

# A G E N D A

## Interim Committee to Study the Allocation of Severance Tax and Federal Mineral Lease Revenue

House Committee Room 0112  
State Capitol Building

Thursday, June 21, 2007  
11:00 a.m. to 5:30 p.m.

### SUMMARY FOLLOWS AGENDA

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**11:00 a.m. - 11:15 a.m.**      ***Call to Order; Opening Comments***

- Senator Gail Schwartz, Chair
- Representative Kathleen Curry, Vice-Chair

**11:15 a.m. - 11:45 a.m.**      ***Overview of Severance Tax and Federal Mineral Lease Revenue in Colorado***

- Mr. Todd Herreid, Legislative Council Staff
- Mr. Marc Carey, Legislative Council Staff

**11:45 p.m. - 12:30 p.m.**      ***Collection of the Severance Tax*** (Working Lunch)

- Mr. Jim Meyers, Department of Revenue
- Mr. Phil Horwitz, Department of Revenue

**12:30 p.m. - 1:00 p.m.**      ***Overview of the Allocation of Severance Tax and Federal Mineral Lease Revenue in Colorado***

- Mr. Todd Herreid, Legislative Council Staff
- Mr. Jason Schrock, Legislative Council Staff

**1:00 p.m. - 1:45 p.m.**      ***Use/Distribution of Severance Tax and Federal Mineral Lease Revenue by the Department of Natural Resources***

- Mr. Bill Levine, Department of Natural Resources
- Mr. Mike Serlet, Colorado Water Conservation Board
- Mr. Steve Biondo, Colorado Water Conservation Board

**1:45 p.m. - 2:00 p.m.**      ***Break***

**2:00 p.m. - 2:45 p.m.**      ***Distribution of Severance Tax and Federal Mineral Lease Revenue by the Department of Local Affairs***

- Mr. Charles Unseld, Department of Local Affairs

**2:45 p.m. - 3:30 p.m.**      ***Existing Research on the Impacts of the Mineral Extraction Industry; Studying the Impacts of the Mineral Extraction Industry on Colorado***

- Mr. Steve Colby, Department of Local Affairs

**3:30 p.m. - 5:00 p.m.**      ***Functions and Scope of the Committee's Working Group***

- Senator Gail Schwartz, Chair
- Representative Kathleen Curry, Vice-Chair
- Working Group

**5:00 p.m. - 5:30 p.m.**      ***Committee Discussion and Other Business***

- Committee Discussion
- Future Meetings
- Tour Discussion

**5:30 p.m.**      ***Adjourn***

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### STAFF SUMMARY OF MEETING

#### ALLOCATION OF SEVERANCE TAX AND FEDERAL MINERAL LEASE REVENUES COMMITTEE

Date: 06/21/07

ATTENDANCE:

Time: 11:13 AM to 05:06 PM

Place: HCR 0112

This Meeting was called to order by  
Senator Schwartz

This Report was prepared by  
Danica Bracken

Balmer	X
Buescher	E
Fischer	X
Isgar	X
Penry	X
Romer	*
Sonnenberg	X
Taylor	X
White	X
Curry	X
Schwartz	X

\* Present after roll call.

Bills Addressed:

Action Taken:

Call to Order - Introductory Comments -  
Existing Structure of Mineral Revenues in Colorado -  
Presentation by the Department of Revenue -  
Allocation of Severance Tax and FML Revenue -  
Presentation by Department of Natural Resources -  
Presentation by Department of Local Affairs -  
Discussion of Function and Scope of Working Group -

#### **11:15 AM -- Call to Order - Introductory Comments**

Senator Schwartz, chair, called the meeting to order and expressed her hope that the committee will develop a comprehensive estimate of the impacts of the mineral extraction industry. She thought that the committee should also look at the current collection and allocation of severance tax and federal mineral leasing (FML) revenue so that it can propose good legislation on how to best address the impacts of the industry on the state and local communities. She stated that the working group that has been assigned to assist the committee will be utilized to assist the committee in its efforts.

Representative Curry, vice-chair, reiterated the need to look at how severance tax and FML revenue is collected, allocated, and how the mineral extraction industry impacts communities. She noted that local governments are concerned about the recent increased level of mineral extraction activities and its impacts. Representative Curry hoped that the committee can gain an understanding of how to best meet the needs of impacted communities.

Members of the committee introduced themselves and indicated the districts that they represent. Legislative staff assigned to the committee from the Office of Legislative Legal Services (OLLS) and Legislative Council Staff (LCS) also introduced themselves.

#### **11:24 AM -- Legislative Council Staff Briefing on the Existing Structure of Mineral Revenues in Colorado**

Mr. Marc Carey, LCS, gave an overview of the current mineral extraction tax structure, and provided information on historical revenue collections and estimates on where the revenue is generated in the state. A copy of the LCS memorandum presented is provided as Attachment A. He discussed the difference between the statutory and effective severance tax rates, the variability of severance tax collections, and the concentration of mineral extraction activities within a few counties. He noted that the extraction activities are becoming less concentrated. He also explained that 90 percent of oil wells and 70 percent of natural gas wells are classified as stripper wells, which are exempt from taxation. He explained that the difference between the statutory and effective tax rates is caused by tax credits, exemptions, and deductions that work to offset or lower the severance tax obligations of taxpayers.

#### **11:36 AM**

Senator Taylor commented that some individuals expect severance tax revenue to continue to grow and noted that history demonstrates that it will not. LCS was asked to provide data at later date on local government property tax revenue from the mineral extraction industry and information on the rationale for the stripper well exemption. Also, LCS indicated it would research whether the income from mineral production interest owners is considered on a single well basis or their total portfolio of wells for tax purposes. It was noted that the answer may be provided later during the meeting. Representative Fischer encouraged the committee and working group to review the State Auditor's audit on the severance tax collection process (Attachment B).

#### **11:42 AM**

Mr. Todd Herreid, LCS, gave an overview of the structure of FML revenue, the history of how much FML revenue has been collected in Colorado, and discussed the counties where FML revenue originates. There are three sources of FML revenue: bonus payments; rental payments; and royalties. Representative White inquired about the selling of leasing rights in certain parts of the state and how much revenue such sales generate. The committee also discussed the future of mineral extraction activities on the Roan Plateau, the rules regarding bonus payment percentages, and the dispute over money in the Naval Reserve Account.

**11:53 AM**

Mr. Herreid indicated that about 95 percent of FML revenue originates from just 10 counties. He explained that the severance tax rate is based on the income earned from production or tonnage produced while FML revenue is generated based on the value of the production. The committee asked for information about the taxation of uranium extraction.

**11:57 AM -- Presentation by the Department of Revenue**

Mr. Phillip Horowitz, acting Chief Auditor, and Mr. Jim Meyers, Director, Mineral Audit Program, Department of Revenue (DOR) introduced themselves. Mr. Horowitz provided background information on the split of FML revenue between the states and the federal government. The committee discussed how the FML revenue should be spent, whether the federal government constrains how states spend their share of FML, and how other states spend their revenue, especially on impacted areas. It was acknowledged that the committee's working group would study these issues. Mr. Horowitz discussed the possibility of the federal government reducing the state share of FML revenue.

**12:08 PM**

Mr. Horowitz explained that the severance tax is imposed on all interest owners and administered at the interest-owner level, but that the tax is withheld at the operator level. He explained that there is confusion regarding the payment of the tax which leads to some noncompliance. He explained that if the tax system was operator-based the number of tax accounts would drop from 8,000 to 300 and thus DOR could more easily audit taxpayers for compliance. The committee discussed the revenue implications of changing the point of taxation from the interest-owner to the operator, especially in regards to TABOR. Mr. Horowitz proposed that the committee consider eliminating the ad valorem tax credit against severance taxes paid and decreasing other taxes paid by operators and interest owners to make administration of the severance tax more efficient.

**12:48 PM**

The committee discussed the mineral extraction taxation system and a tax amnesty program. Mr. Horowitz explained that the ad valorem tax is imposed at the operator level. He stated that DOR routinely audits the top 20 largest operators' for tax compliance, which results in less tax avoidance at the operator level. However, he noted that DOR is not as successful at auditing at the interest-owner level. The committee continued to discuss the point of taxation and how TABOR would impact the ability to make changes to the tax collections process. DOR explained that most other, or possibly all, states impose the severance tax at the operator level.

**12:55 PM -- Legislative Council Staff Briefing on the Allocation of Severance Tax and FML Revenue**

Mr. Todd Herreid, LCS, gave a brief overview of the current statutory allocation of severance tax revenue. A copy of the memorandum presented is provided as Attachment C. He emphasized that beginning in year FY 2007-08, the Department of Local Affairs' (DOLA) allocation of severance tax revenue will be changed so that 30 percent (up from 15 percent) will be allocated through the "direct distribution" process to local governments based on mineral extraction employment and that 70 percent (down from 85 percent) will be allocated in the form of impact assistance grant and loan awards.

**12:57 PM**

Mr. Jason Schrock, LCS, described the FML revenue allocation. He explained that the money goes to the State Public School Fund, to local governments via direct distributions, to DOLA for grants to local governments, and to the Colorado Water Conservation Board Construction Fund for water projects. The Committee inquired about the process for requesting and distributing grants and the reasons for why some local governments get a greater portion of grants than others. Mr. Schrock indicated that DOLA could likely address these questions during their upcoming presentation.

Mr. Herreid indicated that the two LCS memos that were presented on the structure and allocation of severance tax and FML revenue provide data that can be used to compare the amount of revenue generated from and distributed to local governments. The committee requested more information on the proportion of severance tax and FML revenue allocated to local governments.

## **01:18 PM -- Presentation by the Department of Natural Resources**

Mr. Harris Sherman, Executive Director of the Department of Natural Resources (DNR), discussed the statutory purpose of the severance tax and DNR's duties to manage, regulate, and foster the extraction of the state's non-renewable mineral resources, to protect the state's environment and wildlife resources, and to foster the development and conservation of Colorado's water resources.

## **01:23 PM**

Mr. Bill Levine, Budget Director, DNR, explained that half of the severance tax money goes to the Operational Account and the other half goes to the Perpetual Base Account in the Severance Tax Trust Fund. A copy of the presentation materials on the Operational Account is provided as Attachment D. The Oil and Gas Conservation Commission can receive a maximum of 45 percent of the funds in the Operational Account, the Geological Survey can receive a maximum of 20 percent, the Division of Reclamation, Mining, and Safety a maximum of 30 percent, and the Water Conservation Board a maximum of 5 percent.

Mr. Levine emphasized that the majority of DNR's Operational Account programs are geared toward long-term investments for the state. They include the regulation of current mineral extraction activities to minimize environmental impacts, reclamation of old production sites, studies to improve environmental knowledge and benefit natural resource planning, and projects to meet long term water supply needs. He added that species protection is one program that has become a priority, as well as the efforts to support the Interbasin Compact Committee and drought planning. Mr. Levine explained that the Operational Account's main reserve must equal two years of spending for the four major Operational Account programs.

## **01:35 PM**

Mr. Levine explained that the statutes in reference to the Operational and Perpetual Base accounts are silent about whether the money should be spent in certain geographic areas and the money has historically been spent with a statewide focus. He also discussed the increased spending from the Operational Account in recent years due to increased severance tax revenue. The committee discussed how the Operational Account has also been used to pay for state lawsuits resulting from disputes with other states over water resources.

## **01:42 PM**

Mr. Mike Serlet, Section Chief for the Water Supply, Planning, and Finance Section of the Colorado Water Conservation Board (CWCB), DNR, described the operations of the CWCB. A copy of his presentation materials are provided as Attachment E. There are two funds that the CWCB uses to provide money, mostly through loans, for water projects - the Perpetual Base Account and the CWCB Construction Fund. He explained the similarities and differences between the two funds. He emphasized that the Construction Fund can only fund projects that are authorized each year through legislation. Since the Construction Fund's inception, 250 water projects have been funded. He noted that the CWCB's administration costs are currently funded entirely by the Construction Fund, but were formerly half-funded by the General Fund.

Mr. Serlet explained that the Construction Fund's target growth rate is 3 percent and that the balance of both the Perpetual Base Account and the Construction Fund is kept close to zero for the purpose of providing the maximum amount of funding for water projects in the state. He indicated that DNR is planning to propose to the legislature that the Perpetual Base Account can be used to make grants, which would be used for projects in which DNR could partner with other entities.

## **02:02 PM**

Mr. Serlet indicated that the two funds cannot provide money for water treatment or drinking water projects. However, the Colorado Water Resources and Power Development Authority can fund such projects. He explained that the process for awarding money for projects is generally based on a "first come, first served" basis and that demand for funding has not exceeded supply. In statute, agricultural projects are given priority for funding, however, because the demand for funding has not exceeded supply, other projects have not been declined in order to fund agricultural projects. He explained that the State Auditor's Office recommended that the CWCB maintain a balance in the Construction Fund as close to zero as possible.

## **2:34 PM -- Presentation by the Department of Local Affairs**

Ms. Susan Kirkpatrick, Executive Director, Mr. Charles Unseld, Deputy Director, Division of Local Government, and Steve Mr. Colby, Division of Local Government, DOLA, made introductory comments about the programs administered by DOLA using FML and

severance tax money. A copy of DOLA's presentation materials is provided as Attachment F. Mr. Unsel explained DOLA's Local Government Energy and Mineral Impact Assistance Program that provides grant and loan awards to local governments impacted by the mineral extraction industry. He stated that because the mineral extraction industry is volatile the revenue derived from taxes related to the industry are volatile and thus the amount of money available annually for grants and loans fluctuate.

Mr. Unsel provided data on grants and loans allocated for the program as well as mineral extraction activity by region and basin. He emphasized that DOLA does not use a formula to direct funds to areas based on the level of mineral extraction impacts on local communities. He noted that there is a fairly equal distribution of awards by region, with the exception of the Front Range. He discussed the award amounts by type of project. Funding for road projects is increasing as there has been a significant increase in requests for funds to mitigate impacts on roads and bridges. Mr. Colby discussed the use of funds for community development projects.

**2:43 PM**

Mr. Unsel explained how DOLA's technical field staff helps local governments apply for grants and loans so that small jurisdictions are not excluded from the funding process. Mr. Colby indicated that currently only 10 percent of the program's awards are for loans. Mr. Unsel commented on the current administration of the program with the large increase in revenue available recently. New initiatives have been started as a result of increased revenue, such as providing funding for a statewide communication network, water enhancement and treatment projects, and road and bridges projects in areas with high impacts from the mineral industry.

**2:52 PM**

Mr. Colby explained the process and timelines involved with the awarding of grants and loans through the Local Government Energy and Mineral Impact Assistance Program. DOLA first offers technical assistance to local communities and then enters into contracts which require the communities to complete certain steps in order to receive funding. The process of funding projects is relatively long, generally occurring over a seven-year period. Thus, DOLA's impact fund may show a large balance at any given time, but the majority of money in the fund is generally earmarked for projects.

Mr. Unsel discussed the decision process for the awarding of funds through the program. There is an advisory committee that reviews and recommends projects to the director of DOLA, who makes the final decision. He indicated that the director normally does not make decisions contrary to the committee. The committee asked that the criteria used by the advisory committee for funding decisions be made available to them.

**3:02 PM**

Mr. Colby provided information about the socioeconomic impacts of the mineral industry and studies that have been conducted on such impacts. He also explained that DOLA tries to get local governments to work together in dealing with the impacts of the mineral extraction industry.

### **3:18 PM -- Functions and Scope of the Committee's Working Group; Committee Discussion and Other Business**

The committee discussed the scope of work for the working group. Ms. Kirkpatrick expressed concern about the time frame in which the committee is requesting an impact study. Mr. Colby clarified that a socioeconomic study is not being conducted by DOLA. However, data is collected every month by DOLA based on local community needs. Although the data is generally not compiled in a manner that would be helpful for analysis. He assured the committee that DOLA plans to work with the working group and the committee to help meet its needs, but that it will not be able to do all the work. The committee discussed what information on the impacts of the mineral extraction industry can be made available to help with its deliberations. It also discussed how the impacts can be estimated. Mr. Colby warned that the state should not rely on the mineral extraction industry for revenue in the future. Since interest rates and natural gas production have an inverse relationship, it is possible that less natural gas production will occur in the future.

Ms. Kirkpatrick suggested that the committee and working group look at the industry's impacts at the regional level, rather than the county level. Mr. Colby suggested that the committee and working group look at La Plata County's oil and gas boom and bust cycle, which could provide useful information about mineral extraction industry impacts.

**3:33 PM**

Ms. Kirkpatrick explained that there are no studies that either have been or are being conducted for DOLA that would be

especially useful to the committee. Mr. Colby noted that DOLA will help the working group compile the results of other studies on the impacts of the mineral extraction industry. Senator Isgar expressed the need to obtain an assessment of the impacts as a starting point in the committee's deliberations regarding the allocation of severance tax and FML revenue. He suggested that an independent entity conduct such a study. The committee discussed whether it is realistic to expect that a study on the impacts of the industry be completed by fall and whether such a study can even be completed and be useful.

**3:46 PM**

The committee continued to discuss the scope of work for the working group and made some minor revisions.

The committee also discussed a potential tour of mineral extraction sites in northwest Colorado and its next meeting. It also discussed examples of impacts from the mineral extraction industry. A copy of a newspaper article showing an example of the impacts of the industry in northwest Colorado was distributed to the committee (Attachment G).

**4:15 PM**

Representative Fischer expressed his hope that the committee will consider statewide impacts in addition to local community impacts. Representative Curry stated that the mineral extraction industry impacts include both positive and negative impacts and that the committee will consider both.

The committee agreed that the working group's reports will be written and accompanied by a verbal presentation. The committee indicated that there is no budget for the working group, but that the working group can utilize the existing resources of DOLA and DNR and existing studies and data to help with its efforts.

**4:30 PM**

Senator Schwartz explained that the issue of raising severance taxes was not within the scope of the committee. Rather, the committee should focus on maximizing the tax revenue that is currently due to the state. However, it was acknowledged that the working group should have the flexibility to discuss the whether severance tax rates should be changed if it believes it merits consideration.

The committee discussed the short and long term impacts of the mineral extraction industry, the original intent of the use of severance tax revenue, and the benefits that the industry brings to Colorado.

**4:50 PM**

The committee discussed the potential need to save severance tax and FML revenue, possibly in a permanent trust fund, for when the oil and natural gas boom subsides. It also discussed the need to invest the revenue for the long-term benefit of the state. Senator Romer discussed partnering with the mineral extraction industry to help deal with impacts and to invest for the long-term benefit of the state. He also indicated the state should work with the industry to help export natural gas out of Colorado more easily and obtain a better price for the natural gas.

**5:06 PM**

The committee adjourned.