HOUSE RESEARCH ORGANIZATION bill analysis

HB 2615
Counts, Oliveira, Junell, Walker, Sadler, et al.
4/26/1999
(CSHB 2615 by Craddick)

SUBJECT: Extending oil and gas severance tax incentive programs

COMMITTEE: Ways and Means — committee substitute recommended

VOTE: 9 ayes — Oliveira, Bonnen, Craddick, Heflin, Hilbert, Keffer, T. King, Ramsay, Sadler

0 nays

2 absent — McCall, Y. Davis

WITNESSES: For — Grant Billingsley, Permian Basin Petroleum Association; Bob Duenckel, Marathon Oil and Texas Oil and Gas Association; Chris Long, Texas Independent Producers and Royalty Owners Association

Against — None

On — Tony Garza, Texas Railroad Commission

BACKGROUND: The Legislature created the high-cost gas incentive program in 1989 and reenacted it in 1995 to encourage natural gas producers to drill expensive and technically difficult wells. Under current law, high-cost gas produced from a well spudded (begun) or completed between August 31, 1996, and September 1, 2002, is entitled to a reduction in the natural gas severance tax, which normally is 7.5 percent of the wellhead value. The reduced tax rate applies until the total tax reduced equals half of the drilling and completion costs, or for 10 years, whichever comes first. Calculation of the tax reduction is based on the ratio of drilling and completion costs of the high-cost well to twice the median cost of high-cost wells from the previous fiscal year. The Texas Railroad Commission (RRC) must certify an application for a high-cost well to qualify its production for the severance tax reduction. The operator must apply to the comptroller for an exemption based on this certification.

The two-year inactive well program was created in 1993 and reenacted in 1997 to encourage oil and gas producers to keep inactive wells from being plugged. Under current law, the RRC may not certify a two-year inactive well for a tax exemption after February 29, 2000. Wells certified under this program are exempt from severance taxes for 10 years following the RRC's

approval for certification. The operator must apply to the comptroller for an exemption based on this certification. To qualify, a well must have produced no hydrocarbons in more than one month during the two years before the operator's application. The severance tax on crude oil is 4.6 percent of the wellhead value.

DIGEST:

CSHB 2615 would extend by eight years the date up to which a high-cost gas well could qualify for the severance tax reduction. Under the bill, wells would have to be spudded or completed by September 1, 2010, to qualify.

The bill would extend by 10 years the date up to which the RRC could designate a two-year inactive well, to February 28, 2010. It would extend by 10 years the date up to which an application could be made for a two-year inactive well certification, to August 31, 2009.

The bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house.

SUPPORTERS SAY:

CSHB 2615 would extend two incentive programs which, although they cost the some general revenue, create substantial off-setting revenues for schools and local governments through increased ad valorem taxes and for local governments and the state through increased sales taxes and employment.

The high-cost gas program has been highly successful in encouraging producers to recover gas that otherwise would have been left in the ground. Through August 1998, the RRC had certified 12,059 wells that had produced 7.9 trillion cubic feet of gas, generating $820 million in sales tax revenues and $939 million in ad valorem property taxes. The RRC estimates this program's overall economic benefit to the state at more than $42 billion, in contrast to a total tax exemption of just under $1 billion. In 1997, production owing to this incentive accounted for more than one-quarter of the state's total natural gas production.

High-cost gas wells typically are drilled to depths ranging from 9,000 to 15,000 feet, and the gas is difficult to recover because of nonporous rock formations, low natural pressure, and the depth of the well. These kinds of wells usually cost at least $500,000 more than conventional wells. High-cost gas wells tend to produce at high levels for a short period of time. Production rapidly falls off, reducing the return on investment for these kinds of wells.

The two-year inactive well program has been successful at keeping wells from being plugged, enabling those resources to be recovered. Plugged wells produce no oil, add no ad valorem property taxes, employ no people, and provide no economic benefit — including severance taxes — to the state. In many cases, the severance taxes exempted by the program do not represent lost revenue because the state never would have received the revenue anyway. These wells instead would have been plugged and their productive value lost forever.

The Legislature has extended the deadlines for both programs once before. For both programs, activity declined immediately before the expiration date. Extending the programs for 10 years would provide oil and gas producers with certainty that these tax exemptions will be in place so they can effectively plan their exploration and operation activities.

OPPONENTS SAY:

Neither program needs to have its sunset dates extended during this session. The tax incentives for high-cost gas wells and two-year inactive wells are set to expire in 2002 and 2000, respectively. Instead of extending them now, the Legislature should require the comptroller to prepare a report on the effectiveness and economic benefit of these programs. Such a report would provide the Legislature with sufficient quantitative evidence to determine whether these incentives should be extended, modified, or eliminated.

Ten years is too long a period to extend these programs. Past extensions have been for a much shorter period, giving the Legislature periodic opportunities to study the effectiveness of the programs and the justification for continuing them. Appropriations are justified and reviewed biennially. Tax incentives — which, like appropriations, involve the directing of state funds — ought to be reviewed periodically as well.

The Legislature already has provided tax breaks to the oil and gas industry this session. Though this industry provides economic benefits to the state, tax breaks to the industry take funds away from other priorities for investing in the state's economic future.

NOTES:

The committee substitute changed the date past which the RRC no longer could designate a two-year inactive well to February 28, 2010, from February 29, 2010, as February will have only 28 days in 2010.

A related bill, HB 2104 by Craddick, would extend the period up to which the RRC could certify a well for the two-year inactive well program to February 28, 2002, a two-year extension. The bill does not address the high-cost gas program. HB 2104 was placed on the Local, Consent, and Resolutions Calendar and passed the House on April 23.