Overview of New Mexico Taxes on Oil and Gas Production

Presented to the
Revenue Stabilization and Tax Policy Committee

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I. **Summary of statutory provisions**
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I. Statutory provisions: Oil and gas taxes

A. Oil and Gas Severance Tax (Section 7-29 NMSA)

- Tax is imposed on the taxable value of all oil, natural gas or liquid hydrocarbons and carbon dioxide severed from the soil and sold.
- Except for the incentive programs described in the following table, the tax rate is 3.75% of taxable value which is defined to exclude royalties paid to federal, state or tribal governments and reasonable expense of trucking any product from the production unit to the first place of market.
- A credit is available for taxes paid to tribal governments equal to 75% of the lesser of the total taxes owed to the state or the total paid to the tribe in taxes meeting certain qualifications.
- Advanced payments/credits are required from all taxpayers equal to their average monthly tax liability during the previous year as compared against their advance payment carry forward balance.
- The severance tax is distributed to the severance tax bonding fund, with any excess after meeting severance tax bonding fund obligations being distributed to the severance tax permanent fund.

Oil and Gas Severance Tax Incentive Programs[2]

Incentive Category:	Incentive Tax Rate:	Threshold price below which incentive rate applies:
Restoration wells[3]	0.0%	$24.00 per barrel—WTI
Well workover projects	2.45%	$24.00 per barrel--WTI
Stripper wells	1.875%	$1.15 per mcf-Gas[1]
		$15.00 per barrel-Oil[1]
	2.8125%	$1.35 per mcf-Gas[1]
		$18.00 per barrel-Oil[1]
Enhanced oil recovery	1.875%	$28.00 per barrel—WTI

Notes:
1. Average annual taxable value of natural gas or oil sold in New Mexico during the preceding calendar year.
2. No natural gas or oil volumes currently qualify for these incentives because average WTI and taxable value exceeded the threshold levels last year.
3. 10-year exemption.

Oil and Gas Conservation Tax (Section 7-30)

- Tax is levied on the sale of all oil, natural gas, liquid hydrocarbons, carbon dioxide, uranium, coal and geothermal energy severed from the soil of the state.
- A credit is available for taxes paid to tribal governments equal to 75% of the lesser of the total taxes owed to the state or the total paid to the tribe in qualifying taxes.
- The tax rate is 0.19% of the taxable value (sales price less deductions for state, federal and Indian royalties) of products. When the average WTI price of crude oil is over $70 per barrel, the tax rate on oil increases to 0.24%.
- Advanced payments/credits are required from all taxpayers equal to their average monthly tax liability during the previous year as compared against their advance payment carry forward balance. Only applies to oil, natural gas, liquid hydrocarbons and carbon dioxide
- This is a monthly tax.
- Proceeds from the tax are distributed to the state general fund and the oil and gas reclamation fund, administered by the Energy, Minerals and Natural Resources Department.

Oil and Gas Emergency School Tax (Section 7-31)

- Tax is imposed for the privilege of engaging in the business of severing oil, natural gas or liquid hydrocarbons, and carbon dioxide from New Mexico soil.
- Except for the incentive rates described in the table below, the tax rate is 3.15% on the net taxable value of the products listed, with the exception of natural gas, which is taxed at 4%.
- Net taxable value is defined as the actual price received for products at the production unit less federal, state, or Indian royalties and the cost of trucking any product from the production unit to the first place of market.
- A credit is available for taxes paid to tribal governments equal to 75% of the lesser of the total taxes owed to the state or the total paid to the tribe in qualifying taxes.
- A credit is available for production from Jicarilla Apache tribal land equal to the lesser of the tribal tax imposed or 0.7% of taxable value.
- Advanced payments are required from all taxpayers equal to their average monthly tax liability during the previous year.
- The school tax is distributed to the state general fund each month.

Oil and Gas Emergency School Tax Incentive Programs

Incentive Category:	Incentive Tax Rate:	Threshold price below which incentive rate applies:
Stripper wells[1]	2.0% (Gas) 1.58% (Oil)	$1.15 per mcf-Gas[2] $15.00 per barrel-Oil[2]
	3.0% (Gas)	$1.35 per mcf-Gas[2]
	2.36% (Oil)	$18.00 per barrel-Oil[2]

Notes:

1. Stripper wells are oil wells that produce 10 barrels of oil per day and gas wells that produce less than 60 thousand cubic feet of gas per day.
2. Prices are measured by the average annual taxable value of the product reported to the Department during the calendar year preceding the start of the fiscal year to which the tax rate applies.
3. Average taxable value was above both threshold values in calendar 2010 so no production is eligible for these incentives in FY 2012.

Oil and Gas Ad Valorem Production Tax (Section 7-32)

- Tax is levied monthly on the sale of all oil, natural gas, liquid hydrocarbons and carbon dioxide severed from the soil of the state. Along with the O&G Production Equipment Ad Valorem Tax this is the only form of property tax on oil and gas mineral interests.
- Tax is based on the assessed value of products. Assessed value is equivalent to 50% of the taxable value after deducting reported royalties and trucking expenses.
- A credit is available for taxes paid to tribal governments equal to 75% of the lesser of the total taxes owed to the state or the total paid to the tribe based upon defined qualification standards.
- Advanced payments/credits are required from all taxpayers equal to their average monthly tax liability during the previous year as compared against their advance payment carry forward balance.
- This is a monthly tax.
- The tax rate is the property tax rate for the taxing district in which products are severed. This rate changes annually, effective each September 1.
- Net revenue from this tax is distributed to property tax beneficiaries, primarily counties and school districts.

Natural Gas Processors Tax (Section 7-33)

- Privilege tax is levied on processors based on the value of products processed.
- Tax is measured by the heating content of natural gas at the plant's inlet, measured in million British Thermal Units (mmbtu).
- The rate is set initially at $.0065 per mmbtu but will be adjusted every July 1 by a factor

equal to the average value of natural gas produced in New Mexico the preceding calendar year divided by $1.33.

- For FY12 the tax rate is $0.0205 per mmbtu.
- Deductions are allowed for gas used in the processing function, gas legally flared or lost through plant malfunction.
- This is a monthly tax.
- Revenue is distributed to the state general fund.

Oil and Gas Production Equipment Ad Valorem Tax (Section 7-34)

- Tax is levied annually on assessed value of equipment used at each production unit.
- Assessed value is equivalent to 9% of the previous calendar year sales value of the product of each production unit.
- The tax rate is the certified property tax rate for the taxing district in which products are severed.
- A credit is available for taxes paid to tribal governments equal to 75% of the lesser of the total taxes owed to the state or the total paid to the tribe in qualifying taxes.
- Advanced payments/credits are required from all taxpayers equal to their average monthly tax liability during the previous year as compared against their advance payment carry forward balance.
- Tax is paid annually on the same schedule with property taxes.
- The production equipment tax is distributed to property tax beneficiaries, primarily counties and school districts.

II. Statutory provisions: Other minerals taxes

Resources Excise Tax (Section 7-25)

- Three related excise taxes, the "Resources Tax", "Processors Tax" and "Services Tax" are referred to collectively as the "Resources Excise Tax" and are collected under this section.
- "Natural resource" includes timber or timber products and metalliferous or nonmetalliferous mineral products or their combinations. It excludes oil, natural gas and liquid hydrocarbons, or their combinations, and carbon dioxide. These are taxed under separate laws.
- Taxable value is usually the sale price of the natural resource. Deduction is allowed for royalty payments to the United States, to the state, and to Indian tribes and pueblos.
- A deduction is also allowed for sales of natural resources, other than metalliferous mineral ores, to the United States, the State of New Mexico, Indian tribes or pueblos and certain 501(c)(3) organizations.
- Net revenue collections are transferred monthly to the state general fund.

Resources Excise Tax Rates by Mineral

Mineral:	Resources Tax Rate:	Processors Tax Rate:
Potash	0.5%	0.125%
Molybdenum	0.125%	0.125%
Timber	0.75%	0.375%
All others	0.75%	0.75%

- The owner of natural resources is exempted from paying the processors tax if the resources tax has been paid on the severed mineral.
- The service tax is imposed on the service charge of any person severing or processing natural resources in New Mexico that are owned by another person. The tax is at the same rate as the resources tax above.

Severance Tax (Section 7-26)

- For the privilege of severing natural resources, an excise tax is imposed on the severer based on the taxable value or the quantity of natural resources severed and saved.
- Natural resource means timber and any metalliferous or nonmetalliferous mineral product, combination or compound thereof (but does not include oil, gas, liquid hydrocarbons, any combination thereof, or carbon dioxide, all of which are taxed under the Oil and Gas Severance Tax Act).
- All natural resources, except potash, molybdenum, copper, lead, zinc, gold, silver, coal and uranium, are taxed on their gross (sales) value less a deduction for certain costs.
- The value is determined at the first marketable point after severance.
- The deductions allowed vary according to whether the product has a posted field or market price or must be processed or beneficiated before sale.
- In addition to their other cost deductions, all severers of natural resources, except coal and uranium, may deduct rental or royalty payments paid to the United States or the state. Separate provisions for coal and uranium are described below.
- The severance tax on coal is a tax per ton, without deductions, imposed on the quantity of coal "severed and saved".
- The taxable event is sale, transportation out of New Mexico, or consumption of the coal, whichever occurs first.
- As of 1994, coal surtax rates increase with the producer price index.
- Starting in 1999, various coal contract qualification requirements were established that allowed for the exemption from the coal surtax provisions.
- A tax credit is available for severance taxes on coal paid to tribal governments. The credit is equal to 75% of the lesser of the tax owed to the state or the tax paid to the tribe.
- The severance tax on uranium is 3.5% applicable to 50% of the sales price per pound of the content of U_3O_8 contained in the severed and saved or processed uranium.
- Tax must be reported and paid on or before the 25th of the month following severance.
- Collections are transferred to the severance tax bonding fund, which is pledged to payment of principal and interest on outstanding severance tax bonds.

Severance Tax Rates by Mineral

Mineral:	Severance Tax Rate:
Potash	2.5%
Copper	0.5%
Non-metallic minerals	0.125%
Lead, zinc and other metals	0.125%
Gold and silver	0.2%
Timber	0.125%
Coal—Surface mined	$0.57 per ton
Coal—Underground mined	$0.55 per ton
Coal surtax—Surface mined	$1.17 per ton
Coal surtax—Underground mined	$1.13 per ton
Uranium	3.5%

Copper Production Ad Valorem Tax (Section 7-39)

- Ad valorem tax is imposed on the market value of copper produced.
- This tax replaces the ad valorem taxation of copper properties under the Property Tax Code.
- Taxable values will be set annually, based on market value of copper produced.

II. Revenue History and Forecast

Oil and gas production taxes:

- Total production taxes are expected to reach almost $1 billion in FY12.
- The peak level was almost $1.4 billion in FY08.
- Almost $420 million goes to the General Fund, comprising 7.6% of recurring revenue.
- Severance bonding fund revenue is almost $400 million.
- Local governments will receive about $150 million.

Table 1: New Mexico oil & gas production-related tax revenues

.(Dollar amounts in millions)

	O&G Emergency School Tax	O&G Conservation: General Fund	O&G Severance	O&G Ad Valorem Production	Natural Gas Processors[2]	O&G Ad Valorem Production Equipment	Conservation: Reclamation Fund	TOTAL
FY07	$426.6	$18.9	$425.4	$124.7	$35.6	$26.1	$2.3	$1,056.5
FY08	$557.3	$26.1	$567.4	$167.1	$30.6	$25.2	$3.0	$1,374.2
FY09	$370.4	$16.9	$378.1	$114.6	$40.3	$28.2	$2.0	$949.7
FY10	$324.5	$15.2	$327.6	$106.8	$40.4	$34.8	$2.0	$840.9
FY11	$355.7	$21.5	$374.1	$121.6	$18.0	$28.4	$3.4	$922.6
FY12	$373.1	$22.6	$392.9	$127.7	$22.3	$29.9	$3.5	$971.9
FY13	$394.5	$23.8	$414.6	$134.7	$23.2	$31.5	$3.7	$1,026.0
FY14	$396.4	$23.9	$416.8	$135.5	$24.0	$31.7	$3.7	$1,032.0
FY15	$391	$24	$412	$134	$24	$31	$4	$1,019

History: NM Taxation and Revenue Department, monthly operating transfers.
Forecast based on Consensus Revenue Estimating Group assumptions.

- Historical production and prices are illustrated in the following table along with the assumptions used by the consensus revenue estimating group in the July 2011 forecast.
- Oil's share of total taxable value has increased dramatically in recent years. This reflects a sharp increase in the relative price of oil compared with natural gas. This in turn reflects the fact that natural gas prices are set in national markets, which have experienced sharp supply increases in recent years. Oil prices are set internationally and continue to be affected by demand growth in developing economies.

Table 2: Oil and Gas Production and Average Price
History and Forecast

	Oil:		Gas:		Oil Share
Fiscal Year	Price ($/bbl)	Volume Mill. Bbls	Price ($/Mcf)	Volume Bill. Cu. Ft.	Of Taxable Value
FY01	$28.47	70.0	$5.11	1,650	21.6%
FY02	$21.96	69.3	$2.46	1,627	30.8%
FY03	$28.24	68.4	$3.94	1,576	26.6%
FY04	$31.93	67.0	$4.76	1,545	25.4%
FY05	$45.34	63.1	$5.84	1,547	27.0%
FY06	$60.08	60.5	$7.53	1,523	27.0%
FY07	$59.11	60.1	$6.56	1,516	29.5%
FY08	$93.74	60.0	$8.40	1,428	35.4%
FY09	$64.84	62.3	$5.61	1,390	37.7%
FY10	$71.29	62.7	$5.18	1,285	44.0%
FY11*	$85.50	65.4	$5.20	1,224	50.7%
FY12*	$87.80	67.4	$5.60	1,184	51.1%
FY13*	$89.50	68.7	$6.20	1,147	50.3%
FY14*	$89.50	69.4	$6.40	1,111	50.5%
FY15*	$89.50	68.7	$6.50	1,077	50.7%

Source: TRD files and Consensus estimating group.

Other minerals production taxes:

- Total taxes of $34 million per year have been collected in recent years.
- Approximately $10 million has gone to the General Fund with most of the rest going to the Severance Tax Bonding Fund.
- Severance tax on coal comprises about two-thirds of total collections.
- In addition to the revenues shown in the table, coal producers pay about $40 million per year in GRT.

Table 3

Distributions of Production Taxes on Minerals Other than Oil and Gas

	FY08	FY09	FY10
Resources Excise Tax:			
Coal	$3,984,169	$5,325,970	$4,846,138
Copper	$5,722,549	$3,247,558	$2,613,695
Potash	$470,834	$758,216	$604,627
Molybdenum	$104,835	$53,867	$35,382
Others	$1,187,014	$789,195	$1,271,170
Total	$11,469,401	$11,219,400	$9,368,274
Severance Tax:			
Coal	$18,503,226	$19,547,271	$21,778,034
Copper	$768,942	$334,523	$290,317
Potash	$963,129	$2,114,320	$1,882,755
Molybdenum	$47,764	$26,862	$17,691
Others	$716,103	$87,743	$97,609
Total	$20,999,164	$22,110,718	$24,066,406
Conservation Tax:			
General Fund	$1,009,013	$1,306,628	$1,120,551
Reclamation Fund	$118,731	$144,124	$134,603
Total	$1,127,745	$1,450,752	$1,255,154
Total Hard Mineral Taxes	**$33,596,310**	**$34,780,870**	**$34,679,862**
Total Distributions to General Fund	**$12,478,415**	**$12,526,028**	**$10,478,854**

III. Other State and Local Revenue from Oil and Gas Production

In addition to the taxes described so far, the state also receives substantial royalty revenues from oil and gas and other minerals production on federal lands and on state lands. In addition, the state and local governments receive gross receipts tax and income tax collections frm industry operations. The following table presents estimates of the total amount of revenue collected from each of these sources in FY10.

FY 2010 State & Local Revenue from Oil and Gas Operations

State General Fund:	
– Production Taxes	$383 million
– Royalties, bonuses	$413 million
– Taxes on direct activities	$228 million
– Taxes on indirect activities	$251 million
– Total	**$1,275 million**
– Percent of General Fund	27%
Other State Funds:	
– Severance Tax Bonding Fund	$338 million
– Land Grant Permanent Fund	$317 million
Local Governments	$266 million
Grand Total	**$2,196 million**

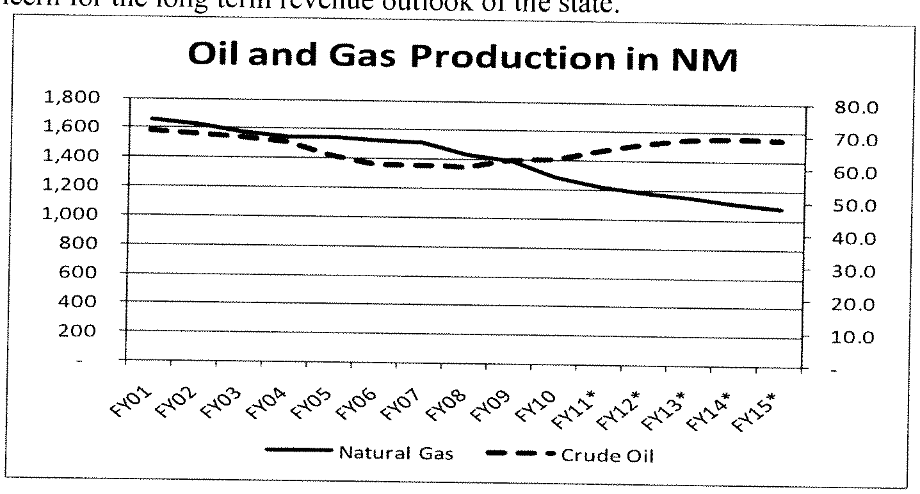
Notes:

- Direct impacts are GRT on purchased goods and services, payroll taxes, income taxes, etc.
- Indirect impacts are economic activity from re-spending of direct impacts.
- Estimates assume a "multiplier" of 2.0 on industry activity.
- These figures do not reflect earnings from the permanent funds.
- These figures do not reflect revenue from refining, transportation and marketing operations.

IV. Policy Issues

Production Trends:

- Natural gas production in New Mexico has fallen by more than 25% over the last 10 years.
- Continued declining production is in the forecast.
- Given the importance of this industry to the state's finances, these trends are a serious concern for the long term revenue outlook of the state.

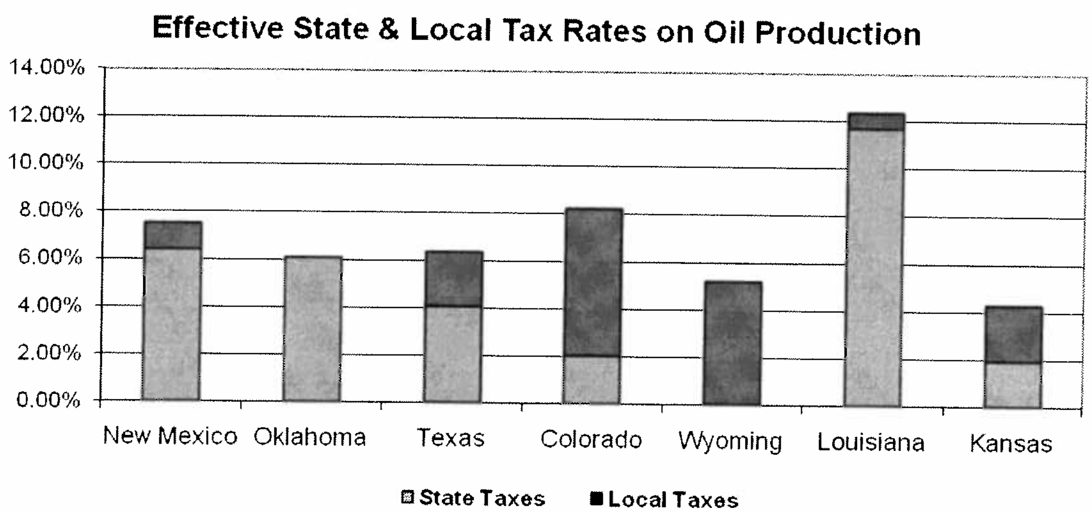


Tax Exporting:

- Tax exporting to nonresident consumers occurs to the extent that the state's tax causes an increase in the price of the commodity as sold to nonresidents.[1]
- This can only happen if a state's production represents a dominant share of the national market.
- New Mexico production represents less than 5% of U.S. natural gas production and 3% of crude oil production. These market shares are not large enough for the state to successfully export its tax burden.
- If the tax burden is not exported, that means it is borne by New Mexicans in the form of fewer jobs, lower wages, lower profits and reduced land values.

Tax Competition:
New Mexico has been rapidly losing market share to other states. This means producers increasingly have other options when they consider where to invest in new production. It is important that we consider how our tax system compares with those of other states and how this affects incentives to produce here.

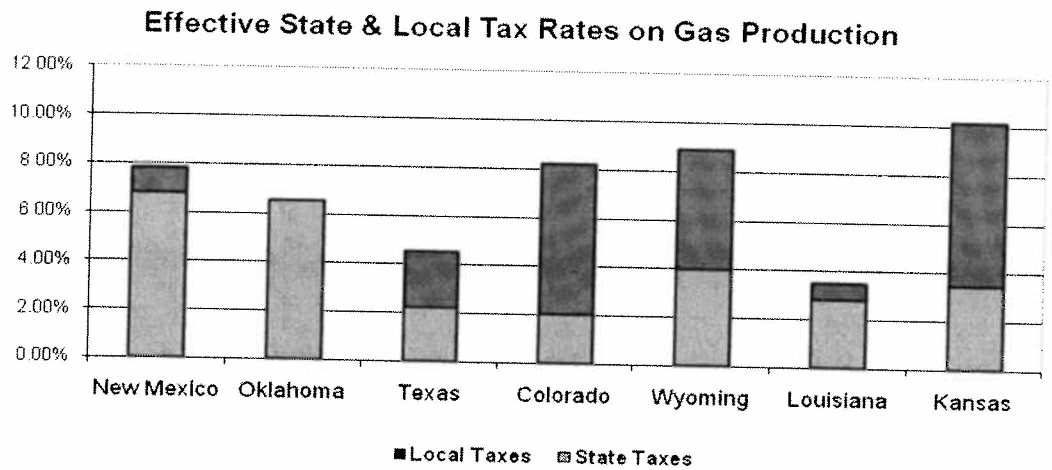
- NM combined effective tax rate on oil is 7.5%, above TX, OK and WY, below LA and CO
- Effective rate = total tax revenue divided by total production value



- NM combined effective rate on Gas is 7.8%, above TX, OK and LA, below CO, WY and KS.

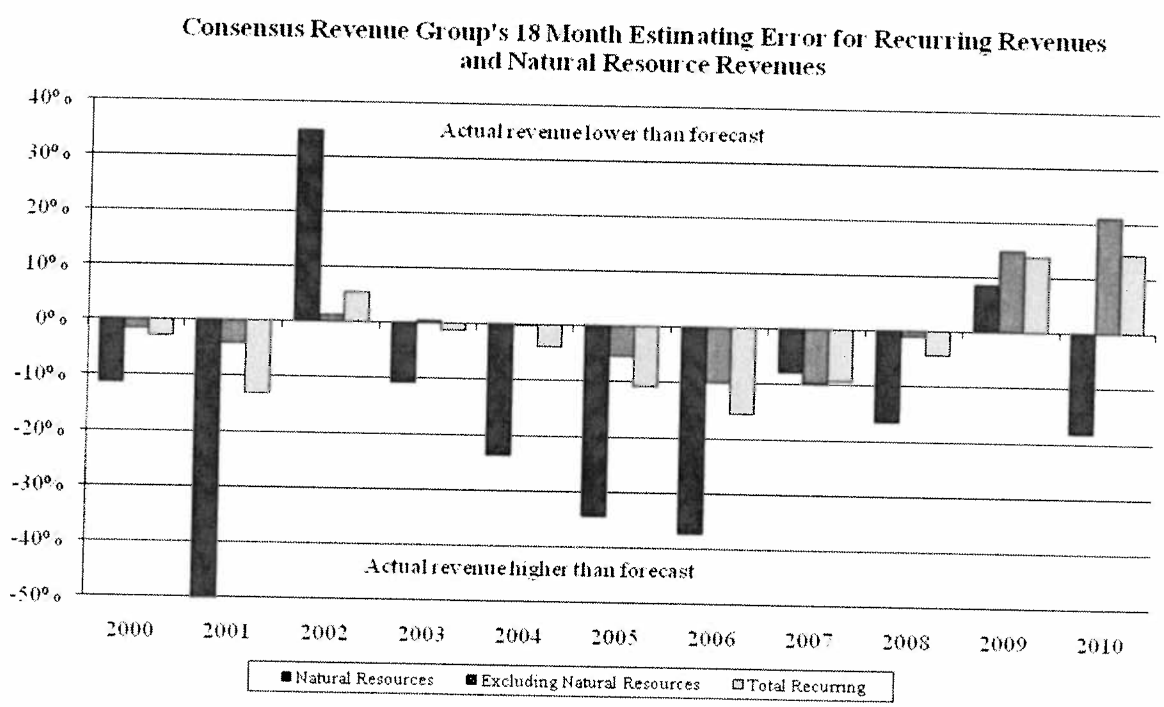
[1] "Tax Exporting and the Commerce Clause," Charles E. McLure, Jr., in Fiscal Federalism and the Taxation of Natural Resources, 1983, Lexington Books.

- NM imposes GRT on industry operations at a higher rate than most of our competing states.
- NM imposes corporate income tax on industry operations at a higher rate than most of our competing states.



Forecast error:

- In most years, O&G revenue increases forecast error—FY10 exception.
- O&G revenue volatility means 10% a prudent minimum for reserves.



V. Conclusions

- The oil and gas producing industry contributed $1.6 billion in taxes, royalties and bonus payments to state and local governments in FY 2010.
- Direct and Indirect industry impacts added another $600+ million.
- Total General Fund revenue of almost $1.3 billion comprises 27% of all General Fund revenue.
- Reliance on O&G production creates two major fiscal challenges: Volatility and Sustainability.
- New Mexico does not control a large enough share of national energy markets to be able to export the burden of our taxes to out of state consumers.
- New Mexico has lost market share in recent years and should re-evaluate policies that affect the incentive to produce here, including tax policies.