LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 85TH LEGISLATIVE REGULAR SESSION

May 2, 2017

TO: Honorable Dennis Bonnen, Chair, House Committee on Ways & Means

FROM: Ursula Parks, Director, Legislative Budget Board

IN RE: **HB2621** by Darby (Relating to state and local tax incentives for certain enhanced oil recovery projects.), **As Introduced**

Estimated Two-year Net Impact to General Revenue Related Funds for HB2621, As Introduced: a negative impact of ($225,082) through the biennium ending August 31, 2019.

Additionally, there would be a negative impact to General Revenue Related Funds of ($16,889,948) through the biennium ending August 31, 2021.

The bill would make no appropriation but could provide the legal basis for an appropriation of funds to implement the provisions of the bill.

General Revenue-Related Funds, Five-Year Impact:

Fiscal Year	Probable Net Positive/(Negative) Impact to General Revenue Related Funds
2018	($117,608)
2019	($107,474)
2020	($7,535,474)
2021	($9,354,474)
2022	($13,270,474)

All Funds, Five-Year Impact:

Fiscal Year	Probable Revenue (Loss) from *General Revenue Fund* 1	Probable Revenue (Loss) from *Foundation School Fund* 193	Probable Revenue (Loss) from *Economic Stabilization Fund* 599	Probable Revenue (Loss) from *State Highway Fund* 6
2018	$0	$0	$0	$0
2019	$0	$0	$0	$0
2020	($7,396,000)	($32,000)	$0	$0
2021	($8,836,000)	($411,000)	($48,000)	($48,000)
2022	($12,264,000)	($899,000)	($616,000)	($616,000)

Fiscal Year	Probable (Cost) from *General Revenue Fund* 1	Probable (Cost) from *Oil & Gas Regulation* 5155	Change in Number of State Employees from FY 2017
2018	($117,608)	($117,608)	2.0
2019	($107,474)	($107,474)	2.0
2020	($107,474)	($107,474)	2.0
2021	($107,474)	($107,474)	2.0
2022	($107,474)	($107,474)	2.0

Fiscal Analysis

The bill would amend the Natural Resources Code by adding Chapter 93 authorizing the Railroad Commission (RRC) to designate enhanced oil recovery reinvestment zones that encompass fields capable of achieving positive production response from Cenozoic Era formations through the implementation of the tertiary enhanced oil recovery process (EOR) within two years of the designation date.

RRC would conduct a public hearing of the reinvestment zone application and designate the zone if certain criteria are met and the designation would likely encourage property improvement within the zone. An application for the designation may be filed with RRC beginning January 1, 2018. RRC designation of the reinvestment zone would not constitute unitization of the field located in the zone.

RRC would adopt rules and prescribe the application form necessary to implement and administer provisions of the bill by January 1, 2018, certify to the Comptroller each designation not later than the seventh day after the designation date, and maintain a central registry with relevant information.

The reinvestment zone would expire on the earlier of the 10th anniversary of the certification date or the payout date of the EOR project.

The bill would provide a property tax limitation on the appraised value of the EOR project for the duration of the reinvestment zone if adopted by a political subdivision's governing body. The amount of the limitation for a tax year would be the appraised value in excess of the hold-harmless appraised value, the value on January 1 of the tax year the reinvestment zone was designated.

The bill would provide a severance tax exemption on the oil volume in excess of the hold-harmless production volume, an average monthly volume of oil produced during the three months preceding the second anniversary date the reinvestment zone was designated. The exemption would apply to the incremental oil produced between the second anniversary of the reinvestment zone designation date and the expiration date of the zone.

The bill would require the operator of the EOR project to reinvest the tax savings on the development and operation of the project for the duration of the reinvestment zone and to provide the necessary information to the comptroller. The Comptroller would adopt rules necessary to implement and administer the tax exemption provisions of the bill by January 1, 2018.

The application for designation of a reinvestment zone may not be filed before January 1, 2018.

The bill would provide that on or after the second anniversary of an enhanced recovery reinvestment zone designation, state sales and use taxes paid on items used exclusively in the operation of the tertiary recovery project during the two years following zone designation would be subject to refund if there was a positive production response as a result of the project. After the initial two years of a zone designation, taxable items used exclusively in the active operation of a tertiary recovery project would be exempt from sales and use tax if there was a positive production response on average during the preceding three months as a result of active operation of the project. Local sales and use taxes would be subject to refund or exemption on the same basis as state tax, if the governing body of a political subdivision authorized refund or exemption.

The bill would take effect immediately upon enactment, assuming it received the requisite two-thirds majority votes in both houses of the Legislature. Otherwise, it would take effect September 1, 2017.

Methodology

Based on published information from the Bureau Economic Geology, there would be multiple potential EOR projects with estimated recoverable reserves of as much as 2 billion barrels of oil in the Gulf Coast Basin where many Cenozoic producing formations are present. It is expected some of these projects would be approved for the severance tax exemption under the provisions of the bill in lieu of existing EOR severance tax incentives as early as fiscal 2018. Estimates are based on annual value of incremental production of oil rising from 100,000 barrels in fiscal year 2020 after the initial two year period of reinvestment zone designation to 7,020,000 barrels in fiscal year 2022. Severance tax foregone on the incremental production is estimated at a tax rate of 2.3 percent, as existing statute already provides for a 2.3 percent reduction in the oil production tax rate for enhanced oil recovery projects. Sales tax effects are estimated proportionally to value of production with the taxable expenditures on well equipment preceding production, and included in total revenue loss from the General Revenue Fund along with severance tax losses. The EOR sales and severance tax exemptions would continue after 2022 with the expectation that by fiscal 2025 the impact would be three times the losses in fiscal 2022.

The bill's proposed limitation on the appraised value in an enhanced recovery reinvestment zone would, in taxing units that adopt the limitation, exempt the total appraised value of the oil and gas reserves in place on January 1 of the tax year in which the reinvestment zone is designated, creating a cost to those taxing units. There would be no cost to the state through the school finance formulas because the exempted value would not be deducted in the Comptroller's property value study. School districts would be unlikely to adopt the limitation because they are not held harmless for the exempted value. As it is unknown if a political subdivision would adopt the property tax limitation on the appraised value of an EOR project, the fiscal impact on units of local government cannot be estimated.

The Railroad Commission indicates it would need 2.0 FTEs, an Administrative Law Judge II and an Engineering Specialist V, to implement the provisions of the bill, which the agency estimates will result in 50 additional hearings per year. Salary and benefits for these FTEs would be $214,948 annually with additional one-time costs in fiscal year 2018 of $20,268. These costs would be divided equally between General Revenue and General Revenue-Dedicated Oil and Gas Regulation and Cleanup Account 5155.

Local Government Impact

There would be a loss of local sales and use tax revenue, depending on the number of political subdivisions that that authorized sales tax refunds. Because the refunds of local sales tax are to be at the discretion of local taxing authorities, the revenue losses cannot be estimated.

Similarly, as it is unknown if a political subdivision would adopt the property tax limitation on the appraised value of an EOR project, the fiscal impact on units of local government cannot be estimated.

Source Agencies: 304 Comptroller of Public Accounts, 455 Railroad Commission

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