Colorado Legislative Council Staff

SB16-218

REVISED FISCAL NOTE

(replaces fiscal note dated May 9, 2016)

FISCAL IMPACT: ☒ State ☒ Local ☐ Statutory Public Entity ☐ Conditional ☐ No Fiscal Impact

Drafting Number:	LLS 16-1285	**Date:**	May 10, 2016
Prime Sponsor(s):	Sen. Lambert; Steadman Rep. Hamner; Rankin	**Bill Status:**	House Appropriations
		Fiscal Analyst:	Greg Sobetski (303-866-4105)

BILL TOPIC: STATE SEVERANCE TAX REFUNDS

Fiscal Impact Summary	FY 2015-2016 *(current year)*	FY 2016-2017	FY 2017-2018
State Revenue			
Cash Funds	See State Revenue section.		
State Diversions			
General Fund	($115.1 million)	potential decrease	
Cash Funds	$115.1 million	potential increase	
State Expenditures			
General Fund			
Cash Funds	See State Expenditures section.		
Appropriation Required: None.			
Future Year Impacts: None.			

Summary of Legislation

This ***reengrossed bill*** addresses a severance tax refund obligation arising as a result of the Colorado Supreme Court's April 25, 2016, decision in *BP America v. Colorado Department of Revenue*. The bill creates a mechanism for refunds of severance tax revenue to businesses, including businesses that revise their severance tax returns to claim additional tax deductions for tax years 2012 through 2015. It establishes a reserve from which all severance tax refunds are to be paid prior to the allocation of tax revenue to cash funds in the Department of Natural Resources (DNR) and the Department of Local Affairs (DOLA). For FY 2015-16, income tax revenue is diverted from the General Fund to the reserve in amounts sufficient to pay any severance tax refunds that exceed severance tax revenue collected after the bill's effective date and before the end of the fiscal year. For FY 2016-17, income tax revenue is diverted each month from the General Fund to the reserve in amounts sufficient to pay any severance tax refund that exceeds 15 percent of severance tax revenue collected for that month.

The bill imposes restrictions on $19.1 million in the Severance Tax Perpetual Base Fund, $10.0 million in the Severance Tax Operational Fund, and $48.3 million in the Local Government Severance Tax Fund. While restrictions are in place, these moneys must remain in their respective cash funds and can not be expended for state purposes. Restrictions may be lifted in whole or in part upon a majority vote of the members of the Joint Budget Committee (JBC).

The bill also extends a statutory repeal date, allowing severance tax revenue to continue to be allocated to the Severance Tax Trust Fund and the Local Government Severance Tax Fund between January 1, 2017, and July 1, 2017.

Background

Per the Supreme Court's decision in *BP America v. Colorado Department of Revenue*, energy companies are able to deduct any transportation, manufacturing, and processing costs from revenue when valuing severed minerals for tax purposes. Costs that may be deducted include those listed on the Netback Expense Report Forms (NERF) submitted by oil and gas producers to county assessors. These include direct costs and foregone returns on investment as a result of expenditures for the transportation, manufacturing, and processing of oil and gas.

The Supreme Court decision allows oil and gas producers to claim significantly larger deductions than allowed previously, reducing severance tax revenue in future years and obligating the state to issue refunds to oil and gas producers that amend tax returns for prior years. Oil and gas producers may file amended tax returns for 2012 and subsequent years.

State Revenue

The bill's effects on state revenue for FY 2015-16 and FY 2016-17 are indeterminate. Under the Supreme Court decision, the state is obligated to issue refunds to taxpayers claiming expanded severance tax deductions. It is unknown how these refunds would be financed by executive branch agencies under current law.

The bill accounts for refunds by diverting income tax revenue to a reserve used for severance tax refunds. Under the bill, refunds would be accounted as a reduction in state revenue. Under current law, it is possible that refunds would be accounted as state expenditures, in which case the bill reduces state revenue and expenditures for refunds by similar amounts.

The bill may expedite payments of refunds to taxpayers. To the extent that refunds are expedited, the bill increases revenue by reducing the state's liability for interest and penalties.

The bill restricts the amounts that may be spent from cash funds in the DNR and the DOLA. To the extent that the bill increases cash fund balances relative to current law, it will result in the accrual of additional interest in these funds.

State diversions. The bill increases income tax diversions from the General Fund to the reserve used to pay severance tax refunds by **$115.1 million in the current FY 2015-16**. Additionally, the bill potentially increases General Fund diversions to the reserve in FY 2016-17.

The estimate for FY 2015-16 represents the maximum amount by which the Supreme Court decision is expected to reduce state severance tax revenue between tax years 2012 and 2015. For tax years 2012 through 2014, the estimate incorporates $25.0 million in return on investment disputes pending with the Department of Revenue Tax Conferree and $73.4 million in anticipated refunds consistent with deductions listed in taxpayer NERF filings. For tax year 2015, total refunds are estimated at $16.7 million, representing 12.5 percent of expected severance tax revenue from oil and gas producers, the same share by which this revenue is expected to be reduced for tax years 2012 through 2014. It is assumed that all refunds for tax years 2012 through 2015 will result in state diversions booked in FY 2015-16 on an accrual accounting basis.

To the extent that severance tax refunds for tax year 2015 are processed after the FY 2015-16 comprehensive annual financial report is finalized, diversions will be made from income tax revenue that would otherwise be accrued to FY 2016-17. Income tax revenue for FY 2016-17 will also be diverted and obligated for refunds if refunds for tax year 2015 are administered on a cash accounting basis.

Additionally, for both FY 2015-16 and FY 2016-17, the bill requires diversions of income tax revenue to offset severance tax refunds made for reasons unrelated to the Supreme Court decision. For FY 2015-16, total refunds for reasons unrelated to the Supreme Court decision are assumed to be less than severance tax revenue collected between the bill's effective date and the end of the fiscal year; thus, the bill is not expected to effect any diversions of General Fund revenue for this purpose. For FY 2016-17, the bill diverts General Fund revenue only if the monthly refund amount exceeds 15 percent of the gross monthly severance tax collection. Based on the historical share of refunds as a percentage of gross severance tax collections, it is assumed that refunds issued below this threshold will approximate refunds made for reasons unrelated to the Supreme Court decision. To the extent that these refunds exceed 15 percent of monthly tax revenue, diversions from the General Fund will be greater than estimated.

State Expenditures

General Fund. The bill reduces the statutory General Fund reserve by up to $115.1 million in FY 2015-16. This amount is encumbered for diversion to the reserve used to pay severance tax refunds.

Cash fund restrictions. The bill places restrictions on specific amounts of money in three state cash funds, requiring that these amounts be held in the funds until released in whole or in part by a majority vote of the JBC. Restrictions are applied to:

- $19.1 million in the Severance Tax Perpetual Base Fund in the DNR;
- $10.0 million in the Severance Tax Operational Fund in the DNR; and
- $48.3 million in the Local Government Severance Tax Fund in the DOLA.

If the JBC chooses not to release these amounts, state expenditures may be reduced for FY 2016-17. The bill specifies that the amount restricted in the Local Government Severance Tax Fund would otherwise be used for grants, rather than direct distributions to local governments. Under current law, refunds required as a result of the Supreme Court decision may reduce the amounts in the funds such that expenditures are reduced by a similar amount.

Allocations of severance tax revenue. The bill extends a statutory repeal date, allowing the current disbursements of severance tax revenue to the Severance Tax Trust Fund and the Local Government Severance Tax Fund to continue between January 1, 2017, and July 1, 2017. Under the March 2016 Legislative Council Staff forecast, severance tax revenue for this period is expected to total $58.4 million. The Supreme Court decision is expected to reduce the oil and gas share of severance tax revenue by 12.5 percent, or $6.5 million. Each fund receives 50 percent of severance tax revenue collected.

Local Government Impact

State DOLA grants to local governments are reduced by up to $28.6 million in FY 2016-17. Under current law, the DOLA is expected to issue $28.6 million in August 2016 grants from the Local Government Severance Tax Fund. The bill restricts this amount, precluding its expenditure until released by a vote of the JBC. Under current law, refunds required as a result of the Supreme Court decision may reduce the amount in the fund such that the August grants are reduced or not made.

Effective Date

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

State and Local Government Contacts

Counties	Legislative Council Staff
Information Technology	Joint Budget Committee Staff
Local Affairs	Municipalities
Natural Resources	Office of State Planning and Budgeting
Personnel	Revenue