LEGISLATIVE FISCAL OFFICE
Fiscal Note

Fiscal Note On: **HB 172** HLS 23RS 575

Bill Text Version: **ENGROSSED**

Opp. Chamb. Action:

Proposed Amd.: **w/ PROP SEN COMM AMD**

Sub. Bill For.:

Date:	May 19, 2023 3:24 PM	**Author:**	DEVILLIER
Dept./Agy.:	Revenue		
Subject:	Reduce Oil Severance Tax Rate	**Analyst:**	Deborah Vivien

TAX/SEVERANCE TAX EG DECREASE GF RV See Note

Reduces the severance tax rate for oil over a certain period of time and fixes the severance tax rate for oil produced from certain wells at the current rate

Present law imposes a severance tax rate on most oil produced in the state at 12.5% of value. Wells producing less than 25 barrels per day and at least 50% salt water per day pay one-half the tax rate (incapable wells at 6.25%). Wells producing less than 10 barrels per day pay one-quarter the tax rate (stripper wells at 3.125%). Present law allows a 100% severance tax exemption for horizontal oil and gas wells for the shorter of the first 24 months of production or payout. The exemption may be reduced by an annually tested price trigger based on the prior year NYMEX average price.

Proposed law reduces the full-rate from 12.5% to 8.5% in one-half percent increments by July 1, 2031. The tax rate will be 12% for FY 25, 11.5% for FY 26, 11% for FY 27, 10.5% FY 28, 10% for FY 29, 9.5% for FY 30, 9% for FY 31, and 8.5% for FY 32 and thereafter. The current tax rates on incapable and stripper well production are retained at 6.25% and 3.125%, respectively. Proposed law eliminates the annual exemption reduction trigger and sets the horizontal well exemption for oil and gas at 80% in FY 24, then and reduces it by 3.5% per year beginning in FY 25 until FY 46, at which time the exemption will expire. Effective upon governor's signature.

EXPENDITURES	**2023-24**	**2024-25**	**2025-26**	**2026-27**	**2027-28**	**5 -YEAR TOTAL**
State Gen. Fd.	$0	$0	$0	$0	$0	**$0**
Agy. Self-Gen.	$0	$0	$0	$0	$0	**$0**
Ded./Other	$0	$0	$0	$0	$0	**$0**
Federal Funds	$0	$0	$0	$0	$0	**$0**
Local Funds	$0	$0	$0	$0	$0	**$0**
Annual Total	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**

REVENUES	**2023-24**	**2024-25**	**2025-26**	**2026-27**	**2027-28**	**5 -YEAR TOTAL**
State Gen. Fd.	SEE BELOW	SEE BELOW	SEE BELOW	SEE BELOW	SEE BELOW	
Agy. Self-Gen.	$0	$0	$0	$0	$0	**$0**
Ded./Other	SEE BELOW	SEE BELOW	SEE BELOW	SEE BELOW	SEE BELOW	
Federal Funds	$0	$0	$0	$0	$0	**$0**
Local Funds	$0	$0	$0	$0	$0	**$0**
Annual Total						

EXPENDITURE EXPLANATION

The Dept. of Revenue estimates that it will incur some $51,360 of staff time cost to modify the tax administration system to incorporate the annual tax rate changes in the bill. Some additional costs will occur each year that the bill changes the severance tax rate. Such costs are typically absorbed by the department initially, but become a component of budget funding as legislative changes accumulate.

REVENUE EXPLANATION

Based on the current official REC forecasts of mineral revenue, and the historical share of severance tax attributable to oil (55%), the phase-down of the full-rate 12.5% tax rate, as provided in the bill, results in state severance tax revenue losses of some $10 M in FY 25, growing to $38.4 M by FY 28, and further growing to $76.8 M by FY 32 when the tax rate phase-down is complete. This revenue loss would be shared with local parish governments through the constitutional parish severance tax allocation. Parish severance tax allocation losses are estimated at $797,000 in FY 25, growing to $2.516 M by FY 28, and further growing to $4.9 M by FY 32. The difference between the total severance tax revenue loss and the parish severance tax allocation loss is the state general fund severance tax loss; ranging from some $9.2 M in FY 25, and growing to $35.9 M by FY 28, and further growing to $71.9 M by FY 32.

Since production on state lands and waterbottoms pays severance tax as well, and state royalty receipts are adjusted for their share of the severance tax, the bill's severance tax reduction results in a relatively small gain in state royalty receipts, shared with parish governments through the constitutional parish royalty allocation (10% of royalties attributable to production within each parish). State general fund royalty gains are estimated at some $91,000 in FY 25, growing to $349,000 by FY 28, and further growing to $698,000 by FY 32. Parish royalty allocation gains are estimated at $10,000 in FY 25, growing to $39,000 by FY 28, and further growing to $78,000 by FY 32. The oil rate reduction in the bill will also reduce the rate for other types of wells and exemptions that are tied to the full rate but not specifically noted in the bill. The fiscal impact is expected to be minimal and not addressed in this fiscal note.

To offset the decline in revenue, the bill also phases out the horizontal well exemption for oil and gas by 3.5% annually beginning in FY 25 and continuing until the exemption expires. As estimated by the LSU Center for Energy Studies, revenue increases are noted in the table below ($ millions) during the oil rate phase-out (updated to May 18, 2023, REC estimates):

	FY24*	**FY25**	**FY26**	**FY27**	**FY28**	**FY29**	**FY30**	**FY31**	**FY32**
Change from rate reduction	$0	($12.5)	($23.9)	($36.3)	($48.4)	($60.5)	($72.6)	($84.6)	($96.7)
Change from exemption reduction	(3.6)	12.3	23.6	35.8	47.7	59.7	71.6	83.5	95.4
Net Impact	($3.6)	($0.2)	($0.3)	($0.5)	($0.7)	($0.8)	($1.0)	($1.1)	($1.3)
Oil Severance Rate	12.5%	12%	11.5%	11%	10.5%	10%	9.5%	9%	8.5%
Horizontal Exemption	80%	76.5%	73%	69.5%	66%	62.5%	59%	55.5%	52%

Senate — Dual Referral Rules

- [ ] 13.5.1 >= $100,000 Annual Fiscal Cost {S & H}
- [x] 13.5.2 >= $500,000 Annual Tax or Fee Change {S & H}

House

- [ ] 6.8(F)(1) >= $100,000 SGF Fiscal Cost {H & S}
- [ ] 6.8(G) >= $500,000 Tax or Fee Increase or a Net Fee Decrease {S}

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CONTINUED EXPLANATION from page one:

Revenue Explanation Continued

The horizontal well exemption was valued based on anticipated prices given most recent price activity. Any change to the forecast or typical market volatility could significantly alter the outcome. The Tax Exemption Budget average, as well as the actual calculations from the REC estimates, were compared to determine reasonableness of a 3.5% annual decrease in the exemption as the closest scalar that would alleviate most of the fiscal cost of the rate reduction.

In the bill, the exemption reduction is expected to generally offset the revenue lost due to the reduction in the oil severance rate, within a standard margin of error. The bill more closely aligns the severance rates of oil and natural gas. Where the oil rate reduction will decrease costs of production for oil producers, the horizontal exemption is primarily taken by natural gas producers and will increase the cost of production for natural gas producers. Annual changes throughout the phase-in are small and occur over a number of years, with the oil severance rate of 8.5% attained in FY 32. The market is expected to adjust as the gradual declines are incorporated into production plans.

Any impacts of the bill will also accrue to the areas in which production takes place as 20% of collections up to an annual cap is sent back to the locals. Though state aggregate impacts are essentially revenue neutral, local impacts will be dependent upon the production patterns in each parish. A maximum exposure may be used to illustrate the potential impact locally, assuming that parish oil production remains fixed and the parish has no horizontal natural gas production to offset the loss with the decreased exemption. For a parish that produces only full rate oil with 20% of severance that exactly equals the parish severance cap of $1.1M, the oil severance rate reduction would reduce parish revenue by about $45,000 per year beginning in FY 25, slowly ramping up with the decrease in the oil severance rate, reaching an estimated $130,000 loss annually by FY 27, and climbing to an estimated $350,000 annual loss by FY 32.

While a severance tax exemption is similar to a price increase for producers, research by the LSU Center for Energy Studies finds that oil and gas production are relatively unresponsive to price changes, and therefore severance tax rates. Specifically, oil production from new wells (one year of age or less) is estimated to increase by 6.2 percent in the long-run in response to a 10 percent increase in prices. A statistically significant response of total production to prices in Louisiana is not observed in the long run. A state unilaterally changing severance tax rates may exhibit greater production response, but this research is focused on activity located very close to state borders, and still finds the response to be small. Thus, the bill is likely to result in revenue losses, though those losses are expected to primarily be offset by the expansion in the base resulting from the reduction in the horizontal exemption.

* The impact in FY 24 is based on the horizontal exemption for oil moving from 60% (estimated today) to 80% as mandated in the bill. Because very little oil is eligible for the horizontal exemption, the impact is small but will decrease the exemption during FY 24, should the 60% exemption remain in place for FY 24 under current law.

Senate	Dual Referral Rules	House	
☐	13.5.1 >= $100,000 Annual Fiscal Cost {S & H}	☐	6.8(F)(1) >= $100,000 SGF Fiscal Cost {H & S}
☒	13.5.2 >= $500,000 Annual Tax or Fee Change {S & H}	☐	6.8(G) >= $500,000 Tax or Fee Increase or a Net Fee Decrease {S}

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