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F I S C A L   I M P A C T   R E P O R T

SPONSOR: Whitaker DATE TYPED: 3/18/03 HB 661/aHAFC/aSFC

SHORT TITLE: New Oil and Gas Wells Tax Credit SB

ANALYST: Neel

APPROPRIATION

Appropriation Contained		Subsequent Year Fiscal Impact (Currently Unknown)		Recurring or Non-Rec	Fund Affected
FY03	**FY04**				
			See narrative		General Fund (Operating Reserve)
			See narrative		Oil and Gas Tax Credit Fund

SOURCES OF INFORMATION

LFC files

Responses Received From

Energy, Mineral and Natural Resources Department (EMNRD)
State Land Office (SLO)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of SFC Amendment

The proposed amendment strikes HAFC Amendment 7, and replaces the emergency clause with a contingent effective date based on the price of oil and gas. The new effective date is triggered when the monthly value of either oil or gas for four consecutive months is $19.00/barrel or less for oil or $2.25/mcf or less for natural gas.

Upon the effective date, $12.0 million is transferred from the General Fund’s Operating Reserve to the Oil and Gas Tax Credit Fund for the tax credits associated in HB661. Provisions of HB 661 expire June 30, 2008.

It should be noted that the last time natural gas or oil were at the "triggering" level was November 2001 through February 2002 when the average price of oil fluctuated $17.66 and $18.70 a barrel. Prior to this time frame, the last time the "triggering level was reached was August and July of 1999 for oil and gas, respectively. Based on the current futures markets for natural gas and oil it does not appear that the "triggering" price levels will be met within the next 18 month revenue horizon. However, the triggering price levels will almost certainly be met within the next five years, which is the life span for the bill.

Synopsis of HAFC Amendment

The House Appropriations and Finance Committee amendments make minor changes to House Bill 661 (HB661) to correct some technical deficiencies and to change the source of the funds used to pay the tax credits.

The title of the bill is corrected so that it summarizes all of the bills' objectives, including the objective of promoting drilling from a single well pad, reducing the surface impact of oil and gas operations and enhancing state revenues. The amendment also makes minor typographical corrections throughout.

An important amendment is contained in Subsection D of the bill. The amendment substitutes a new Subsection D. That subsection clarifies that the tax credit authorized by the bill is to be disbursed as a refund. New Subsection D states that a request for a refund is to be processed by the Taxation and Revenue Department, and a refund will be issued to the operator by warrant. A refund request will be processed only after the Oil Conservation Division (OCD) certifies that the well upon which the tax credit is claimed meets the requirements of the bill. Finally, new Subsection D clarifies that upon receipt of the refund, the operator is to allocate the refund among the working interest owners.

The amendment defines "operator" as that person shown on the records of the OCD as the operator of the well.

Finally, the amendment provides funding for the tax credits authorized in the bill from the operating reserve rather than the general fund (see note under technical issues).

Synopsis of Original Bill

House Bill 661 amends statute to provide for a tax credit against the Oil and Gas Emergency School Tax for each new oil and gas well drilled between January 1, 2003 and July 1, 2004 and completed as a producing well. The amount of the credit is $15,000 for vertical wells and $30,000 for a well that was directionally or horizontally drilled, utilized technology that enables more than one well-bore to be drilled from a single pad or utilized a single new well-bore to access more than one petroleum reservoir. The tax credit is automatically repealed on July 1, 2004 or when a total of $12 million of credits have been certified. The Oil Conservation Division of the Energy, Minerals and Natural Resources Department is responsible for certifying eligibility of wells for the credit to the Taxation and Revenue Department, which will issue the credits. The bill appropriates $12 million from the General Fund to the Oil and Gas Tax Credit Fund, from which credits will be issued.

Significant Issues

Prices for natural gas and crude oil have trended somewhat higher over the past year, after a period of low prices (see attachment 1 & 2). According to a recent article in the Wall Street Journal Larry Nichols chairman of Devon Energy Corp. stated "we've permanently moved into a new era of gas prices" and natural-gas prices in the $2 and $3 per million BTUs range could be a thing of the past.

Not only does the bill encourage new drilling, it also encourages operators to minimize surface disturbance and impact by providing a larger credit for drilling multiple wells on a single location or pad, drilling horizontal wells and completion of wells into multiple strata from a single well-bore. Approximately 1,416 new wells were drilled in 2001, while according to EMNRD's web site approximately 1465 APD were issued for new wells in 2002. EMNRD notes that 35 wells were directionally or horizontally drilled and none were drilled from the same location as another well. Another 217 wells drilled in 2001 were completed into multiple strata. If enacted, the bill may increase the number of wells drilled on the same pad or multiply completed well, thus reducing overall surface impact without reducing production.

FISCAL IMPLICATIONS

The appropriation of $12,000 contained in this bill is a non-recurring expense to the General Fund's Operating Reserve. Any unexpended or unencumbered balance remaining at the end of FY05 shall revert to the General Fund.

TECHNICAL ISSUES

Section 6-4-2.1 NMSA 1978 stipulates that amounts in the General Fund Operating Reserve may be expended only upon specific authorization by the legislature" and only in the event general fund revenues and balances, including all other transfers to the general fund authorized by law, are insufficient to meet the level of appropriations authorized."

POSSIBLE QUESTIONS

Should a triggering mechanism be included in HB 661 that would allow tax credits for oil and gas wells if the price of New Mexico oil or gas fell below a specified price level?

Should the tax credit be allowed retroactively?

SN/njw