REPORT HIGHLIGHTS

SEVERANCE TAXES

PERFORMANCE AUDIT, JANUARY 2020

DEPARTMENT OF NATURAL RESOURCES
DEPARTMENT OF REVENUE

CONCERN

The Departments of Natural Resources (Natural Resources) and Revenue (Revenue) could improve their processes to help ensure that the State has accurate information on the amount of natural resources being extracted and that taxpayers are accurately reporting production data and calculating their severance tax liabilities. Further, some of the statutory elements of Colorado's severance tax system do not align with principles of good tax policy and high-quality revenue systems, and make it difficult to determine if the State is receiving the severance taxes that it is due.

KEY FINDINGS

- The Colorado Oil and Gas Conservation Commission (Commission), within the Department of Natural Resources, does not collect some required oil and gas production information. Of the 420 operators actively producing during Calendar Years 2016 through 2018, 316 operators submitted 1,209 incomplete monthly well reports and/or failed to submit as many as 50,055 required monthly well reports. The Commission did not impose penalties on any of the operators for failing to report.
- Had the Commission imposed the maximum $200 per day, per well fine it has set in rules for 30 days, these 316 operators would have been subject to as much as $308 million in penalties for the violations.
- The Commission does not verify that oil and gas operators have conducted the proper maintenance and calibrations of measurement equipment to ensure the accuracy of oil and gas production reporting.
- Only eight of the 79 mine operators with active permits (10 percent) submitted production reports for Calendar Year 2017 and Natural Resources has not produced an annual mining report since 1981, both of which are required by statute.
- Eight of the 11 operators (73 percent) in our sample did not submit *Oil and Gas Withholding Statements,* which are used to identify interest owners who have not filed severance taxes, with their severance tax returns.
- Revenue does not always use complete production data when conducting oil and gas severance tax audits to verify production amounts reported on severance tax returns.
- We estimate that, after applying all applicable tax exemptions, credits, and deductions, Colorado's effective severance tax rate is 0.54 percent of gross revenue for oil and gas and 0.62 percent for coal.

BACKGROUND

- Severance taxes are intended to recapture a portion of the wealth that is lost when nonrenewable natural resources are removed from the earth and sold for private profit.
- Resources subject to severance tax include oil, gas, coal, metallic minerals, molybdenum, and oil shale. Tax rates vary based on the specific resource.
- Natural Resources is responsible for collecting data on the production of the resources listed above. Revenue is responsible for collecting severance taxes and assessing the accuracy of the taxes paid.
- The State collected $102.7 million in severance taxes for Fiscal Year 2018. Of this amount, 94 percent ($96.1 million) is attributable to oil and gas.

KEY RECOMMENDATIONS

- Ensure that oil and gas operators submit required monthly production reports by identifying and following up with operators that are in violation of reporting requirements.
- Implement processes to verify the accuracy of measurement equipment for oil and gas wells.
- Require mine operators to annually report on mining activities and issue an annual report on the mining industry, including production information.
- Determine if Revenue has the authority to require *Oil and Gas Withholding Statements*. If not, work with the General Assembly to obtain the authority and use the statements to identify unfiled severance tax returns.
- Work with the Commission to obtain data on missing or incomplete oil and gas well production reports for severance tax audits.

The Departments of Natural Resources and Revenue and the Commission agreed with these recommendations.