Second Regular Session
Seventy-third General Assembly
STATE OF COLORADO

REENGROSSED

This Version Includes All Amendments
Adopted in the House of Introduction

LLS NO. 22-0916.02 Megan Waples x4348 **HOUSE BILL 22-1391**

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A BILL FOR AN ACT

CONCERNING THE STATE SEVERANCE TAX ON OIL AND GAS, AND, IN CONNECTION THEREWITH, MAKING AN APPROPRIATION.

Bill Summary

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

Joint Budget Committee. The bill changes the calculation of the ad valorem credit allowed against the state severance tax on oil and gas. In tax years beginning on and after January 1, 2024, the credit for ad valorem taxes is calculated on a per-well basis for wells that are not exempt from taxation by applying the prior year's mill levy to the current year's gross income multiplied by an assessment rate of 87.5%, and taking

Shading denotes HOUSE amendment. Double underlining denotes SENATE amendment.
Capital letters or bold & italic numbers indicate new material to be added to existing statute.
Dashes through the words indicate deletions from existing statute.

HOUSE
3rd Reading Unamended
May 4, 2022

HOUSE
Amended 2nd Reading
May 3, 2022

87.5% of that amount for the credit. This calculation is simplified to multiplying 76.56% of the gross income of the well by the mill levy fixed in the prior calendar year.

A working group consisting of the director of the office of state planning and budgeting and the executive directors of the departments of revenue, natural resources, education, and local affairs, or their designees, is required to develop an implementation plan for making additional changes to the state severance tax on oil and gas. The implementation plan must make recommendations concerning the steps necessary to change the legal incidence of tax from interest owners to operators while maintaining revenue neutrality, require electronic filing of returns for severance taxes, and require additional electronic data collection to the tax.

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

SECTION 1. Legislative declaration. (1) The general assembly hereby finds and declares that:

(a) The severance tax, first enacted in 1977, is imposed on nonrenewable natural resources that are removed from the earth, including metallic minerals, molybdenum, oil, gas, and coal;

(b) The state severance tax is intended to recapture a portion of the wealth that is lost to the state when nonrenewable resources are removed from the earth;

(c) The vast majority of gross collections from the severance tax come from oil and gas production;

(d) The severance tax on oil and gas is currently paid by each person owning a working interest, royalty interest, production payment, or other interest in any oil or gas produced in Colorado (interest owners) as a percentage of gross income;

(e) Producers and first purchasers of oil and gas who disburse funds to the interest owners are required to withhold one percent of the amount owed to the interest owners to cover the severance tax. The interest owner then claims a credit for the amount withheld on the interest owner's annual tax return, either paying or obtaining a refund of the difference.

(f) In a January 2020 audit report, the office of the state auditor noted that this structure significantly increases the number of taxpayers required to make a return and makes it difficult for the Colorado department of revenue to determine whether all taxpayers have filed required returns if producers and first purchasers do not provide complete and accurate information;

(g) Current law allows a credit against the severance tax on oil and gas equal to 87.5% of all ad valorem taxes paid to local governments and special districts on oil and gas leaseholds and lands, except those imposed on equipment and facilities used for production, transportation, and storage and those paid on stripper wells (ad valorem credit);

(h) Because ad valorem taxes are paid on the prior year's production, the mill levy for the taxes lags production by a full year. In addition, for cash basis taxpayers, the credit is only claimed once the ad valorem taxes are paid, creating an additional lag.

(i) The lag between production, assessment, and payment of ad valorem taxes and the claiming of the ad valorem credit poses several challenges to the administration of the severance tax. Because production from oil and gas wells often declines rapidly after the first few years, taxpayers may not be able to claim the full value of the credit. In addition, the lag contributes to year-over-year volatility in state severance tax revenue.

(j) The revenues from the state severance tax are divided between the department of natural resources (DNR) and the department of local affairs (DOLA);

(k) The money allocated to DNR is deposited into the severance tax trust fund, where it is held in trust as a replacement for the depleted natural resource, for development and conservation of the state's water resources, and for use in funding programs that promote sound natural resource planning. Money in the fund is then distributed to two other funds and used to support various programs generally administered by DNR and the Colorado water conservation board.

(l) The money allocated to DOLA is credited to the local government severance tax fund and distributed to local governments, and 70% of the money is distributed through grants and 30% is distributed through a direct distribution formula;

(m) There is significant year-over-year volatility in severance tax revenues and the amount of money that is distributed each year to state programs and local governments through these funds;

(n) This volatility cannot be attributed solely to fluctuations in commodity prices and appears to be exacerbated by the structure of the ad valorem credit as well as the withholding and payment structure for the tax;

(o) The volatility in severance tax revenues creates challenges for the state programs and local governments receiving those revenues;

(p) In 2021, the general assembly enacted Senate Bill 21-281, which convened a severance tax working group to evaluate the severance tax and make recommendations related to its structure and administration;

(q) Among other recommendations, the working group recommended changing the legal incidence of the oil and gas severance tax to be imposed on operators instead of interest owners. This recommendation responds to the concerns raised by the office of the state auditor by improving efficiency and allowing better administration and enforcement of the tax. With adequate planning for implementation, changing the legal incidence of the tax while making any necessary adjustments to the tax rates and payment structures could ease the administration and enforcement of the tax while maintaining revenue neutrality.

(r) The working group also recommended changing the calculation of the ad valorem credit to be based on an estimated amount for the ad valorem taxes using the prior year's mill levy applied to the current year's gross income. The working group proposed that taxpayers calculate their credit by applying the prior year's mill levy to their current year's income multiplied by the assessment rate of 87.5%, which is a percentage used to determine the valuation of the oil and gas leaseholds and lands for purposes of the property tax, and claiming 87.5% of that amount for the credit. This change would eliminate the lag between the taxes being assessed or paid and the credit being claimed, and reduce the associated volatility in the severance tax revenue, without affecting state revenue overall.

(s) Reducing volatility and easing the administration of the state severance tax are important goals that must be addressed.

(2) The general assembly further finds and declares that:

(a) Its purpose in changing the calculation of the ad valorem credit allowed against the state severance tax on oil and gas is to reduce volatility in severance tax revenues and to improve the administration of the state severance tax while maintaining revenue neutrality to the greatest extent possible; and

(b) Additional planning is necessary to implement the working group's recommendation to change the legal incidence of the tax in a manner that will improve the administration and enforcement of the state severance tax for taxpayers and the state.

SECTION 2. In Colorado Revised Statutes, 39-29-105, **amend** (2)(b); and **add** (2)(c) as follows:

39-29-105. Tax on severance of oil and gas. (2) (b) With respect to oil and gas, there shall be allowed, as a credit against the tax computed in accordance with the provisions of ~~paragraph (b) of subsection (1)~~ SUBSECTION (1)(b) of this section for each taxable year commencing on or after January 1, 2000, BUT PRIOR TO JANUARY 1, 2025, an amount equal to eighty-seven and one-half percent of all ad valorem taxes assessed during the taxable year in the case of accrual basis taxpayers or paid during the taxable year in the case of cash basis taxpayers upon oil and gas leaseholds and leasehold interests and oil and gas royalties and royalty interests for state, county, municipal, school district, and special district purposes, except such ad valorem taxes assessed or paid for such purposes upon equipment and facilities used in the drilling for, production of, storage of, and pipeline transportation of oil and gas. However, no credit shall be allowed for ad valorem taxes paid or assessed on oil and gas production that is exempt from the state severance tax pursuant to subsection (1) of this section.

(c) FOR A TAXABLE YEAR BEGINNING ON OR AFTER JANUARY 1, 2025, FOR EACH WELL THAT IS NOT EXEMPT FROM THE STATE SEVERANCE TAX PURSUANT TO SUBSECTION (1)(b) OF THIS SECTION, THERE IS ALLOWED A CREDIT AGAINST THE TAX COMPUTED IN ACCORDANCE WITH THE PROVISIONS OF SUBSECTION (1)(b) OF THIS SECTION IN AN AMOUNT

CALCULATED BY THE FORMULA C = 0.7656 X GI X ML, WHERE:

(I) C IS THE AMOUNT OF THE CREDIT;

(II) GI IS THE GROSS INCOME ATTRIBUTABLE TO THE WELL FOR THE CURRENT TAXABLE YEAR; AND

(III) ML IS THE TOTAL OF ALL MILL LEVIES, FIXED NOT LATER THAN DECEMBER 22 OF THE PRECEDING CALENDAR YEAR PURSUANT TO SECTION 39-1-111, BY ALL LOCAL GOVERNMENTS FOR PROPERTY AT THE WELL'S LOCATION.

SECTION 3. In Colorado Revised Statutes, 39-29-108, **add** (7) as follows:

39-29-108. Allocation of severance tax revenues - definitions - repeal. (7) (a) THE DIRECTOR OF THE OFFICE OF STATE PLANNING AND BUDGETING AND THE EXECUTIVE DIRECTORS OF THE DEPARTMENTS OF REVENUE, NATURAL RESOURCES, EDUCATION, AND LOCAL AFFAIRS, OR THEIR DESIGNEES, SHALL, IN CONSULTATION WITH THE STAKEHOLDER GROUP CONVENED PURSUANT TO SUBSECTION (7)(c) OF THIS SECTION, DEVELOP AN IMPLEMENTATION PLAN WITH RECOMMENDATIONS TO:

(I) CHANGE THE LEGAL INCIDENCE OF THE STATE SEVERANCE TAX ON OIL AND GAS FROM INTEREST OWNERS TO OPERATORS. AT A MINIMUM, THE IMPLEMENTATION PLAN MUST MAKE RECOMMENDATIONS RELATED TO:

(A) THE LEGISLATIVE AND ADMINISTRATIVE STEPS NECESSARY TO IMPLEMENT THE CHANGE;

(B) ANY CHANGES TO THE TAX RATE AND STRUCTURE THAT ARE NECESSARY TO IMPLEMENT THE SHIFT IN LEGAL INCIDENCE IN A MANNER THAT IS REVENUE NEUTRAL TO THE GREATEST EXTENT POSSIBLE; AND

(C) ANY OTHER RECOMMENDATIONS TO REDUCE DISRUPTION TO

THE STATE, LOCAL GOVERNMENTS, AND STAKEHOLDERS DURING AND AFTER THE TRANSITION;

(II) REQUIRE ELECTRONIC FILING OF RETURNS FOR SEVERANCE TAXES; AND

(III) REQUIRE ADDITIONAL ELECTRONIC DATA COLLECTION NECESSARY TO EASE THE ADMINISTRATION AND ENFORCEMENT OF THE STATE SEVERANCE TAX ON OIL AND GAS, INCLUDING CONSIDERATION OF OPPORTUNITIES FOR INCREASED DATA SHARING AMONG STATE AND LOCAL GOVERNMENT AGENCIES.

(b) THE IMPLEMENTATION PLAN REQUIRED BY SUBSECTION (7)(a) OF THIS SECTION MUST INCLUDE A QUANTITATIVE FISCAL ANALYSIS OF THE CHANGE DESCRIBED IN SUBSECTION (7)(a)(I) OF THIS SECTION AND THE CALCULATION OF THE CREDIT ALLOWED IN SECTION 39-29-105 (2)(c) AND MAKE RECOMMENDATIONS AS TO HOW THEY CAN BE IMPLEMENTED WHILE MAINTAINING REVENUE NEUTRALITY.

(c) THE PERSONS IDENTIFIED IN SUBSECTION (7)(a) OF THIS SECTION SHALL ESTABLISH A STAKEHOLDER GROUP, CONSISTING OF AFFECTED INDUSTRIES AND PARTIES, INCLUDING LOCAL GOVERNMENT REPRESENTATIVES, TO ASSIST IN THE DEVELOPMENT OF THE IMPLEMENTATION PLAN.

(d) THE PERSONS IDENTIFIED IN SUBSECTION (7)(a) OF THIS SECTION SHALL SUBMIT THE WRITTEN IMPLEMENTATION PLAN TO THE JOINT BUDGET COMMITTEE NO LATER THAN JANUARY 15, 2024. PRIOR TO SUBMISSION OF THE IMPLEMENTATION PLAN, THE STAKEHOLDER GROUP SHALL HAVE AN OPPORTUNITY TO REVIEW THE DRAFT RECOMMENDATIONS AND INDIVIDUAL STAKEHOLDERS MAY PROVIDE COMMENTS IN RESPONSE TO THE IMPLEMENTATION PLAN TO BE INCLUDED WITH THE SUBMISSION OF

THE IMPLEMENTATION PLAN.

(e) THIS SUBSECTION (7) IS REPEALED, EFFECTIVE JULY 1, 2024.

SECTION 4. Appropriation. (1) For the 2022-23 state fiscal year, $16,877 is appropriated to the governor's office for use by the office of state planning and budgeting. This appropriation is from the general fund, and is based on the assumption that the office will require an additional 0.2 FTE. To implement this act, the office may use this appropriation for personal services.

(2) For the 2022-23 state fiscal year, $116,524 is appropriated to the department of revenue for use by the executive director's office. This appropriation is from the general fund. To implement this act, the office may use this appropriation as follows:

(a) $94,819 for personal services related to administration and support, which amount is based on an assumption that the office will require an additional 1.9 FTE; and

(b) $21,705 for operating expenses related to administration and support.

SECTION 5. Act subject to petition - effective date. This act takes effect at 12:01 a.m. on the day following the expiration of the ninety-day period after final adjournment of the general assembly; except that, if a referendum petition is filed pursuant to section 1 (3) of article V of the state constitution against this act or an item, section, or part of this act within such period, then the act, item, section, or part will not take effect unless approved by the people at the general election to be held in November 2022 and, in such case, will take effect on the date of the official declaration of the vote thereon by the governor.