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## FISCAL IMPACT REPORT

**ORIGINAL DATE** 02/05/16  
**SPONSOR** Kernan **LAST UPDATED** 02/16/16 **HB** \_\_\_\_\_

**SHORT TITLE** Tax Rate Differential for Certain Oil **SB** 34/a SCORC

**ANALYST** Alejandro

### REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY16	FY17	FY18	FY19	FY20		
\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	<b>Recurring</b>	<b>Severance Tax Bonding Fund</b>

Parenthesis ( ) indicate revenue decreases

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Energy, Minerals, and Natural Resources Department (EMNRD)

Taxation and Revenue Department (TRD)

### SUMMARY

#### Synopsis of SCORC Amendment

The Senate Corporations and Transportation Committee amendment includes the following changes to the bill:

- Inserts the term “Temporary” to describe the tax rate differential,
- Specifies that the provisions of the bill apply specifically to enhanced oil recovery projects that use anthropogenic carbon dioxide,
- Removes new language regarding the application of anthropogenic carbon dioxide as it pertains to enhanced recovery projects that do not employ such methods, and
- Adds a repeal date of July 1, 2026.

Further, the amendment introduces the following definition: “anthropogenic carbon dioxide” means carbon dioxide captured from an industrial source, which would otherwise be released into the atmosphere as industrial emission of greenhouse gas.

The committee also amended the eligibility for reduced severance tax rates as follows:

- 2.75 percent of taxable value if 25-50 percent of the total amount of injected carbon dioxide is anthropogenic; and
- 1.75 percent of taxable value if more than 50 percent of the total amount of injected carbon dioxide is anthropogenic.

### Synopsis of Bill

Senate Bill 34 amends the Oil & Gas Severance Tax Act to increase the availability of a reduced oil and gas severance tax rate for enhanced oil recovery projects that inject carbon dioxide. Currently, the Act provides for a 50 percent reduction in the severance tax from 3.75 percent to 1.875 percent for all enhanced oil recovery projects when the posted price of crude oil for the prior year ending May 31 averages less than \$28 dollars per barrel. SB 34 would allow the 50 percent reduction for enhanced oil recovery projects that use carbon dioxide when the price averages less than \$60 a barrel for the prior year. The bill also adds a definition of “posted price” to mean the price of West Texas Intermediate crude oil published by the U.S. Energy Information Administration (EIA).

The effective date of this bill is July 1, 2016.

### **FISCAL IMPLICATIONS**

EMNRD has indicated that there are currently no enhanced oil recovery projects in New Mexico that use injected anthropogenic carbon dioxide. As such, there is no immediate fiscal impact of this bill. However, there are 710 producing wells that use non-anthropogenic carbon dioxide injection and could theoretically be converted, as well as 354 active secondary recovery projects in New Mexico that inject water. Some, but not all, of these projects have the geologic and economic potential to be converted to carbon dioxide injection projects in the future, however that number is not known.

For illustrative purposes, LFC staff calculated the revenue impact of 25 enhanced recovery wells using anthropogenic carbon dioxide and qualifying for the severance tax rates stipulated in this bill. Using an average per-well production figure of 9,740 barrels per year (based on current non-anthropogenic carbon dioxide recovery production figures provided by EMNRD), the lower tax rates would reduce severance taxes by \$96,000 to \$190,000 in FY18, depending on the concentration of carbon dioxide used. These figures are based on Consensus Revenue Estimating Group oil prices, and apply a 12.5 percent deduction to account for royalties paid and transportation costs in order to arrive at the “taxable value” per Section 7-9-4.1 NMSA 1978.

This bill may be counter to the LFC tax policy principle of adequacy, efficiency and equity. Due to the increasing cost of tax expenditures revenues may be insufficient to cover growing recurring appropriations.

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure’s fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

## **SIGNIFICANT ISSUES**

The reduced severance tax rate would improve the economics associated with implementing a new carbon dioxide injection project. Given the cost of processing and transporting anthropogenic carbon dioxide for this purpose, it is unlikely that it would be adopted on a substantial scale in the near future. However, there are several enhanced oil recovery operations in the United States that use anthropogenic CO<sub>2</sub>, and a \$1.1 billion natural gas processing plant is under development in West Texas that will capture CO<sub>2</sub> for such purposes. As the economics for this process improve, so too does the potential for application in New Mexico.<sup>1</sup>

## **PERFORMANCE IMPLICATIONS**

The LFC tax policy of accountability is not met since TRD is not required in the bill to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose.

## **ADMINISTRATIVE IMPLICATIONS**

EMNRD Oil Conservation Division (OCD) must certify enhanced oil recovery projects under the Enhanced Oil Recovery Act, Sections 7-29A-1 et seq., in order for the projects to be eligible for the reduced tax rates under the Oil and Gas Severance Tax Act. That Act refers to the enhanced recovery rate under subsection A (3) of Section 7-29-4 NMSA 1978. Since SB 34 now adds another enhanced recovery rate under subsection A (4) of Section 7-29-4, SB 34 needs to also amend the Enhanced Oil Recovery Act to avoid a conflict.

Since OCD already approves enhanced oil recovery projects under the Enhanced Oil Recovery Act, EMNRD contends that SB 34 should not result in any significant increase in work for the agency.

The implementation of the changes proposed in this bill will require changes to the GenTax system and the Taxpayer Access Point system. Both system changes represent minimal administrative impact to TRD.

## **CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP**

- SB 34 is similar to HB 285.
- HB 285 conflicts with and relates to HB 107 which also amends Section 7-29-4.
- HB 107 seeks to increase the availability of reduced severance tax rates for stripper wells.

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<sup>1</sup> For more information on the economics of enhanced oil recovery through application of carbon dioxide, see US Department of Energy, “Carbon Dioxide Enhanced Oil Recovery: Untapped Domestic Energy Supply and Long Term Carbon Storage Solution,” [www.netl.doe.gov](http://www.netl.doe.gov) .