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(970) 242-3264 ★ FAX (970) 245-8300

P.O. Box 550 ★ Grand Junction, CO 81502-0550

www.club20.org

**CLUB 20 Opposes Initiative #113 concerning
Amending the Distribution of Severance Tax Revenues**

June 9, 2008

SUBJECT: An Open Letter in Opposition to Proposed Severance Tax Initiative #113

FROM: Reeves Brown, CLUB 20 Executive Director

CLUB 20 – the 55-year old coalition of Western Colorado’s 22 counties – has long supported the dedication of mineral severance tax revenues for the priority purpose of mitigating the adverse impacts of energy development on source communities. These communities struggle with inadequate funds to meet growing demands on their local infrastructure – from road maintenance and water treatment to law enforcement and social services. At present, 50% of severance tax revenues go back to those local communities through direct allocations or energy impact grants.

CLUB 20 recently reviewed the proposed Severance Tax Initiative #113 which may be on the ballot before Colorado voters in November. Initiative #113, while effectively increasing the severance tax rate, would decrease the local share from the current 50% to only 22% and initiate 5 new funding targets which will compete for severance tax revenues. Because of this adverse impact to locally impacted communities, the CLUB 20 Executive Committee has voted unanimously to oppose Initiative #113.

Following is a detailed economic analysis of Initiative #113 produced by Jim Evans, a professional economist and member of CLUB 20’s Executive Committee. Mr. Evans’ analysis concludes that – had Initiative #113 been in effect in recent years – it would have dramatically reduced the revenues which energy impacted communities received, and it could have an equally adverse impact on those same communities in future years.

**An Economic Analysis of Initiative #113
and It’s Effect on Local Energy-Impacted Communities**

by Jim Evans, Economist

Contrary to what proponents of Initiative #113 might say, the initiative does not “hold harmless” the severance tax revenues now available for local governments through the Colorado Energy Impact Program. In order to truly hold harmless the revenues which these locally impacted communities depend on, the existing uses of revenue must be protected and the revised formula must only apply to new or increased revenue. Instead, Initiative #113 eliminates the property tax deduction from the gross severance liability (estimated at \$100 million in 2006) and then reduces the local share of all oil & gas severance taxes to the State Energy Impact Program

from 50% down to 22%. My analysis, based upon the peak oil and gas production year of 2006, indicates that the formula change would reduce energy impact grants and distribution available to local governments by as much as \$23 million annually!

My analysis included actual severance tax data for the six-year period 2001 – 2006. This is the most recent data available on the Colorado Department of Local Affairs (DOLA) web site, dated March, 2007. For 2006 there was a “Gross Severance Liability” of \$300 million, less the oil and gas property tax deduction of \$100 million, for a net Severance Tax of \$200 million. Under current law the 50% local government share is \$100 million. The Colorado Department of Natural Resources (DNR) operating programs receive the other 50% share. Under the Initiative #113 formula, the property tax deduction of \$100 million would be eliminated leaving \$300 million in severance taxes. Then an estimated ½ of exempt low production wells would be added back at an estimated \$50 million providing a net severance tax of \$350 million. The 22% local share would be \$77 million, a \$23 million reduction. The 50% DNR share would be similarly reduced by \$23 million.

An analysis of each of the past six years (2001 through 2006) indicates that only in one year (2003) would the local share gain. In each of the other five years the local share would have been reduced, for a net six year reduction of the local share by an estimated \$45 million overall loss.

Severance Tax Variability Problem

The potential overall loss of funds for the State Energy Impact Program could seriously hamper future DOLA efforts on behalf of local governments to hedge against the variability of the annual severance tax revenue. Currently DOLA administratively retains a portion of its 50% share of severance tax revenues to provide a cushion in case of an unanticipated revenue shortfall. However, Initiative #113 would permanently limit the local share of oil and gas severance tax to 22%. The drafters of Initiative #113 apparently recognize this variability problem because they propose to establish a 10% reserve for the new Severance Tax Stabilization Operational Account. Unfortunately for local governments, this reserve is for the new severance tax programs only. Local governments in energy impact areas would continue to face the variability problem with no access to the reserve and with DOLA only receiving 22% rather than 50% of the Severance Tax revenue for the Local Government Energy Impact Program.

Technical Problem

It also appears that the proposed initiative would reinsert statute language concerning severance tax employee reports that had been eliminated this year in SB08-218. This technical problem would require all severance taxpayers to submit to the state an annual report even if the taxpayer had no qualifying employees. This glitch would undo part of the reporting simplification worked out over the past few years by the DOLA Severance Tax Task Force. It could require up to 200 unnecessary reports annually.

Proposed Distribution

In the peak Colorado oil and gas production year of 2006, there was oil and gas production of \$10 billion. After deductions for transportation costs from the well to market plus exemption of marginal producing wells, the gross severance liability was \$300 million, or 3%. After the \$100 million property tax deduction the net severance tax was \$200 million with the 50% local share at \$100 million. The 50% DNR share was also \$100 million. Under initiative #113, there would be no property tax deduction which would increase severance tax by \$100 million. There would be no change in the deductions allowed for transportation costs, but the marginal wells exemption would be cut in half for an estimated additional severance tax increase of about \$50 million, for a total severance tax increase of about \$150 million. This \$150 million plus the reduction of \$23 million for local governments and the \$23 million reduction for DNR Operating programs would be shifted to the new Severance Tax Stabilization Fund, a total of \$196 million for new programs.

The two stage distribution under Initiative #113 would be as follows:

<u>First Stage Distribution</u>	<u>\$Millions</u>
22% Local Government Energy Impact Fund	\$ 77
22% DNR Operational Fund	77
56% New Severance Tax Stabilization Fund	196
Total	\$350

<u>Second Stage Distribution</u>	<u>\$Millions</u>
10% Reserve, then distribute from balance:	\$ 20
60% Four-Year College Scholarships	105
15% Wildlife Habitat Acquisition	26
10% Clean Energy Fund	18
10% CDOT Highways	18
5% CDPHE Water Quality Grants	9
Total	\$196

Concerns regarding the Proposed Distribution and Increased Tax

The proposed distribution changes and tax increase raise the following concerns about the enactment of Initiative #113:

1. Severance tax revenues to the most impacted communities which are responsible for generating these revenues could be significantly reduced, and therefore these communities' ability to meet their growing infrastructure needs caused by this energy development would be hindered.

2. It may be poor timing for a tax increase that surely would be passed through to consumers, either at the gas pump or in utility bills, further aggravating the impact of high energy costs on the economy.
3. The combination of the proposed new severance tax together with proposed new regulations on Colorado's oil and gas industry has already caused at least two energy companies to cancel or reduce planned production investments in Colorado. Colorado's robust economy is an anomaly amidst the national recession, and this is largely due to the energy industry's investment in our state. If the severance tax burden on industry is increased via the passage of Initiative #113, at the same time that the regulatory burden is also increased, then Colorado will become less competitive in attracting these industry investments which are propelling our state's economy.
4. Initiative #113's emphasis on the use of college scholarships rather than providing direct financial assistance to the institutions themselves does nothing to address their growing funding needs and, as such, will likely result in encouraging Colorado's colleges and universities to continue to increase tuitions and expenditures to meet these needs. Tuition increases at Colorado universities – at 11% and 9% the past 2 years – have already been reported as the second highest rate increases in the nation.
5. The Wildlife Habitat Acquisition program may aggravate taxpayer concerns about taking private property out of the local property tax base. Such concerns have been reported in the Craig/Moffat County area and in the Salida/Ft. Carson area.

Conclusion

Despite the stated intent of Initiative #113 that existing energy impact programs “not be adversely impacted”, it appears that these programs WILL be adversely impacted, and quite significantly so. Further, it appears that Initiative #113 may provide no significant benefit to Colorado's institutions of higher education. The ultimate effect of Initiative #113 will be to reduce severance tax revenues from those local communities which are most adversely affected and shift these monies to individual college scholarships and new programs for open space.

Jim Evans
1449 White Avenue
Grand Junction, CO 81501
970/255-1027 (H) 910/489-7667 (C)