LEGISLATIVE FISCAL OFFICE
Fiscal Note

Fiscal Note On: **HB 29** HLS 202ES 4
Bill Text Version: **REENGROSSED**
Opp. Chamb. Action: **W/ SEN FLOOR AMD**
Proposed Amd.:
Sub. Bill For.:

Date: October 20, 2020 11:39 AM
Author: DEVILLIER
Dept./Agy.: Natural Resources / Revenue
Analyst: Greg Albrecht
Subject: Severance Tax Exemption For Orphaned Wells

TAX/SEVERANCE-EXEMPTION REF SEE FISC NOTE GF RV See Note
Suspends severance taxes on production from certain oil wells (Items #26 and 61)

Proposed law provides an exemption from severance taxes on oil production occurring from any newly drilled well, a completed well undergoing enhancements that require a DNR permit, or an orphan well. The exemption lasts up to the earlier of either payout of well drilling or enhancement costs is achieved, or 12-months for new wells, 6-months for recompleted wells, or 24-months for orphan wells. Well eligibility is determined by the Dept. of Natural Resources, while the period of exemption is determined by the Dept of Revenue. The availability of the exemption extends to projects that commence production on or after January 1, 2021 and on or before December 31, 2025. Participating wells are limited to only one exemption per wellhead. If a participating orphaned well is unable to produce in paying quantities, the operator may be reimbursed costs to plug and abandon the well from the Oilfield Site Restoration Fund. The Fund threshold, above which the per barrel and mcf fee is halted is increased to $25 million from $14 million. The Fund's fees are applicable to production participating in the bill's tax exemption. Effective upon governor's signature.

EXPENDITURES	2020-21	2021-22	2022-23	2023-24	2024-25	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	$0	$0	$0	$0	$0	**$0**
Federal Funds	$0	$0	$0	$0	$0	**$0**
Local Funds	$0	$0	$0	$0	$0	**$0**
Annual Total						

REVENUES	2020-21	2021-22	2022-23	2023-24	2024-25	5 -YEAR TOTAL
State Gen. Fd.	($4,515,000)	($6,484,000)	($10,375,000)	($10,375,000)	($10,375,000)	**($42,124,000)**
Agy. Self-Gen.	$25,000	$81,000	$129,000	$129,000	$129,000	**$493,000**
Ded./Other	($735,000)	($1,056,000)	($1,689,000)	($1,689,000)	($1,689,000)	**($6,858,000)**
Federal Funds	$0	$0	$0	$0	$0	**$0**
Local Funds	$0	$0	$0	$0	$0	**$0**
Annual Total	**($5,225,000)**	**($7,459,000)**	**($11,935,000)**	**($11,935,000)**	**($11,935,000)**	**($48,489,000)**

EXPENDITURE EXPLANATION

The Department of Revenue's current assessment of staff time associated with modifications to the tax processing system to incorporate a new tax return necessary to implement the payout-based exemption in this bill is $151,000. Although necessary determinations are required of the Dept of Natural Resources, the exemption is against severance tax administered by the Dept of Revenue, and additional personnel in the Dept of Revenue may be necessary.
Continued on page 2

REVENUE EXPLANATION

The estimated severance tax losses resulting from the bill are based on adjustments to the loss estimates of the reengrossed bill. Those estimates are explained on page 2 as included on the fiscal note for the reengrossed bill. Those estimates were adjusted downward for this version of the bill in proportion to the different lengths of time this version of the bill allows for exemption (6 months for recompleted wells and 12 months for new wells) relative to the length of time in the reengrossed bill (24 months for all wells). Costs for new wells are such that they will receive a full 12 month exemption. Costs for recompletions are such that they will likely receive a full 6 month exemption, although there may be some of these wells that achieve payout before 6 months. Orphan wells receive a 24 month potential exemption period, but the nature of orphan wells is such that it seems unlikely that orphan wells will significantly participate in the program. By shortening the months of potential exemption from the reengrossed bill, this version of the bill reduces the severance tax loss ramp-up, since wells will come off of exempt status earlier, subjecting their production to tax earlier. This assumes that production from these wells is sustained beyond their exemption period. The FY21 severance tax loss is the same as in the reengrossed bill, since these wells will likely receive at least 6 months of exemption, and only one-half of a year's production was already assumed to be affected in the reengrossed bill.

The dedicated fund reductions in the table above reflect the loss to the parish severance tax allocation and the wetlands fund allocation from the overall loss of state severance tax collections. The bill does, however, increase the threshold of the Oilfield Site Restoration Fund per barrel and per mcf fees (from $14 million to $25 million) above which the fee collections are halted. Thus, additional dedicated funding to that special fund is possible, largely dependent upon the volume of oil and gas production in the state; although such fee collections have not achieved those levels in the past.

Self-generated fee revenue will also likely accrue to the Dept of Natural Resources from $504 fee associated with the Application for Severance Tax Relief - Well Status Determination each year. Discussed on page 2.

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}
[x]	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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CONTINUED EXPLANATION from page one:

Severance Tax Discussion for the Reengrossed Bill
Using FY20 as an initial model for a baseline of activity affected by the bill, the Dept of Natural Resources indicates that there were some 55 new wells (735,000 barrels) and 160 recompletion wells (4.2 million barrels) brought into production. The severance tax value of this production at an FY20 oil price of $46.42/bbl is approximately $28 million per year. This accounts for the different tax rates applied to the wells based on their daily volumes (12.5% full-rate, 6.25% incapable, 3.125% stripper). Well costs (new and recompletion) can vary considerably across wells, but the relatively low severance tax value per well (at most $420,000, at least $363) suggests that nearly all affected wells are likely to receive a 24-month exemption. Thus, the FY20 proxy generates a first full year effect of the bill of some $28 million of severance tax revenue loss. The second full year of revenue loss is double at $56 million; the second 12-months of exemption for the first year's participating wells plus the first 12-months of exemption for the second year's participating wells. Revenue losses stabilize at that level through FY27 before falling off as the last wells entering the program in 2025 exhaust their 24-months of exemption. The period of FY21 is roughly half a one-year effect, depending on how fast program participation ramps up.

This is a simple model of the potential revenue loss from the bill. More realistic losses are likely less than this due to the major factors of a somewhat lower oil price outlook, probably fewer wells involved than in FY20, and the possibility that some wells may achieve the payout equivalent of their severance tax exemption in less than 24-months. However, if oil prices strengthen over time, these dampening factors would be less significant or even reversed. That said, an adjustment of the FY20 model results by as much as 25%, still results in first full year revenue losses of $21 million and subsequent full years of $42 million. Annual losses are likely to ramp up to these full year effects because the bill starts one-quarter of the way into FY21, and wells will come in production over the course of year. There is no precise way to estimate the phase-in of the exemption effect. To reflect this ramp-up, it is assumed that 1/4 of a full year effect occurs in FY21, and one-half of first and second year effects accumulate over FY22 and beyond. Allocation of revenue loss is approximately 86% to the general fund and 14% to the dedicated funds {wetlands fund (3%) and parish allocations (11%)}. Some portion of this exempted production will occur on state lands/waterbottoms, resulting in a small royalty gain offset (less than 1%) to the severance tax losses estimated above. In addition, specific estimates of revenue loss are highly uncertain at this time due to the effects of the Covid-19 virus pandemic on economic activity in general and oil prices in particular.

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 natural 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 response to a 10 percent increase in prices in the long run. 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 research on this case still finds the response to be small. Thus, the bill is likely to result in revenue losses.

The fiscal note assumes that the bill does not intend to provide its tax exemption to oil condensate produced by natural gas wells.

Continued Revenue Explanation
DNR could not indicate whether any meaningful baseline of orphaned wells being brought back into production occurs. Since orphaned wells are abandoned and not producing because they don't produce in paying quantities, the bill's severance tax exemption is not likely to reduce baseline severance tax receipts to any meaningful degree. To the extent the bill encourages orphaned wells to be brought back into production, it may eventually result in additional severance tax collections once restarted wells achieve payout or within 24-months of new production. This potential result is likely to be small since the wells are likely to produce at marginal rates and pay low severance tax rates of 3.125% or 6.25% of value. The current relatively low oil price environment makes paying quantities even less likely. From an overall activity perspective, while the bill may work to encourage orphan well activity, that activity may occur at the expense of other marginal well activity, resulting in little or no net additional activity.

The Dept of Natural Resources has expressed concern regarding the provision that provides for reimbursement from the Oilfield Site Restoration Fund to well operators that plug and abandon a well that fails to produce in paying quantities. The program/Fund has limited resources for plugging the existing priorities of orphan wells, and the bill's language may allow wells affected by this bill to draw on the Fund without going through the program's prioritization and bidding process for plugging and abandoning. However, the bill provides the authority to the Secretary of the Dept to approve or deny reimbursement in whole or in part, and to promulgate appropriate rules, in consultation with the office of conservation.

Continued Revenue Dept Expenditure Explanation
The Revenue Dept Taxpayer Compliance Division and the Field Audit Division each anticipate the need for an additional position to review returns to verify proper certification, and to administer taxpayer inquiries and compliance ($78,000 FY21, $160,000 FY22).

Natural Resources Expenditure and Self-Generated Revenue Discussion
Since the bill relies on existing DNR permitting, administrative costs of the Dept may not be materially effected. The Dept indicates that there will be potentially an additional 500 hours of work time associated with processing approximately 255 applications per year for the required certifications ("Application for Severance Tax Relief - Well Status Determination") each year. The application fee is $504, generating $129,000 per year in fee revenue to the Dept. DNR does not anticipate the need for additional personnel, but these fees would be available to cover additional administrative costs. The fee revenue would be deposited to the Oil and Gas Regulatory Fund statutory dedication, but is depicted on the table on page one as self-generated revenue to distinguish it from the revenue loss components of the bill. This fee revenue is depicted as ramping up at the same pace as the total revenue loss estimates. However, should there be an influx of applications for various types of recompletions, the Dept may require additional resources to timely process permits.

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