Allocation of Severance Tax and Federal Mineral Lease Revenues

2007 Report to Legislative Council

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Marc Carey, Senior Fiscal Analyst
Todd Herreid, Economist III
Jason Schrock, Economist II

Office of Legislative Legal Services

Ed DeCecco, Senior Staff Attorney
Jason Gelender, Senior Staff Attorney
Tom Morris, Senior Staff Attorney

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Committee Charge

The Committee to Study the Allocation of Severance Tax and Federal Mineral Leasing (FML) Revenues was charged by SJR 07-042 with:

- proposing legislation or other policy changes concerning the allocation of severance tax or FML revenue as it deems appropriate;
- holding hearings to receive information or public input regarding the allocation of severance tax and FML revenue; and
- charging a working group to study and develop issues relating to the allocation of severance tax or FML revenue, including the issue of evaluation of the current system of quantifying and addressing local impacts from the energy and mineral industries, issues identified by the committee, and any other issues relating to the allocation identified by the working group.

In addition, SB 07-253 required the committee to study whether the General Assembly should authorize the State Treasurer to enter into price insurance contracts as a means to reduce the volatility of severance tax revenue received by the state. Further, HB 07-1309 required the committee to study the allocation of the additional interest earnings generated from changing the oil and gas severance tax collection period from quarterly to monthly.

Working group. As required by SJR 07-042, an 11-member working group was appointed to work with the committee. This group was charged by the committee with:

- evaluating and quantifying the impacts of the mineral extraction industry; and
- making policy recommendations to the committee with respect to the severance tax collection process and the allocation of mineral extraction-related revenue.

Legislative members of the committee were encouraged to participate in the activities of the working group, but could not vote on any matter decided by the working group. Further, the committee and working group were authorized to hold joint meetings in order to receive information from stakeholders. The committee provided the working group with a scope of work to follow for its study activities. In addition, the working group presented its findings and recommendations to the committee. Written reports prepared by the working group are available upon request.

Committee Activities

The Committee to Study the Allocation of Severance Tax and FML Revenues held six meetings during the 2007 interim. Meetings included a variety of presentations by representatives of:

1) entities and programs that currently receive severance tax and FML revenue;
2) state agencies involved in the collection and allocation of the revenue;
3) communities impacted by the mineral extraction industry;
4) entities that study and monitor the impacts of the industry;
5) the mineral extraction industry;
6) other states regarding their use of mineral extraction-related revenue;

7) financial experts;
8) legislative staff; and
9) other interested parties.

While the working group generally met separately to study and develop recommendations for the committee, working group members and committee members regularly participated in each other's meetings. The committee and working group also visited areas of Garfield and Rio Blanco counties in northwest Colorado to tour mineral extraction related facilities, observe the impacts of the mineral extraction industry, and take testimony from representatives of local communities regarding the positive and negative impacts of the mineral extraction industry.

The committee's meetings primarily focused on the following three issues: (1) the impacts on local communities from mineral extraction activities; (2) the collection of severance tax and FML revenue; and (3) the allocation of severance tax and FML revenue.

Impacts of the mineral extraction industry. The committee heard testimony on the impacts of mineral extraction activities from state and local officials, private citizens, industry representatives, and the working group. The testimony indicated that mineral extraction activity has both positive and negative impacts on communities. In some cases, the industry is already working with local governments to pay some of the additional costs associated with the negative impacts. The committee recommends Bill C to encourage more partnerships between the industry and local governments to mitigate impacts. The bill allows severance taxpayers an option to"prepay" a limited amount of their tax liability through contributions to fund public facility or physical infrastructure projects in impacted communities.

The collection of severance tax and FML revenue*.* The committee's working group devoted an extensive amount of time to studying the existing severance tax structure and collections process to identify ways to improve and simplify the current system. The working group recommended that the issues and potential consequences of making changes be studied more thoroughly through the creation of a "task force" comprised of a broad representation of stakeholders. The committee supported the prompt creation of this task force so that any improvements to the current system could be made as soon as practicable.

Allocation of severance tax and FML revenue. According to committee testimony and the findings of the working group, the current amount of severance tax and FML revenue allocated to local areas is not sufficient to offset the negative impacts resulting from mineral extraction activities. Thus, the committee and working group discussed several concepts intended to improve the current allocation of revenue in order to better assist the areas of the state impacted by energy production.

Several local governments testified that the current formula governing DOLA's direct distribution of severance tax and FML revenue to local governments could be improved to ensure that resources are allocated to the communities that need it most. The working group also came to this conclusion and studied other measures to improve the direct distribution formula to better account for the scale and types of impacts occurring in local areas. Some of the provisions in Bill A are the result of these discussions.

The committee and working group also discussed improving DOLA's energy and mineral impact assistance program so that the money distributed by the program is utilized most effectively. Bill A incorporates some of the recommendations resulting from these discussions. Most of the changes to the program, however, were recommended to be made administratively to allow DOLA to identify the most effective way to allocate the funds.

In addition, the committee and working group heard testimony regarding the mineral extraction industry's impact on the state's wildlife and outdoor recreational resources. The committee recommends Bill B as a result of these discussions which earmarks some severance tax revenue for the Division of Wildlife and the Division of Parks and Recreation.

The committee also discussed the use of bonding and other financing mechanisms as a way to bridge the short term needs of communities with the future stream of severance tax, FML, and property tax revenue received by those communities. A financial advisor for the state of New Mexico provided testimony on how New Mexico utilizes a portion of its severance tax revenue to issue bonds to fund capital construction projects.

Finally, the committee heard testimony from various stakeholders regarding changes to the allocation of the state's FML revenue. Given the recent growth in the state's FML revenue, the committee recognized:

- the importance of improving and simplifying the FML allocation process;
- the ongoing priority to use FML revenue to help mitigate the impacts of the mineral extraction industry; and
- the possibility of using FML revenue to provide increased resources for higher education purposes and for a permanent trust fund.

Because specific recommendations were not finalized by the time this report was provided to Legislative Council, no legislation intended to accomplish these goals is included in this report. However, the committee has scheduled a meeting on November 14, 2007, to consider legislation related to these concepts. The committee also plans to consider financing mechanisms using mineral extraction-related revenue to address industry impacts at this meeting. Any legislation that the committee recommends will be provided to the Legislative Council at its November 15, 2007, meeting.

Committee Recommendations

At the time of this report, the committee had discussed and deliberated 18 legislative proposals of which the following three are recommended for consideration during the 2008 legislative session. The co-chairs of the working group presented the group's final recommendations at the committee's fifth meeting. Many of the provisions of the following proposals are related to recommendations by the committee's working group. Some working group recommendations, however, did not require statutory changes.

The following bills were adopted by the interim committee:

Bill A — Distribution to Local Governments of State Revenues Derived from Mineral Extraction. Bill A changes the statutory formula that governs DOLA's allocation of severance tax and FML money to local governments under the direct distribution program. Current law requires

DOLA to distribute the money to local governments based on the proportion of industry employees that reside in their jurisdictions. The bill changes the formula so that the money is allocated to counties based on the proportion of:

- industry employees residing in the county;
- mining and well permits issued in the county; and
- mineral production occurring in the county.

The money allocated to each county would be split between the county government and the county's municipalities based on the proportion of industry employees that reside in the jurisdictions. The bill directs DOLA to establish the weight that each of the above factors is given, with no factor given a weight of less than 25 percent. Further, DOLA is required to submit biennial reports to specified committees of the House and Senate that evaluate the effectiveness of the factors in allocating the money to impacted areas.

Bill A also makes changes relating to the nine-member Energy Impact Assistance Advisory Committee, which is charged with reviewing the impacts of the industry and making recommendations on how to assist impacted areas. First, the bill adds to the committee the executive director of the Department of Public Health and Environment and increases the number of members who are residents of impacted areas from five to seven. It also requires these members, who are appointed by the Governor, to be confirmed by the Senate. Further, the bill gives the advisory committee the additional responsibility to make recommendations to DOLA on how to distribute its money with priority given to impacted areas.

Finally, the bill requires DOLA to consider the economic needs of a local government when providing grants under its energy and mineral impact assistance program. DOLA is also required to provide a detailed accounting of its distributions of severance tax and FML revenue to local governments to the state auditor in addition to its current requirement to provide the information to the General Assembly.

Bill B — Allocation from the Operational Account of the Severance Tax Trust Fund. Bill B allocates some severance tax revenue to the Division of Wildlife and the Division of Parks and Recreation in the Department of Natural Resources. To accomplish this, the bill reduces the annual limit on the amount of money in the Operational Account that the Colorado Oil and Gas Conservation Commission can receive from 45 percent to 40 percent and that the Division of Reclamation, Mining, and Safety can receive from 30 percent to 25 percent. The divisions of Wildlife and Parks and Recreation can then receive up to 5 percent each of the Operational Account's money.

Bill C — Severance Tax Prepayment Option for the Mitigation of the Impacts of Mineral Extraction Activities. For tax years commencing on or after January 1, 2009, Bill C allows a taxpayer to make a prepayment of severance taxes, up to $1 million annually, through contributions for public facility or physical infrastructure projects in areas directly and substantially impacted by mineral extraction activities. No more than $5 million can be prepaid by all taxpayers in the state annually. The prepayment must be approved by DOLA and must be based on an agreement between the taxpayer and the state or local government. The bill also specifies that the amount of the prepayment cannot exceed the taxpayer's severance tax liability, and any excess cannot be carried forward or refunded. The prepayment option expires December 31, 2013.