STATE OF COLORADO

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Bill Ritter, Jr.
Governor

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Director

MEMORANDUM

TO: Title Setting Review Board

FROM: Todd Saliman, Director

DATE: March 31, 2008

SUBJECT: Fiscal Analysis for Proposed Ballot Initiative #68

Ballot Initiative #68 would amend the existing severance tax statutes to eliminate the *ad valorem* property tax credit that may be taken by oil and gas interest holders against their severance tax liabilities, and eliminate the tax exemption for wells producing less than fifteen barrels of oil or ninety thousand cubic feet of gas per day. As the initiative raises the revenue retained by the state from an existing tax without increasing the tax rate, the Governor's Office of State Planning and Budgeting (OSPB) is tasked with calculating the annual amount of the tax increase as specified by TABOR in the following format: "Shall state taxes be increased $_____ annually…?"

The OSPB has several caveats regarding the estimated fiscal impacts of the proposed Ballot Initiative #68. It is important to note that the revenue received from elimination of the ad valorem tax credit and small well exemption could vary greatly from the fiscal estimate if passed. In an effort to create a reasonable fiscal estimate, the OSPB consulted with the Department of Local Affairs and Legislative Council Staff economists on the assumptions inherent to this analysis.

- **Severance taxes are extremely volatile.** Energy prices are determined by global supply and demand and are highly sensitive to unforeseeable economic and geopolitical events. The production decisions of firms in Colorado depend on several variables apart from output price, such as interest rates, technological ability and the political climate around drilling in areas of environmental significance.

- **The fiscal impact of this initiative is not completely observable *ex post*.** The total value of all *ad valorem* tax credits and small well exemptions is not tracked by the Department of Revenue due to the layout of the severance tax form and limitations of the tax accounting software system. Therefore, it will not be possible to precisely identify how much of the presumed gain in tax revenue is due to the elimination of the credit and the small well exemption and how much results from changes in price or production volume or from deductions relating to transportation, processing and manufacturing costs. Therefore, there is no basis for calculating exactly the net revenue gain for TABOR compliance purposes.

Fiscal Analysis

Prices for Colorado's natural gas and oil are a weighted approximation, derived at the point-of-sale at hubs located in surrounding states where Colorado natural gas and oil is priced. These weighted prices are tracked by the Colorado Oil and Gas Conservation Commission and are accessible from their website (http://oil-gas.state.co.us/). Colorado is distant from markets, leading to generally lower prices and a "basis differential" from national market gas prices. Ultimately, the basis differential, combined with national market behavior in response to supply and storage capacity, all act to create an extremely dynamic price environment.

The OSPB estimates that the aggregate fiscal impact from these changes will be $260.8 million in FY 2009-10 over the current-law OSPB forecast.

The gross amount of tax revenue generated by the elimination of the *ad valorem* credit will be $213.3 million in FY 2009-10. The OSPB incorporated the component analysis used by the Department of Local Affairs in order to make projections regarding the value of production of oil and gas in FY 2009-10 as the basis for this estimate, incorporating estimates of gross production value, exemptions for small wells, and deductions for transportation, manufacturing and processing costs to indirectly estimate the value of the *ad valorem* credit.

The additional revenue generated from collecting severance taxes on small wells will be $47.5 million in FY 2009-10. This is at the low end of a range of reasonable estimated impacts, because it is possible that many marginal small wells could become unprofitable and be shut down.