



**Colorado
Legislative
Council
Staff**

SB16-218

**FINAL
FISCAL NOTE**

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

Drafting Number: LLS 16-1285 **Date:** August 29, 2016
Prime Sponsor(s): Sen. Lambert; Steadman **Bill Status:** Signed into Law
 Rep. Hamner; Rankin **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	See State Revenue section.		
Cash Funds			
State Diversions			
General Fund		(\$51.4 million)	
Cash Funds		\$51.4 million	
State Expenditures	See State Expenditures section.		
General Fund			
Cash Funds			
Appropriation Required: None.			
Future Year Impacts: None.			

Summary of Legislation

This 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. Deductible costs specifically include direct costs and foregone returns on investment as a result of expenditures for these purposes. Additional costs listed on the Netback Expense Report Forms (NERF) submitted by oil and gas producers to county assessors may also be deductible. An agency rulemaking process to determine the degree to which these deductions may be claimed is ongoing.

The Supreme Court decision allows oil and gas producers to claim 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 severance tax refunds by diverting income tax revenue to a reserve used to pay these 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 **\$51.4 million in FY 2016-17**. The bill is not expected to divert income tax revenue in the current FY 2015-16.

For FY 2015-16, the bill diverts income tax revenue to the reserve only if, for the period between the bill's effective date and the end of the fiscal year, required severance tax refunds exceed severance tax collections. Only a refund to BP America Production Company, in the amount of \$2.4 million, is expected to be made in FY 2015-16 on a cash accounting basis. Because severance tax collections are expected to be sufficient to pay this refund, no diversion is expected.

For FY 2016-17, the bill requires that monthly diversions be made in amounts sufficient to pay refunds that exceed 15 percent of gross severance tax revenue collected for the month. This fiscal note assumes that all refunds required as a result of the Supreme Court decision that are booked in FY 2016-17 on a cash accounting basis will trigger diversions of income tax revenue. This amount is estimated at \$39.6 million, including \$25.3 million in refunds for return on investment deductions explicitly permitted in the Supreme Court decision and \$14.3 million in refunds for other NERF deductions expected to be permitted as a result of revisions to severance tax rules. To the extent that these refunds are paid in months when non-*BP America* related refunds total less than 15 percent of gross severance tax collections, the bill will not require income tax diversions, and the total amount diverted for FY 2016-17 will be less than estimated.

The bill is also expected to result in diversions of income tax revenue for non-*BP America* related refunds that exceed 15 percent of gross severance tax collections for a given month. Based on severance tax refund data since early 2004, approximately 12.3 percent of annual severance tax refunds exceed 15 percent of gross tax receipts for the months in which they are paid. Diversions for refunds unrelated to the Supreme Court decision are expected to total \$11.8 million in FY 2016-17.

State Expenditures

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. It is expected that restrictions placed on the Severance Tax Operational Fund will reduce DNR expenditures for endangered species conservation programs by at least \$1.5 million. 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 June 2016 Legislative Council Staff forecast, severance tax revenue for this period is expected to total \$42.8 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 was signed into law by the Governor and took effect on June 10, 2016.

State and Local Government Contacts

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Information Technology
Local Affairs
Natural Resources
Personnel

Legislative Council Staff
Joint Budget Committee Staff
Municipalities
Office of State Planning and Budgeting
Revenue