HOUSE RESEARCH ORGANIZATION bill analysis | 4/27/95 | HB 398 Counts, Craddick (CSHB 398 by Craddick)

SUBJECT: Extending the exemption of high-cost gas from gas production tax

COMMITTEE: Ways and Means — committee substitute recommended

VOTE: 6 ayes — Craddick, Wolens, Heflin, Holzheauser, Marchant, Place

0 nays

1 present, not voting — Finnell

4 absent — Horn, T. Hunter, Oliveira, Place

WITNESSES: For — Grant Billingsley, Texas Independent Producers and Royalty Owners Association., Panhandle and Royalty Owners Association, Permian Basin Petroleum Association, North Texas Oil and Gas Association, West Central Texas Oil and Gas Association., and Wagner and Brown, LTD.; Kathleen E. Magruder, Enron Capital and Trade Resources; Robert J. Duenckel, Marathon Oil Co.; Arnold H. Brackenridge, Trans Texas Gas Corporation; Ben Sebree, Texas Mid-Continent Oil and Gas Association; David Sebree, Conoco, Inc.

Against — None

On — Mike Reissig, Comptroller's Office

BACKGROUND: A temporary exemption from the natural gas production tax is authorized by the Tax Code for high-cost gas, as defined in Tax Code sec. 201.057(a)(2), if the gas is produced from wells spudded (begun) or completed between May 24, 1989, and September 1, 1996. This exemption applies to production during the period beginning September 1, 1991 and ending August 31, 2001.

DIGEST: CSHB 398 would amend the Tax Code to extend the eligibility period for the exemption from severance taxes paid on high-cost gas wells. The bill would change the last date for spudding or completing high-cost gas wells from September 1, 1996, to September 1, 2006. The bill would exempt production for 120 consecutive calendar months beginning the first day of production.

For wells spudded or completed between September 1, 1996, and August 31, 1997, taxes would have to be paid when due, but an operator could apply for a refund on or after September 1, 1997. The time period for which an operator is entitled to a refund would be included in the 120-month limit of tax exemption.

The bill would extend the deadline for applications to the comptroller to December 31, 2007. The bill would take effect September 1, 1995.

SUPPORTERS SAY:

During the last decade the state has experienced depressed oil and gas prices, reduced exploration and drilling, and falling production. Since 1982 more than 135,000 Texas jobs in the oil and gas sector have been lost. Today, the challenge is to prevent further job losses in an industry that is still vital to the lives of hundreds of thousands of Texans.

HB 398 would extend the incentives package first enacted by the Legislature in 1989. High-cost gas, commonly known as "tight sands" gas, is inherently expensive to drill and produce. The Legislature provided a severance tax exemption for 10 years on wells drilled that are certified by the Railroad Commission as high-cost gas. This tax exemption is for new production only, not production currently paying severance taxes.

High-cost gas wells are typically drilled to depths ranging from 9,000 feet to 15,000 feet, with costs increasing the deeper the well. Typical high-cost gas wells cost $500,000 to $600,000 more to drill than conventional wells. Recovery of gas is made more difficult by rock formations that are not porous (called tight gas), restricted flow or the extreme well depth. These wells generally produce at high levels for a short period, then production falls off rapidly, greatly decreasing the rate of return on investment.

The high-cost gas program has been highly successful in encouraging producers to drill these difficult and expensive wells. From 1989 to 1994 there were 5,913 high-cost gas wells drilled producing 3.2 trillion cubic feet of gas. These wells were exempt from $432 million in severance taxes, but accounted for more than $335 million in sales taxes and $346 million in ad valorem taxes.

Conservative estimates show that the 5,913 high-cost gas wells exempted from taxes from 1989 to 1994 have had a total positive impact to the state of over $16 billion, and produced more than $675 million in state and local taxes.

At the present price of gas, these high-cost gas wells could not and would not be drilled without this incentive. Gas producers will leave the state and produce elsewhere if these incentives are allowed to expire. The current economics of the gas market does not provide enough of a financial incentive to continue to explore, drill and produce without these tax incentives.

To avoid any loss of general revenue certified for the fiscal 1996-97 budget, CSHB 398 would require that taxes be paid on production from high-cost gas wells spudded or completed during fiscal 1997, the first year of the extension of the tax exemption. Operators would be entitled to a refund for taxes paid during this period after the next fiscal biennium ends on August 31, 1997.

A floor amendment will be offered to satisfy concerns raised about the length of the exemption proposed by the bill.

OPPONENTS SAY:

The merits of the exemption are evident, but the extension of the tax break that would last until the year 2016 for producers who apply for the exemption in the year 2006 may be too long. HB 398 should be amended to limit the extension to 1999 and require the Railroad Commission to file a report with the Legislative Budget Board, before the 75th Legislature meets in 1997, outlining the number of wells drilled under the extension of this exemption program and examining its impact on the state's economy and finances.

NOTES:

The committee substitute added the provisions requiring payment of the tax during fiscal 1997 and the refund for certain producers and changed the ending date for the exemption. The substitute extends all application and certification deadlines that are applicable to the program.

Rep. Craddick said he planned to offer a floor amendment regarding the expiration date for the exemption.