FISCAL IMPACT REPORT

		LAST UPDATED	
SPONSOR	Sanchez/Munoz	**ORIGINAL DATE**	2/24/23
SHORT TITLE	Oil & Gas Re-Stimulation Well Tax Credit	**BILL NUMBER**	House Bill 450
		ANALYST	Torres, I.

REVENUE* (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY23	**FY24**	**FY25**	**FY26**	**FY27**		
	Negative, likely tens of millions or more				Recurring	Senior Severance Bonding Capacity
	Negative, likely tens of millions or more				Recurring	Supplemental Severance Bonding Capacity
	Negative, likely tens of millions or more				Recurring	Severance Tax Bonding Fund

Parenthesis ( ) indicate revenue decreases
*Amounts reflect most recent version of this legislation.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT*
(dollars in thousands)

	FY23	FY24	FY25	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
EMNRD		$800.0	$300.0	$1,100.0	Recurring	General Fund

Parentheses ( ) indicate expenditure decreases.
*Amounts reflect most recent version of this legislation.

Relates to SB443

Sources of Information
LFC Files

Responses Received From
State Land Office (SLO)
Taxation and Revenue Department (TRD)
Department of Finance and Administration (DFA)
Energy, Minerals, and Natural Resources Department (EMNRD)
State Investment Council (SIC)

SUMMARY

Synopsis of House Bill 450

House Bill 450 (HB450) amends the Oil and Gas Severance Tax Act (NMSA 1978, §§ 7-29-1 to -23) to provide a new severance tax exemption for certain oil and gas produced from a well that has undergone a "re-stimulation treatment." The tax exemption would be valid for five years once the re-stimulation treatment is completed, up to a maximum of $2 million.

The bill defines a "re-stimulation treatment" to mean "recompletion or rework activities that use the existing wellbore of a well for the purpose of initiating or propagating fractures in a target geologic formation to enhance or cause production of products," i.e. fracking. For a producer to be eligible for the tax exemption, the well in question must be producing for at least five years before being fracked, and excludes wells that are already "part of an enhanced recovery project pursuant to the Enhanced Oil Recovery Act or a converted existing vertical wellbore that is converted to a horizontal wellbore."

The bill further provides that only "excess products" from the well – that is, production above "the average monthly production from the well in the 12-month period prior to the date when the re-stimulation treatment is completed" is eligible for the exemption.

Finally, to be eligible for the credit, a producer must use recycled or treated water (as defined in the Produced Water Act (NMSA 1978, §§ 70-13-1 to -5) for the re-stimulation work, if the work requires the use of water.

This bill does not contain an effective date, and as a result, would go into effect June 16, 2023, (90 days after the Legislature adjourns) if signed. However, the tax exemption is effective for products produced after August 31, 2023.

FISCAL IMPLICATIONS

There is insufficient data to determine the fiscal impact of this bill, such as data on the number of wells that typically receive re-stimulation treatments each year, the amount of additional production typically generated through a re-stimulation treatment, or the degree to which the exemption in HB450 would incentivize new re-stimulation treatments. Furthermore, HB450 is proposing to provide a tax credit for activities that occur regularly in the oil field today across a range of scenarios – some operators recomplete/rework wells to enhance production from existing wells while others are restimulating wells to produce from formations or pools not previously accessed by the wells. As drafted, the tax credit in HB450 would apply to both scenarios. Therefore, the number of eligible wells is likely to be in the dozens, if not more, annually.

To the extent that the exemption leads to forgone severance tax revenue, this would result in reduced revenue to the severance tax bonding fund, which would result in a proportional reduction in capital outlay funding each year and reduced inflows into the severance tax permanent fund (STPF). The current statutory allocation of severance tax revenues is 86.2 percent for capital outlay and 13.8 percent to STPF.

Additionally, despite not being charged with specific actions in the bill, the contemplated tax exemption would have a significant fiscal impact on the Energy, Minerals and Natural Resources Department's Oil Conservation Division ("OCD"), according to the department. Estimated additional costs are reflected on page 1.

This bill creates or expands a tax expenditure with a cost that is difficult to determine but likely significant. LFC has serious concerns about the significant risk to state revenues from tax expenditures. The committee recommends the bill adhere to the LFC tax expenditure policy principles for vetting, targeting, and reporting or action be postponed until the implications can be more fully studied.

This bill may be counter to the LFC tax policy principle of adequacy, efficiency, and equity.

Overall, the legislation would incentivize producers to maintain operations on some wells that might otherwise no longer be economically viable and need to be plugged.

The bill could have a negative but indeterminate impact to the land maintenance fund due to potential risk of needing to absorb plugging and remediation costs in the event the operators of those wells become insolvent at some point after enactment of the bill when they otherwise would have plugged the wells but for HB450. The bill would also have an indeterminate but minimal positive fiscal impact to the land grant permanent fund due to wells that would otherwise have been plugged continuing to generate marginal state royalty revenue.

SIGNIFICANT ISSUES

The bill makes no distinction between vertical and horizontal wells, even though fracking horizontal wells requires significantly higher investment and will likely yield significantly higher production.

The State Land Office submits:

> The Oil and Gas Severance Tax Act and the Natural Gas and Crude Oil Production Incentive Act (NMSA 1978, §§ 7-29b-1 to -6) already confer generous and extensive tax exemptions and tax reductions on marginally producing oil and gas properties. For instance, those Acts provide a ten-year tax exemption for reworking low-producing wells, called a "production restoration project" exemption. NMSA 1978, § 7-29-4 (no severance tax due on natural gas or oil removed from a wellhead where the producer conducted a "production restoration project"). Production restoration projects" include re-entry into wells to drill deeper or sidetrack to a different location, recompletion, fracturing, and other reworking operations, NMSA 1978, § 7-29-2, and producers are eligible for the tax exemption if the restoration work is performed on a well with negligible production, § 7-29b-3(A)(2) (eligible wells have less than 30 days of production in the preceding 2 years)…
>
> Stripper well production is only taxed at between 1.875% and 2.1875%, *id*. § 7-29-4(A)(6)-(8), oil or gas produced from a well involved in a well workover project is only taxed at between 2.45%, *id*. § 7-29-4(A)(4)-(5), and oil and gas produced from wells under qualified enhanced recovery projects at 1.875%, *id*. § 7-29-4(A)(3). This compares to a default excise tax rate of 3.75% for oil and gas production. *Id*. § 7-29-4(A)(1)-(2).
>
> HB 450 states the $2 million tax exemption for "re-stimulation" projects does not apply to wells already receiving tax reductions under the Enhanced Oil Recovery Act. Crucially, though, the bill would allow other forms of double-dipping under the Oil and Gas Severance Tax Act. Wells which are stripper wells or wells undergoing a "production restoration project" and receiving tax subsidies could also be eligible to receive an outright tax exemption if the same work also qualifies as a "re-stimulation" under the bill…

The bill does not require any particular level of investment, just some modicum of very broadly defined fracking. Vertical wells, which are cheaper to frack and will likely yield less of a production enhancement as compared with horizontal wells, get identical treatment under the bill. In addition, no Oil Conservation Division review or approval of the "re-stimulation" work takes place – in contrast to some of the other industrial practices that are incentivized by current statutes, such as enhanced recovery projects; a producer must submit basic information to the Department of Taxation and Revenue to claim the tax exemption, but it is essentially a self-certifying process.

Similarly, the bill does not require any production assessment of wells prior to re-stimulation, or any particular production threshold to ensure that the "new, improved" well has good long-term production potential. A producer could take a vertical stripper well that produces around 1 barrel of oil a month – which a non-negligible number of stripper wells currently operated in New Mexico do – spend $50,000 on limited reworking of the well, and then produce tax-free (up to the $2 million cap) for up to five years, easily recouping the cost of the reworking and then avoiding all excise taxation for five years – a windfall to the producer with no discernible benefit to New Mexico taxpayers Given the robust financial health of the oil and gas industry in New Mexico, policymakers should consider whether an additional and significant tax exemption is in New Mexicans' interest.

EMNRD adds:

OCD has primary jurisdiction under the Oil and Gas Act over production reporting. As TRD attempts to verify submissions by operators and subsequent tax exemption requests, TRD will look to OCD to provide verification of information and help it ensure reporting accuracy or the appropriateness of recompletion costs. However, HB 450 does not recognize that production reporting is a process, involving multiple corrections and adjustments in the regular course of events. These adjustments occur even for reports from prior months. Adjustments will become problematic if they impact tax liability for an operator one way or another, and will make tracking tax exemption eligibility quite time-consuming, repetitive, and difficult for both TRD and OCD…

HB 450 defines restimulation as recompletion or rework activities and imposes not substantive limits on it, except that it utilize produced water, not be enhanced oil recovery or the conversion of a vertical well bore to a horizontal one. Even with those limitations, recompletion and rework can cover a broad range of activities, some of which close up to $2 million but many cost less. The credit language should be clear that a taxpayer has to submit documentation of costs, we believe that is the intent but it is not clearly stated. Without such an explicit requirement there may be an incentive to claim higher costs than were actually incurred. Such information puts TRD, and by extension OCD, in the position of having to independently evaluate the cost of a recompletion…

Finally, as drafted, the well would cover restimulation efforts for an existing well from an existing formation and restimulation efforts uses to access new pools or formations. The former may represent a scenario where some state subsidy is appropriate as it maximizes recovery from the reservoir that the existing well produced from. The latter, however, may not be appropriate for a full exemption, since under that scenario an operator is accessing a new pool/formation that the existing wells did not utilize. In that scenario the state potentially should not forego revenue in what is effectively new production from that well.

TECHNICAL ISSUES

From the State Land Office:

Producers looking to re-stimulate wells plan ahead of time and also bring a well down before fracking. Therefore, using twelve months prior to re-stimulation as a production baseline would be artificially low and thereby inflate what is "excess product[ion]" from the well after being fracked, and therefore expand what production is tax-free. Revising the "excess products" definition to provide a longer look-back period (for instance, two years) would result in a more accurate representation of the well's actual production.

The Taxation and Revenue Department notes:

As written, the exemption does not require the taxpayer to be certified as eligible for the exemption [and TRD recommends adding one]. Based on that technical nature, the certification process would be better suited to fall under the Oil Conservation Division (OCD) of EMNRD. An model of this type of certification for an exemption is in Section 7-29B-3 NMSA 1978, where OCD certifies the project, and the taxpayer applies for the exemption with the certificate to Tax and Rev.

In addition, clarification is needed regarding the $2 million maximum cap per well in Subsection A. It is unclear if the $2 million is referring to tax liability or to the value of the product.

There may be a conflict on the frequency of reporting by taxpayers. Subsection B says that a report may be submitted at any time after the first day of production following the completion of the treatment of the well. Subsection C says that a taxpayer shall report annually the amount of exemption.

Finally, TRD recommends that the language of the bill be changed to a deduction, rather than an exemption. Exempt income is not reported, making it impossible to track the effectiveness and cost of the tax expenditure. Deductible income is reported, even though it is not taxable, and better enables TRD to review the effectiveness and cost of the tax policy.

The Energy, Minerals and Natural Resources Department adds:

Eligibility for the exemption should only apply to wells that satisfy OCD requirements for restimulation, and HB450 should specify that the relevant approvals should be submitted to TRD as part of the exemption application.

Production reporting occurs monthly. To aid verifiability of the exemption it should only be available in the first month following restimulation, not the first day.

Because the exemption in HB450 is not limited on a per-well basis, theoretically a well could receive a covered restimulation multiple times and receive a new exemption each time. While there may be practical limitations on the attractiveness of this scenario (i.e., reservoir characteristics may make a subsequent restimulation not fruitful) a well should only be able to claim the severance tax exemption once.

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy**: Revenue should be adequate to fund needed government services.
2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity**: Different taxpayers should be treated fairly.
4. **Simplicity**: Collection should be simple and easily understood.
5. **Accountability**: Preferences should be easy to monitor and evaluate.

Does the bill meet the Legislative Finance Committee tax expenditure policy principles?

1. **Vetted**: The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee, to review fiscal, legal, and general policy parameters.
2. **Targeted**: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
3. **Transparent**: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
4. **Accountable**: The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date.
5. **Effective**: The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions “but for” the existence of the tax expenditure.
6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.

LFC Tax Expenditure Policy Principle	Met?	Comments
Vetted	✘	
Targeted		
Clearly stated purpose	✘	
Long-term goals	✘	
Measurable targets	✘	
Transparent	✘	
Accountable		
Public analysis	✘	
Expiration date	✘	
Effective		
Fulfills stated purpose	?	
Passes “but for” test	?	

Efficient	✘	
Key: ✓ Met ✘ Not Met ? Unclear		

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