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

**SPONSOR** Clahchischilliage  **ORIGINAL DATE** 2/23/15  **LAST UPDATED** 3/14/15  **HB** 573

**SHORT TITLE** Severance Tax Distribution to Some Counties  **SB**

**ANALYST** van Moorsel

## REVENUE (dollars in thousands)

| Estimated Revenue | | | | | Recurring or Nonrecurring | Fund Affected |
|---|---|---|---|---|---|---|
| **FY15** | **FY16** | **FY17** | **FY18** | **FY19** | | |
| $0.0 | ($3,949.3) | ($4,299.4) | ($4,471.0) | ($4,431.3) | Recurring | Severance Tax Bonding Fund |
| $0.0 | $3,949.3 | $4,299.4 | $4,471.0 | $4,431.3 | Recurring | Local Governments |
| $0.0 | $0.0 | $309.6 | $151.3 | ($48.5) | Recurring | Severance Tax Permanent Fund |

Parenthesis ( ) indicate revenue decreases

| Estimated Severance Tax Bonding Capacity Impact | | | | | Recurring or Nonrecurring | Fund Affected |
|---|---|---|---|---|---|---|
| **FY15** | **FY16** | **FY17** | **FY18** | **FY19** | | |
| ($2,100.0) | ($2,071.1) | ($3,802.7) | ($3,734.7) | ($3,577.4) | Recurring | Senior STB Capacity |
| $0.0 | ($3,949.3) | ($1,777.2) | ($1,934.7) | ($2,011.9) | Recurring | Supplemental STB Capacity |

Parenthesis ( ) indicate revenue decreases

## SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Department of Finance and Administration (DFA)
Energy, Minerals and Natural Resources Department (EMNRD)

## SUMMARY

Synopsis of Bill

House Bill 573 amends the Tax Administration Act to distribute one percent of severance tax revenues to the county in which the natural resources were severed.

The effective date of this bill is July 1, 2015.

## FISCAL IMPLICATIONS

The estimated impact of the bill is based on the Board of Finance's February severance tax bonding capacity estimate. Estimated revenue into the severance tax bonding fund (STBF) is reduced by 1 percent to reflect the transfer to the counties where the resources were severed. The revenue impacts to counties are based on FY14 ONGARD data showing the value of oil and gas by the county in which the commodity was severed.

Severance tax on oil and gas represented 97.7 percent of the total severance tax collected in FY14. The vast majority of these commodities is produced in Eddy, Lea and San Juan counties, which together represented nearly 87 percent of the value of oil and gas produced in New Mexico in FY14. The table below shows the percentage of the value of oil and gas produced in FY14 by county. The table also approximates the severance tax revenue generated transferred to these counties pursuant to the provisions of HB 573 as estimated by distributing the total impact to the severance tax bonding fund to the counties based on their percentage share of the value of oil and gas produced in FY14. Although the estimate does not consider the contribution of coal and other non-oil-and-gas minerals, these minerals contribute less than 2.5 percent of severance tax in FY14.

| County | FY14 O&G value | % of Total | HB 573 Distribution |
|---|---|---|---|
| **Eddy** | **$6,838,124,615** | **40.1%** | **$1,580,749** |
| **Lea** | **$5,861,996,176** | **34.4%** | **$1,355,101** |
| **San Juan** | **$2,102,118,585** | **12.3%** | **$485,941** |
| Rio Arriba | $1,607,435,979 | 9.4% | $371,586 |
| Chaves | $207,401,168 | 1.2% | $47,944 |
| Sandoval | $142,519,083 | 0.8% | $32,946 |
| Colfax | $102,122,759 | 0.6% | $23,607 |
| Harding | $82,485,645 | 0.5% | $19,068 |
| Union | $66,158,989 | 0.4% | $15,294 |
| Roosevelt | $31,912,794 | 0.2% | $7,377 |
| Quay | $9,489,203 | 0.1% | $2,194 |
| McKinley | $6,457,617 | 0.0% | $1,493 |

Reducing revenue to the severance tax bonding fund (STBF) is contributes to a lower capital capacity. Over the 5-year forecast period, senior STB capacity is reduced by $15.3 million. Beneficiaries of statutory earmarks of senior STB capacity would see a decrease as well. Over FY15-FY19:

- The 10 percent earmark for water projects is reduced $1.5 million;
- The 5 percent earmark for tribal infrastructure projects is reduced $760 thousand; and
- The 5 percent earmark for colonias projects is reduced $760 thousand.

Supplemental STB capacity, dedicated for public school capital outlay, would see a reduction totaling $9.7 million in FY15-FY19.

Estimated transfers to the severance tax permanent are estimated to increase pursuant to the provisions of the bill. During FY15-FY19, the fund would be expected to see additional transfers totaling $400 thousand. Investments earnings on these additional deposits would have a further marginal contribution to the copruis of the STPF, in turn slightly increasing the annual distribution from the STPF to the general fund in the amount of 4.7 percent of the 5-year average of year-ending market values of the fund.

DFA points out, however, that changes to the STPF are not estimated to be significant enough to cause a material fiscal impact on general fund revenues distributed from the STPF.

**SIGNIFICANT ISSUES**

The Board of Finance analysis reports the following concerns about redirecting severance tax revenue from bonding programs:

> Under current law, all severance tax receipts are distributed to the severance tax bonding fund where they are pledged for repayment of senior and supplemental severance tax bonds. Redirecting a portion of severance tax revenues to anywhere other than the severance tax bonding fund may be determined as a violation of the State's contract with holders of outstanding STBs, in other words the bill may impair the bonds.
>
> Aside from this legal issue, as a result of the strength of the revenue pledge and other factors, senior severance tax bonds have been able to achieve a strong credit rating of AA+, just one step below AAA, the highest rating possible. By redirecting a portion of revenues pledged for repayment of STB and SSTB debt service, this bill could potentially send an adverse message to bondholders and rating agencies. The Department of Finance and Administration is concerned that there could be unintended fall-out affecting the bonding program credit ratings as a result of this bill.
>
> In the past, legislation was enacted to reduce the State shared portion of municipal gross receipts taxes, a revenue stream that municipalities had pledged for debt service on outstanding bonds, from 1.335 percent to 1.225 percent. The bond market reacted badly regarding new issuances of municipal gross receipts tax bonds until the legislature adopted Section 7-1-6.4(B), which states that the change in distribution caused by the reduction of the state shared distribution must be increased to the amount that would have been paid before the reduction to meet any outstanding debt service obligations.

The bill does not clarify or provide for an intended use of the funds by recipient counties. At the state level, severance tax revenues are dedicated to the state’s bonding program to finance capital outlay projects. However, without a specific dedication of the revenue in the bill, it appears counties may use the revenue for opearational purposes.

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy**: Revenue should be adequate to fund needed government services.
2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity**: Different taxpayers should be treated fairly.
4. **Simplicity**: Collection should be simple and easily understood.
5. **Accountability**: Preferences should be easy to monitor and evaluate

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