drill, which the Division uses for plugging and reclaiming efforts, these costs are often insufficient. Still, stripper wells are not exempt from local property taxation.

In addition, the thresholds below which a well becomes a stripper (15 bbl per day of oil or 90,000 cubic feet per day for gas, for the average of all producing days during the taxable year) have not been examined since 2000, when the General Assembly amended the exemption to increase the threshold for oil wells from 10 to 15 barrels per day, and added the exemption for gas wells. Colorado's exemption is one of the most generous of its kind in the US. This is in spite of large, often regional variation in the financial health of operators. Further, the exemption's benefit to taxpayers generally increases as oil and gas prices decrease, since such an environment might require more inducement for extraction given lower profits. Yet unlike similar exemptions in six other states, Colorado's stripper well exemption does not depend at all on the value of oil and gas prices, and the OSA evaluation found that it likely has limited effectiveness at encouraging operators to keep stripper wells in production (especially for gas wells).

It is important to note that stripper well interest owners are also allowed a variable credit against their federal income taxes [26 USC 45I].

However, it is possible that any reduction in the exemption could result in a net loss to the state given that it might lead to a larger backlog of orphaned wells for the state to plug and reclaim and a loss of local property tax revenues from that production. It could also result in

reduced payments to interest owners, many of whom are landowners in rural areas of the state. We recommend further studying the exemption's current thresholds, in which environments it serves as a more effective incentive for operators, and a cost/benefit analysis of any potential changes to it.

November 17, 2021

Nate Pearson  
Office of State Planning & Budgeting  
[nate.pearson@state.co.us](mailto:nate.pearson@state.co.us)

Brendon Reese  
Department of Revenue  
[brendon.reese@state.co.us](mailto:brendon.reese@state.co.us)

Chantal Unfug  
Department of Local Affairs  
[chantal.unfug@state.co.us](mailto:chantal.unfug@state.co.us)

Department Leads:

We are writing to provide feedback on stakeholder discussions required by SB21-281, and led by the Colorado Office of State Planning and Budgeting, Department of Revenue, and Department of Local Affairs.

We understand that there will be a handful of items that are likely to be included on the final recommendations list. We support much of what has been discussed, including structural and procedural changes that can reduce administrative burdens and provide more predictable state severance tax revenues in the long run. Ahead of the release of the draft recommendations, COGA and API Colorado would like to offer the following comments.

#### Shifting Taxation from Interest Owners to Operators

Decreasing the number of taxpayers from 40,000 mineral right property owners to roughly 200 or 300 operating companies in the state would certainly improve state administrative efficiencies and reduce costs. However, while we support those objectives broadly, this massive change should not be underestimated in its complexity and would require significant discussion beyond this legislatively directed stakeholder process. For example:

- 1) The current system is bifurcated. Operators do not have access to the individual tax obligations of mineral right owners. Discussions with mineral right owners need to occur to better understand their perspectives and preferences.
- 2) Operators and mineral right owners have contractual agreements that would need to be considered and understood. We need to understand how these potential changes could impact those contracts.
- 3) It is impossible for operators to calculate and pay severance tax on behalf of all well owners under the current severance tax structure. The tax rate each owner pays is currently determined by the total revenue that each owner receives. That revenue comes from every proportional

share of any well that they own, and often from multiple wells that are sometimes managed by different operators.

- 4) Mineral right owners currently adhere to a progressive tax system with a sliding scale. The more revenue they make the more taxes they pay, and conversely the fewer dollars they make the fewer taxes they pay. Shifting to an operator focused framework may undo some of that progressive tax structure.
- 5) In order to maintain revenue neutrality and not trigger any TABOR violations, analysis would need to be run to determine ideal rates and how those new rates would interplay with local ad valorem taxes and the associated credits.

Given all of these complexities, we would suggest final recommendation language pointing to further and necessary discussion on this particular topic over the coming year. That language could identify this significant tax policy shift as a prioritized “next step,” while pointing to the important “first steps” that can be more quickly realized in the 2022 legislative session. That includes the following:

#### Electronic Filing

COGA and API Colorado, and our member companies, strongly support moving to an electronic filing system. A paper filing option would remain necessary for a small number of taxpayers, but the overall shift should ease the collection process and improve data gathering.

#### Move from a Cash Basis to an Accrual Basis Tax System

Currently, the system affords both practices, but shifting to an accrual-only system will standardize the severance tax framework. That would reduce the two-year lag between local property assessments and tax receipts, and what is paid at the state level, to just a one-year difference. Industry supports this change and believes it would help reduce some of the dramatic revenue swings between high and low severance tax years.

#### Severance Tax Stabilization Fund

Industry strongly supports the establishment of a severance tax stabilization fund. During the 2021 legislative session SB21-281 bill sponsors spoke about the need for more predictability. This fund would be a powerful tool to achieve that goal.

A figure of \$100 million in annual state severance tax appropriations was referenced in those discussions as an amount that would be useful to budget from, as it is not too low and appears to be an appropriate amount that ensures agencies allotted severance tax revenues maintain sufficient funding. And, it is neither too high, in that dollars would likely not be pulled from this new fund at a rate that could risk bankrupting its balance.

A predictable \$100 million annual severance tax appropriation would allow spillover amounts to slowly grow the fund over time. In ten years, it should find itself at an amount where future objectives could be revisited. We would encourage final recommendations to reference that ten-year timeframe specifically, to signal to lawmakers the intent of keeping that fund stable as it grows. While not constitutionally



protected, this may help prevent premature raiding of the fund, with a planned reexamination of its purpose after an appropriate amount of time.

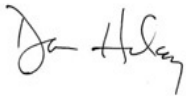
It is important to note that FY 2021-2022 should provide a window of opportunity for the creation of a Severance Tax Stabilization Fund. Commodity prices for both oil and natural gas remain high, and severance tax revenues should be large enough to place this fund on sound footing at its inception. Additionally, with higher-than-expected state General Fund revenues and an influx of federal stimulus dollars and federal infrastructure dollars, Colorado finds itself in a financially stable position and well suited to implement a long term strategy such as this. That too should reduce the validity of claims that those additional severance tax revenues are needed elsewhere.

COGA and API Colorado believe these recommendations would serve as an important first step toward meeting the objectives of SB21-281 and would create momentum for further discussion.

Finally, regarding the topic of possible adjustments to statute that would prevent further metro district tax abuse, we believe existing language within [SB21-281](#) was a positive step in achieving that goal. While this language does not apply retroactively, it may disincentivize new metro districts from enacting unreasonable mill levy rates or stacking that would diminish state severance tax revenues, or obstruct the typical economics of oil and natural gas development. After significant dialog on this topic, we have not been able to identify a more elegant solution, but are open to consider it should one arise.

Thank you for your hard work on these difficult and complicated matters, and please consider these suggestions ahead of drafting your recommendations.

Sincerely,



Dan Haley  
President & CEO  
Colorado Oil & Gas Association



Lynn Granger  
Executive Director  
American Petroleum Institute Colorado

December 15, 2021

Nate Pearson  
Office of State Planning & Budgeting  
[nate.pearson@state.co.us](mailto:nate.pearson@state.co.us)

Brendon Reese  
Department of Revenue  
[brendon.reese@state.co.us](mailto:brendon.reese@state.co.us)

Chantal Unfug  
Department of Local Affairs  
[chantal.unfug@state.co.us](mailto:chantal.unfug@state.co.us)

Department Leads:

The Colorado Oil & Gas Association (COGA) and American Petroleum Institute Colorado (API CO) submit the following comments in reference to the recently released draft recommendation's specific to severance taxes as required by SB21-281, and led by the Colorado Office of State Planning and Budgeting, Department of Revenue, and Department of Local Affairs. COGA and API CO represent all facets of the natural gas and oil industry in Colorado. We appreciate the opportunity to comment and look forward to continuing discussions with the state agencies and Joint Budget Committee as these recommendations are further contemplated.

While we support much of what was discussed during the stakeholder meetings, we were disappointed there was not more opportunity to formally engage with the agencies. Given the complexities associated with the state's severance tax system, we believe there should have been additional meetings and engagement opportunities ahead of the release of the recommendations. Understanding though that there was limited time, we are hopeful there will be a more extensive stakeholder process ahead of implementation of any of the recommendations.

COGA and API CO offer the following comments in response to the SB19-281 recommendations. We understand these comments will be attached via an appendix to the state's comments and not incorporated into the final draft that is submitted to the joint budget committee. Please note, given there was limited time between the release of the draft recommendations and the date in which the agencies would submit the final report to the General Assembly, these comments are not exhaustive and again we would reiterate the necessity of additional conversations before moving forward with any of these recommendations.

**Recommendation 1:** *Shift from taxing all interest owners to only operators*

Decreasing the number of taxpayers from 40,000 mineral right property owners to roughly 200 or 300 operating companies in the state would certainly improve state administrative efficiencies and reduce costs. However, while we support those objectives broadly, this massive

change should not be underestimated in its complexity and would require significant discussion beyond this legislatively directed stakeholder process. For example:

- 1) The current system is bifurcated. Operators do not have access to the individual tax obligations of mineral right owners. Discussions with mineral right owners need to occur to better understand their perspectives and preferences.
- 2) Operators and mineral right owners have contractual agreements that would need to be considered and understood. We need to understand how these potential changes could impact those contracts.
- 3) It is impossible for operators to calculate and pay severance tax on behalf of all well owners under the current severance tax structure. The tax rate each owner pays is currently determined by the total revenue that each owner receives. That revenue comes from every proportional share of any well that they own, and often from multiple wells that are sometimes managed by different operators.
- 4) Mineral right owners currently adhere to a progressive tax system with a sliding scale. The more revenue they make, the higher tax rate they fall under, and conversely the fewer dollars they make, they pay a lower tax rate. Shifting to an operator focused framework may undo some of that progressive tax structure.
- 5) In order to maintain revenue neutrality and not trigger any TABOR violations, analysis would need to be run to determine ideal rates and how those new rates would interplay with local ad valorem taxes and the associated credits.

Given these complexities, we would urge the Joint Budget Committee not to move forward with this recommendation during the 2022 legislative session, and instead allow for further stakeholder conversations to take place to ensure this recommendation is thoroughly vetted and avoids unintended consequences.

**Recommendation 2:** *Base the ad valorem credit on severance-tax-year gross income and prior-year mill levy rate*

Similar to recommendation 1, this would result in a significant change in the current system. With that being said, this is a new concept, that could be worthwhile to consider in a more extensive stakeholder process. Conversations during the stakeholder process specific to this topic were limited, and therefore industry would recommend not moving forward with in the 2022 legislative session, but instead considering this within the list of long-term program fixes.

**Recommendation 3:** *Implement and require an electronic filing system*

COGA and API Colorado, and our member companies, strongly support moving to an electronic filing system. A paper filing option would remain necessary for a small number of taxpayers, but the overall shift should ease the collection process and improve data gathering.

**Recommendation 4:** *Require additional reporting*

While industry can appreciate the desire to have additional data, we question the State's ability to appropriately compile and analyze that data. Before additional reporting is required, industry would urge the state to clearly outline how this reporting will be used, and what additional resources will be needed to properly leverage this new information.

**Recommendation 5:** *Further evaluate SB21-281 impacts on metropolitan districts and additional considerations for metropolitan district service plan approval*

Regarding the topic preventing further metro district tax abuse, we believe existing language within [SB21-281](#) was a positive step in achieving that goal and we support the first recommendation to maintain existing language and assess the broader impacts after at least one full year of reporting. While this language does not apply retroactively, it may disincentivize new metro districts from enacting unreasonable mill levy rates or stacking that would diminish state severance tax revenues, or obstruct the typical economics of oil and natural gas development.

After significant dialogue on this topic with the Metro District Education Coalition, we would like to counter the statement within the report on page 27: "The Metropolitan District Education Association communicated to DOLA that they were unable to verify any instances of 'stacked' metropolitan district mill levies on wellheads in Weld County." We have provided ample examples of instances where this has occurred, and have received confirmation that this has in fact happened.

**Recommendation 6:** *Potential shifts in distribution methodology* and **Recommendation 7:** *Creation of a constitutional severance tax perpetual trust*

Industry strongly supports the establishment of a severance tax stabilization fund or trust. During the 2021 legislative session SB21-281 bill sponsors spoke about the need for more predictability. This fund would be a powerful tool to achieve that goal.

A figure of approximately \$100 million in annual state severance tax appropriations was referenced in those discussions as an amount that would be useful to budget from, as it is not too low and appears to be an appropriate amount that ensures agencies allotted severance tax revenues maintain sufficient funding. And, it is neither too high, in that dollars would likely not be pulled from this new fund at a rate that could risk bankrupting its balance.

A predictable \$100 million annual severance tax appropriation would allow spillover amounts to slowly grow the fund over time. In ten years, it should find itself at an amount where future

objectives could be revisited. We support the final recommendations reference to a ten-year timeframe specifically, to signal to lawmakers the intent of keeping that fund stable as it grows. While not constitutionally protected, this may help prevent premature raiding of the fund, with a planned reexamination of its purpose after an appropriate amount of time.

It is important to note that FY 2021-2022 should provide a window of opportunity for the creation of a Severance Tax Stabilization Fund. Commodity prices for both oil and natural gas remain high, and severance tax revenues should be large enough to place this fund on sound footing at its inception. Additionally, with higher-than-expected state General Fund revenues and an influx of federal stimulus dollars and federal infrastructure dollars, Colorado finds itself in a financially stable position and well suited to implement a long-term strategy such as this. That too should reduce the validity of claims that those additional severance tax revenues are needed elsewhere.

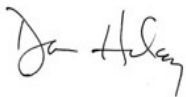
**Recommendation 8:** *Evaluate stripper well exemption thresholds*

This is not a topic that was acknowledged or discussed during either of the stakeholder meetings that took place. Based on conversations that took place during the last legislative session, we believe there are broader unintended consequences that could occur as a result of changes to the stripper well exemption thresholds and prior to making any changes, the benefits and consequences should be studied and understood.

Overall, we are supportive of much of what is included in the *SB21-281 Severance Tax Work Group Preliminary Recommendations* report. We believe that some of the recommendations are more straight forward than others and would encourage additional conversations on the more complex provisions. With the 2022 legislative session quickly approaching, it would make sense to strategize what fixes should move forward immediately versus those that warrant additional conversations and a longer term project timeline.

Thank you for your hard work on these complicated matters, and please consider these comments as the state and JBC further contemplate implementation of any the preliminary recommendations. If you have any questions, please do not hesitate to contact us.

Sincerely,



Dan Haley  
President & CEO  
Colorado Oil & Gas Association



Lynn Granger  
Executive Director  
American Petroleum Institute Colorado



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January 6, 2022

Colorado General Assembly  
Joint Budget Committee  
200 E Colfax Avenue  
Denver, CO 80203

Dear members of the Joint Budget Committee:

The Colorado Municipal League (CML) appreciates the opportunity to provide feedback on the Severance Tax Working Group recommendations. We are providing you with this letter which reiterates our concerns with two portions of the recommendation, as well our recommendations for possible paths forward.

Colorado Revised Statute 39-29-108 requires severance tax revenues to be deposited into both the State Severance Tax Trust Fund and the Local Government Severance Tax Trust Fund. Local governments benefit from funds in the Local Government Severance Tax Trust Fund, which are distributed directly to local governments or used to provide grants and loans to local governments who are socially or economically impacted by mineral extraction. It is extremely important to local governments to preserve the funding owed to them through these grants, loans, and direct distributions as impacts often far outlast reduction or cessation of extraction activities.

Recommendation #7, to consider the creation of a severance tax perpetual trust fund, requires contributions from both the State Severance Tax Trust Fund and the Local Government Severance Tax Trust Fund. While state programs would directly benefit from the fund's stability, there is significant uncertainty about the impacts on direct distributions to local governments. Creation of a perpetual trust fund would redirect local direct distribution dollars to directly benefit the state, while providing no discernable benefit to impacted local governments.

We have further concerns about the ability of future legislatures to drain funding from a perpetual trust fund to backfill the state's budget in times of economic downturn. \$400 million of local government severance tax and federal mineral lease dollars were swept for this purpose from 2008-2015 without being reimbursed. A perpetual fund can only be protected if it is constitutionally established, otherwise the door remains open for these actions to occur legislatively in the future.

We would ask that the state find more stable revenue sources for state programs that rely on severance tax rather than using money owed to locals to contribute to a permanent trust fund. If the legislature chooses to pursue a severance tax perpetual trust, it should consist of only the money distributed to the State Severance Tax Trust Fund and exempt the Local Government Severance Tax Trust Fund.

Additionally, we have concerns with a small portion of recommendation #5 on page 27 that adds language to C.R.S. 32-1-203 ("Action on service plan - criteria") requiring counties/municipalities to consider the impact on all taxpayers, including mineral interest owners, during the review of metropolitan district service plans. As a purely local matter, the review and approval of metropolitan district service plans is left to the local governments to determine based on the unique circumstances of each community. Local government review of service plans typically has little to do with the interests of the parties involved and is more about the need for the district, its financial capacity, and the structure. The local review is a

legislative decision, as opposed to a judicial review determining the rights of interested parties. A more appropriate solution is to incorporate this requirement into the judicial hearing that authorizes the organization of the district and adjudicates the interests of parties.

Thank you again for including us in the conversation. We are always happy to provide information and recommendations on behalf of municipalities in Colorado. Please contact Heather Stauffer, [hstauffer@cml.org](mailto:hstauffer@cml.org) with questions or for additional information.

Sincerely,

A handwritten signature in black ink, appearing to read "Kevin Bommer". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Kevin Bommer  
Executive Director

A handwritten signature in black ink, appearing to read "Heather Stauffer". The signature is cursive and somewhat stylized, with the first letters being larger and more prominent.

Heather Stauffer  
Legislative & Policy Advocate