IMPACT ASSISTANCE CREDITS

EVALUATION SUMMARY

SEPTEMBER 2020
2020-TE27

THIS EVALUATION WILL BE INCLUDED IN COMPILATION REPORT SEPTEMBER 2020

	Mineral and Mineral Fuels Impact Assistance Severance Tax Credit	Mining and Milling Impact Assistance Corporate Income Tax Credit
YEAR ENACTED	1979	1980
REPEAL/ EXPIRATION DATE	None	None
REVENUE IMPACT	$0	$0
NUMBER OF TAXPAYERS	None	None
AVERAGE TAXPAYER BENEFIT	None	None
IS IT MEETING ITS PURPOSE?	No	No

WHAT DO THESE TAX EXPENDITURES DO?

MINERAL AND MINERAL FUELS IMPACT ASSISTANCE SEVERANCE TAX CREDIT (IMPACT ASSISTANCE CREDIT)—Provides taxpayers a credit against the State's severance tax equivalent to eligible contributions made to local governments to address local impacts related to a new severance operation or expansion of an existing operation.

MINING AND MILLING IMPACT ASSISTANCE CORPORATE INCOME TAX CREDIT (MINING IMPACT INCOME TAX CREDIT)—Provides mining and milling operators a credit against their corporate income tax equivalent to eligible contributions made to local governments to address local impacts related to new or expanded severance operations.

WHAT IS THE PURPOSE OF THESE TAX EXPENDITURES?

Statute does not explicitly state a purpose for either credit. Based on our review of statute, legislative history, and information provided by stakeholders, we inferred that the purpose of both credits is to encourage mineral and energy producers to make contributions up front to address costs that local governments anticipate incurring due to a producer's new or expanded severance operations.

WHAT DID THE EVALUATION FIND?

We determined that these expenditures are not meeting their purpose because they are not used. The Impact Assistance Credit was last used in 1990 and the Mining Impact Income Tax Credit appears to never have been used.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to repeal both credits since they are not being used. Alternatively, the General Assembly could consider revising the structure of the Impact Assistance Credit to make it more functional for the oil and gas industry.

IMPACT ASSISTANCE CREDITS

EVALUATION RESULTS

WHAT ARE THE TAX EXPENDITURES?

Statute provides two similar tax expenditures for coal, mineral, oil, and gas producers and milling businesses that make contributions to local governments to address the local impacts of severance operations.

MINERAL AND MINERAL FUELS IMPACT ASSISTANCE SEVERANCE TAX CREDIT (IMPACT ASSISTANCE CREDIT) [SECTION 39-29-107.5, C.R.S.]— The Impact Assistance Credit provides taxpayers a credit against the State's severance tax for qualifying contributions made to local governments to address local impacts related to a new severance operation or expansion of an existing operation. All taxpayers liable for severance taxes are eligible for the credit, which is equivalent to the amount of a taxpayer's contributions, plus an additional 0.75 percent of the contribution amount for each month between the date the contributions are made and when the credits can be applied against the taxpayer's severance tax liability. Credits in excess of a taxpayer's severance tax liability are not refundable, but are allowed a carryforward period of 10 years. The credit was created in 1979, two years after the State began to assess severance tax. Only new operations were initially eligible for the credit; however, in 1980, the expenditure was expanded to allow the credit for existing operations that expand or increase production.

According to statute [Section 39-29-107.5(2)(a), C.R.S.], eligible contributions to local governments can be in the form of cash transfers, materials, and services. The contributions can be used for planning and construction of public facilities and infrastructure, such as roads, schools, recreation facilities, water facilities, sewage facilities, police and fire protection, and hospitals. To qualify, each contribution must:

- Be necessary due to the initiation of a new severance operation or increase in production of an existing operation. The contribution can be to offset the impact of the new or expanding operation itself, as well as the increased need for public facilities and infrastructure to accommodate the increase in population due to employees moving to the area. Contributions related to ongoing operations without an increase in production are not eligible.
- Be documented in a written agreement between the prospective severance taxpayer and the local government impacted by the operation.
- Not exceed 50 percent of the taxpayer's total expected severance tax liability over the next 10 years due to the new or expanded operation.
- Receive approval from the executive director of the Department of Local Affairs.

Once approved, the Department of Local Affairs must forward a certification of eligibility to the taxpayer, the local government, and the Department of Revenue. Taxpayers claim the credit on their Department of Revenue Severance Tax Return for the appropriate type of mineral production. For example, coal producers would be required to complete Form DR 0020C, the Colorado Coal Severance Tax Return, and put the eligible credit amount on Line 18. The credit is then subtracted from the taxpayers' severance tax liability.

MINING AND MILLING IMPACT ASSISTANCE CORPORATE INCOME TAX CREDIT (MINING IMPACT INCOME TAX CREDIT) [SECTION 39-22-307, C.R.S.]—The Mining Impact Income Tax Credit provides coal mines and mills a credit against their corporate income tax equivalent to the amount of eligible contributions they make to local governments to address local impacts related to new or expanded operations. The credit is only available to coal mines and mills that file as corporations. Oil and gas producers and individual taxpayers are not eligible. Section 39-22-307(1), C.R.S., limits the annual credit amount taxpayers can claim to their income tax liability attributable to the new or expanded mining or milling operations. Taxpayers may claim the credit against their corporate income tax liability during the first five years of a new operation or following the expansion of an existing operation [Section 39-22-307(3), C.R.S.]. Established in 1980, the Mining Impact Income Tax Credit has remained substantively unchanged since its enactment. Eligible contributions for the Mining Impact Income Tax Credit must meet the same requirements regarding their form, size, and purpose as outlined above for the Impact Assistance Credit, and must also be approved by the executive director of the Department of Local Affairs [Section 39-22-307(2)(b), C.R.S.]. In addition, according to Section 39-22-307(2)(c), C.R.S., if the total of all credit claims received by the Department of Local Affairs exceeds $100,000, then the credit amounts certified for taxpayers is prorated based on each taxpayer's total contribution for impact assistance. This effectively caps the amount of credits the Department of Local Affairs can approve at $100,000 per year.

Department of Revenue staff stated that there is not an established method for taxpayers who wish to claim the credit and the Department has not issued any taxpayer guidance related to it. Taxpayers would likely claim the credit by deducting the credit amount from their income tax liability, using Line 20 on their C-corporation Income Tax Return (Form DR 0112).

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURES?

Statute does not specifically identify the intended beneficiaries of the Impact Assistance Credit or the Mining Impact Income Tax Credit. Based on how it operates and information provided by stakeholders, we inferred that the intended beneficiaries of the Impact Assistance Credit are taxpayers liable for severance tax who make contributions to local governments, which includes coal and mineral mining companies and oil and gas producers and interest owners. Based on its operation, we inferred that the intended beneficiaries of the Mining Impact Income Tax Credit are limited to corporations that engage in mining and milling operations in the state. In addition, the local governments and residents of the communities in which mining operations are located are indirect beneficiaries of both credits because they encourage businesses to make contributions to assist local governments in renovating existing public infrastructure and establishing new facilities for these communities.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURES?

Statute does not explicitly state a purpose for either the Impact Assistance Credit or the Mining Impact Income Tax Credit. Based on our review of statute, legislative history, and information provided by stakeholders, we inferred that the purpose of both credits is to encourage mineral and energy producers to make contributions up-front to address costs that local governments anticipate incurring due to producers' new or expanded severance operations. Although oil and gas producers are eligible for the Impact Assistance Credit, stakeholders indicated that the design of the credits appears to be targeted to mining operations.

ARE THE TAX EXPENDITURES MEETING THEIR PURPOSE AND WHAT PERFORMANCE MEASURES WERE USED TO MAKE THIS DETERMINATION?

We determined that the Impact Assistance Credit and the Mining Impact Income Tax Credit are not meeting their inferred purpose because they are not being used. Statute does not provide quantifiable performance measures for these credits. Therefore, we created and applied the following performance measure to determine the extent to which the credits are meeting their inferred purpose:

PERFORMANCE MEASURE: *To what extent are the credits being used to address local impacts related to severance operations?*

RESULT:

IMPACT ASSISTANCE CREDIT—According to the Department of Local Affairs and the Department of Revenue, there have been no credits issued since 1990 and no taxpayers have attempted to qualify by submitting an agreement to the Department of Local Affairs since 1994.

In 2008, to better understand why taxpayers were no longer using the credit and to consider possible improvements, the General Assembly passed House Bill 08-1084, directing the Departments of Local Affairs, Natural Resources, and Revenue, and stakeholders from local governments and relevant industries to convene a study group to develop recommendations to improve the credit. According to the report issued by this study group in January 2009, industry changes had caused the credit to become obsolete. Specifically, industry stakeholders indicated that the credit is better suited to coal and mineral mining operations for which a single, large-scale operation with most employees residing in the same area is more common. At the time the credit was created, coal and mineral mining was a more prevalent industry in the state and there was significant use of the credit between 1980 and 1990, as coal mining companies established new and expanded operations. However, the mining industry has declined since that time, while oil and gas operations have grown significantly. Oil and gas producers reported that they have not used the credit because their operations are typically more dispersed across local jurisdictions, and have more complex ownership structures, which makes the credit difficult for this industry to use. For example, an oil producer may have multiple wells across hundreds of square miles, with employees residing in multiple local jurisdictions. As a result, it would be difficult to define a single new or expanded operation and determine its impact within a specific local government's boundaries.

Further, according to local government representatives, though the credit would be useful in some circumstances, they have a need for ongoing support to address local impacts, which is not aligned with the credit because it is structured to facilitate contributions only at the outset of new or expanded operations. These stakeholders also indicated that other existing programs, such as the Department of Local Affairs' Energy and Mineral Impact Assistance Program, which provides grants funded by severance tax collections, and Direct

Distribution Program, through which a portion of severance taxes are distributed to local governments, provide a more strategic use of funds to address local government impacts. Local governments also expressed concern that if the credit were used more frequently, there would be a decrease in severance taxes available to fund these programs.

Based on this input from stakeholders, the study group concluded that there was no need to modernize or change the statute, since other programs are sufficiently addressing local government impact assistance needs. Following this report, the General Assembly did not propose legislation to change the credit and there have been no attempts to modify the Impact Assistance Credit since that time.

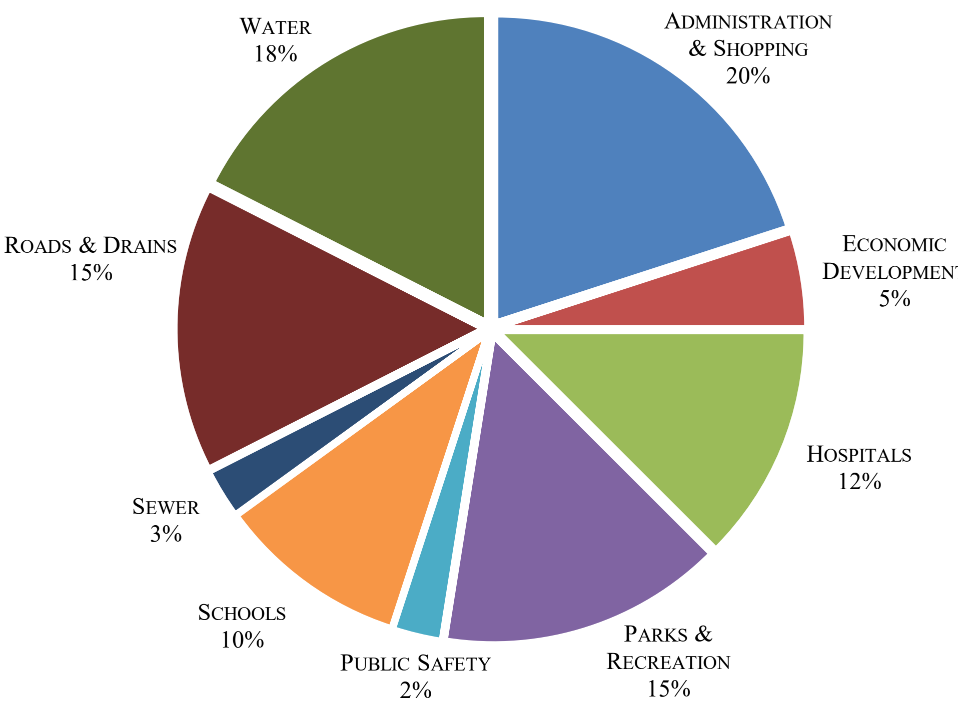
MINING IMPACT INCOME TAX CREDIT—The Department of Local Affairs was unable to find any evidence that this credit has ever been used and none of the stakeholders and potential beneficiaries who we contacted were aware of it. Department of Revenue staff were also not familiar with the credit and confirmed that there have been no credits claimed for at least 20 years. This credit was not considered by the House Bill 08-1084 study group discussed above; however, because its structure and eligibility requirements are similar to the Impact Assistance Credit, it appears likely that it has also become obsolete due to changes in the mining industry.

WHAT ARE THE ECONOMIC COSTS AND BENEFITS OF THE TAX EXPENDITURES?

We found that neither credit has any current revenue impact or economic costs or benefits because they are not being used and have not been used since 1990, if ever.

Historically, the Impact Assistance Credit had significant economic impacts. Specifically, between 1980 and 1990, 40 agreements for the Impact Assistance Credit were approved by the Department of Local Affairs. The approved credits totaled about $7.4 million, which is an average credit of about $185,000 per credit agreement. All of the credits allowed were granted to the coal mining industry and most went toward local government infrastructure projects. EXHIBIT 1.1 provides the type of projects for which credits were approved between 1980 and 1990.

EXHIBIT 1.1.
APPROVED IMPACT ASSISTANCE TAX AGREEMENTS
BY PROJECT TYPE,
CALENDAR YEARS 1980 THROUGH 1990



SOURCE: OSA analysis of the Study Group House Bill 08-1084 Report.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURES HAVE ON BENEFICIARIES?

Because the credits are not being used, there would likely be no impact if the credits were eliminated. Based on our discussions with the Department of Local Affairs, the Department of Revenue, and stakeholders, there are no indications that any potential beneficiaries are considering applying for the credits in the future.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

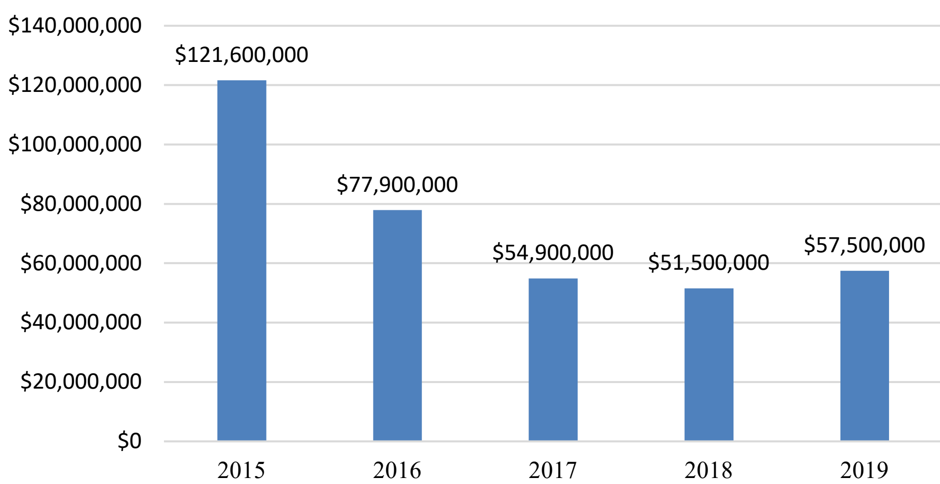
Of the 34 other states and District of Columbia that impose a severance tax, production tax, or milling tax on the extraction of natural resources, we did not identify any other states that provide similar tax expenditures.

ARE THERE OTHER TAX EXPENDITURES OR PROGRAMS WITH A SIMILAR PURPOSE AVAILABLE IN THE STATE?

DEPARTMENT OF LOCAL AFFAIRS' ENERGY AND MINERAL IMPACT ASSISTANCE PROGRAM GRANTS AND DIRECT DISTRIBUTIONS—Half of the State's severance tax revenue (following an initial allocation of $1.5 million to the Innovative Energy Fund) is distributed to the Department of Local Affairs' Energy and Mineral Impact Assistance Program (Program) to address the local impacts caused by severance operations. Of these funds, 70 percent are available for loans and grants to local governments that are socially or economically impacted by the mineral extraction industry, and 30 percent are distributed to local governments.

In Calendar Year 2019, the Program awarded $43.1 million in severance tax funds and $14.4 million in federal mineral lease funds through discretionary grants, totaling $57.5 million. Municipalities, counties, local districts, and state agencies are eligible for the grants, which can be used for local projects, including road, water, and sewer improvements; construction or improvement of local facilities; and planning. EXHIBIT 1.2 provides the amount of Program grants awarded during Calendar Years 2015 through 2019. According to the Department of Local Affairs' Annual Reports, there were no discretionary loans made during these years. As shown, due to the volatility of state severance tax collections, the amount granted each year has varied widely.

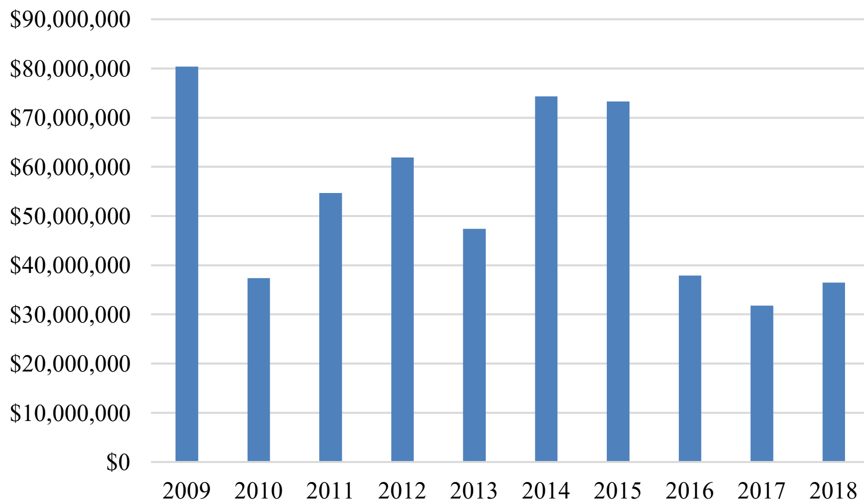
EXHIBIT 1.2.
ENERGY AND MINERAL IMPACT GRANT AWARDS,
CALENDAR YEARS 2015 THROUGH 2019



SOURCE: OSA analysis of the Department of Local Affairs Energy and Mineral Impact Program Annual Reports.

In addition to local government grants, Section 39-29-110(1)(c), C.R.S., requires the Department of Local Affairs to directly distribute 30 percent of its share of state severance tax revenue to local governments through a formula that is based on their statewide share of production; production employees' location of residence; mining and well permits; and mineral production. The Department of Local Affairs also receives 40 percent of the State's total federal mineral lease payments, 50 percent of which is directly distributed to counties based on production employees' location of residence, amount of federal mineral leases generated, population, and road miles located in the area. In Fiscal Year 2018, the Department of Local Affairs distributed about $16.2 million in severance tax funds and $20.3 million in federal mineral lease funds to counties and municipalities, for a total of $36.5 million. EXHIBIT 1.3 shows the total state severance tax and federal mineral lease direct distribution payments for Fiscal Years 2009 to 2018.

EXHIBIT 1.3.
TOTAL SEVERANCE TAX AND FEDERAL MINERAL LEASE DIRECT DISTRIBUTIONS,
FISCAL YEARS 2009 THROUGH 2018



SOURCE: OSA analysis of the Department of Local Affairs Severance Direct Distribution and Federal Mineral Lease Distributions.

WHAT DATA CONSTRAINTS IMPACTED OUR ABILITY TO EVALUATE THE TAX EXPENDITURES?

We did not identify any data constraints during our evaluation of the Mineral Impact Assistance Credit or the Mining and Milling Impact Assistance Credit.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER REPEALING THE IMPACT ASSISTANCE CREDIT AND THE MINING IMPACT INCOME TAX CREDIT. As discussed, although about $7.4 million in Impact Assistance Credits were awarded to coal mining companies from 1980 to 1990, no credits have been approved since that time due to a decline in new and expanded mining operations that would qualify. Further, although oil and gas producers are also eligible for the Impact Assistance Credit, according to stakeholders, the credit's structure makes it difficult for these producers to use it. Although local governments continue to face impacts due to severance operations, local government stakeholders indicated that the Energy and Mineral Impact Assistance Program, which disperses severance tax revenues to local governments through grants and direct distributions, provides a more strategic use of funds available for addressing local government impacts related to severance operations.

Additionally, the Mining Impact Income Tax Credit appears to have never been used and none of the industry or local government stakeholders who we contacted were aware that the credit existed. Because it has a similar structure and eligibility requirements as the Impact Assistance Credit, it is likely obsolete for similar reasons.

THE GENERAL ASSEMBLY COULD CONSIDER REVISING THE STRUCTURE OF THE IMPACT ASSISTANCE CREDIT TO MAKE IT MORE FUNCTIONAL FOR THE OIL AND GAS INDUSTRY. If the General Assembly does not repeal the Impact Assistance Credit, it could make changes to better allow oil and gas producers to qualify. As discussed, this credit was established during a period when mining was more prevalent and the structure of the credit worked well for mining companies, which often had separate, large operations whose long-term employees typically resided in the impacted communities. However, mining production has declined in recent years and most severance tax revenue now comes from oil and gas production. Although oil and gas producers are also eligible for the credit, oil and gas production tends to be dispersed across large geographic areas and multiple jurisdictions, making it difficult to define a single "operation" for the purposes of credit qualification. For these reasons, oil and gas industry stakeholders reported that it would be difficult for them to claim the credit, and Department of Local Affairs data indicate that no oil and gas companies have ever claimed it.

Although a 2009 report from the study group convened under House Bill 08-1084 recommended against changing the credit, its report provided several statutory changes it had considered to improve the credit, which the General Assembly could now consider as well. One of these included clarifying the definition of an "operation" for the purposes of qualifying for the credit to allow oil and gas operations to qualify. Specifically, the report indicated that allowing taxpayers to qualify based on the totality of their operations, as opposed to requiring a single, defined operation, would better facilitate the use of the credit. Another revision discussed by the study group was changing requirements that relate to the employees of an operation residing within the local government boundaries, since oil and gas operations and employees tend to be dispersed across multiple jurisdictions. Additionally, the study group considered several changes to clarify the statutory language to make it easier for potential beneficiaries to understand how to use it, such as clarifying definitions; the time periods for determining the commencement of a new or expanded operation; and the method for establishing the contribution limits based on anticipated severance tax liability at the outset of a new or expanded operation.

Although we lacked information necessary to estimate the potential revenue impact of these possible changes, to the extent that any changes increase the use of the credit, they would reduce state severance tax revenue. Because about half of this revenue is distributed to local governments through the Energy Impact Assistance Program Fund, which is used to provide grants and direct distributions to local governments to offset the impact of severance operations, there would also be a corresponding decrease in funds available to local governments through this program equivalent to about half of the amount of credits claimed. However, to the extent that changes to the credit encouraged producers to make contributions to local governments, there could be an increase in the overall funding available for impact assistance.