HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 515 Oil and Gas Production Taxes
SPONSOR(S): Evers and others
TIED BILLS: None **IDEN./SIM. BILLS:** SB 978

	REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1)	Energy & Utilities Policy Committee	20 Y, 0 N	Keating	Collins
2)	General Government Policy Council			
3)	Finance & Tax Council			
4)				
5)				

SUMMARY ANALYSIS

HB 515 replaces the current 5% excise tax applicable to tertiary oil production in Florida with tiered tax rates based on the delivered price of the oil as follows:

- 5% of gross value when the delivered price is $100 or more per barrel
- 3% of gross value when the delivered price is between $60 and $100 per barrel
- 1% of gross value when the delivered price is less than $60 per barrel

The bill amends the definition of tertiary oil in s. 211.02(3)(a), F.S., to update and correct a reference to federal law.

According to the U.S. Department of Energy's (U.S. DOE) website, crude oil development and production in U.S. oil reservoirs can include up to three distinct phases: primary, secondary, and tertiary (or enhanced) recovery. During primary recovery, only about 10 percent of a reservoir's original oil in place is typically produced. Secondary recovery techniques can result in the recovery of 20 to 40 percent of the original oil in place. With much of the easy-to-produce oil already recovered from U.S. oil fields, some producers have attempted tertiary, or enhanced oil recovery (EOR), techniques that may ultimately produce 30 to 60 percent or more of the reservoir's original oil in place but at relatively high cost.[1]

The bill creates exemptions from the excise tax on oil and gas production in Florida for on-shore production after July 1, 2009, from certain new wells, certain shut-in or temporarily abandoned wells returned to service, and horizontal wells and wells with a total measured depth greater than 15,000 feet. The bill provides that each of these exemptions will be repealed on June 30, 2019.

The economic impacts of this bill will likely depend on oil and gas producers' operating costs and current and forecast market conditions for oil and gas. Because the bill helps to lower operating costs, the bill could encourage additional oil and gas production in Florida. The bill could also exempt a large portion of the potential future oil and gas production in Florida from the excise tax, reducing potential revenues to the state's General Revenue Fund, the producing counties' general revenue funds, and the Minerals Trust Fund.

This bill was discussed at the February 27, 2009, Revenue Estimating Conference, but is under continued review for a consensus estimate of impacts.

[1] http://fossil.energy.gov/programs/oilgas/eor/index.html

HOUSE PRINCIPLES

Members are encouraged to evaluate proposed legislation in light of the following guiding principles of the House of Representatives

- Balance the state budget.
- Create a legal and regulatory environment that fosters economic growth and job creation.
- Lower the tax burden on families and businesses.
- Reverse or restrain the growth of government.
- Promote public safety.
- Promote educational accountability, excellence, and choice.
- Foster respect for the family and for innocent human life.
- Protect Florida's natural beauty.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Present Situation

Section 211.02(1), F.S., provides for an excise tax to be levied upon production of oil within Florida for sale, transport, storage, profit, or commercial use. The tax is measured by the value of the oil produced and saved or sold during a month. The current tax rate for small well oil[2] and tertiary oil is 5 percent of the gross value. The tax rate for all other oil is 8 percent of the gross value.

Tertiary oil is defined in s. 211.02(3)(a), F.S., as the excess barrels of oil produced, or estimated to be produced, as a result of the actual use of tertiary recovery methods in a qualified tertiary recovery project, over the barrels of oil which could have been produced by continued maximum feasible production methods in use prior to the start of tertiary recovery. A "qualified tertiary recovery project" is defined in s. 211.02(3)(a), F.S., as a project for enhancing recovery of oil which meets the requirements of s. 4993(c), Internal Revenue Code of 1954, as amended, or substantially similar requirements.

According to the U.S. Department of Energy's (U.S. DOE) website, crude oil development and production in U.S. oil reservoirs can include up to three distinct phases: primary, secondary, and tertiary (or enhanced) recovery. During primary recovery, only about 10 percent of a reservoir's original oil in place is typically produced. Secondary recovery techniques can result in the recovery of 20 to 40 percent of the original oil in place. With much of the easy-to-produce oil already recovered from U.S. oil fields, some producers have attempted tertiary, or enhanced oil recovery (EOR), techniques that may ultimately produce 30 to 60 percent or more of the reservoir's original oil in place but at relatively high cost.[3]

The Florida Department of Environmental Protection (DEP) oversees permitting for oil and gas drilling, production, and exploration within Florida.[4] As of February 26, 2009, DEP's website identified six active operators of oil and gas wells in Florida. These operators produce oil from fields in two areas in Florida: the upper-northwest Florida Panhandle and the eastern portions of several Southwest Florida counties. In 2008, the South Florida fields yielded 723,459 barrels of oil, and the Northwest Florida fields yielded 1,232,062 barrels of oil. The "Jay" field produced the vast majority of the oil from

---

[2] "Small well oil" is defined in s. 211.01(21), F.S., as oil produced from a well from which less than 100 barrels of oil per day are severed (i.e., extracted or withdrawn), considering only those days of the month during which production of oil from the well actually occurred.

[3] http://fossil.energy.gov/programs/oilgas/eor/index.html

[4] Chapter 377, Part I, F.S.

Northwest Florida, accounting for 1,143,918 barrels.[5] While the South Florida fields are still able to use primary recovery methods, the Jay field is required to use more expensive tertiary techniques to extract oil. Due to the recent decline in oil prices, the operator of the Jay field, Quantum Resources, stopped production in late December 2008.

Section 211.025, F.S., provides for an excise tax to be levied upon production of natural gas within Florida for sale, transport, profit, or commercial use. The amount of tax is determined by the volume, in mcf (1000 cubic feet), of gas produced and sold or used by a producer. The gas tax rate is adjusted annually by applying the following formula to a base tax rate of $0.171 per mcf:

Annual average of the gas fuels producer price index ÷ 1109.0.[6]

Section 211.027, F.S., provides exemptions from the tax imposed under s. 211.02, F.S., for specified on-shore oil and gas production. These exemptions do not currently include production from new wells or temporarily closed wells that have been returned to commercial use.

<u>Effect of Proposed Changes</u>

HB 515 changes current law in two ways. First, it modifies the excise tax rate applicable to tertiary oil production in Florida. Second, it creates additional exemptions from the excise tax for specified on-shore production of oil and gas.

Excise Tax Rate Applicable to Tertiary Oil Production

The bill amends s. 211.02(1), F.S., to vary the tax rate applicable to tertiary oil based on the delivered price of the oil, as follows:

- 5% of gross value when the delivered price is $100 or more per barrel
- 3% of gross value when the delivered price is between $60 and $100 per barrel
- 1% of gross value when the delivered price is less than $60 per barrel

Depending upon a producer's cost structure and the price of oil at a given time, this tiered tax structure might allow for some continued production of tertiary oil when production would not otherwise be economical at that time, might not impact production at all, or might allow for greater profitability from production at that time.

As noted above, the Jay field, which is the only field in Florida currently producing tertiary oil, stopped production in late December 2008. The Jay field operator, Quantum, Resources, has identified its current operating cost as $53 per barrel for tertiary oil and has stated that a price of $65 per barrel is needed to justify continuing operations under its current cost structure.[7] According to the U.S. DOE's Energy Information Administration (EIA), U.S. spot prices for crude oil have remained below $65 per barrel since late October and were in the range of $37 to $40 per barrel in February 2009.[8] EIA forecasts that the nominal price for crude oil will reach $60 per barrel by late 2010, will exceed $100 per barrel in 2013, and will increase thereafter.[9]

If EIA's forecast is accurate and if current operating costs for the Jay field do not decrease significantly, the proposed tax structure may not spur additional production of tertiary oil in the short term (i.e., before 2011). If the operator of the Jay field can lower its operating costs significantly, the proposed tax structure may spur some additional tertiary oil production in this time period. When oil prices exceed current operating costs but remain below $100 per barrel, the tax rate applicable under the proposed

---

[5] Florida Oil and Gas Production Annual Report for 2008, at http://www.dep.state.fl.us/water/mines/oil_gas/index.htm
[6] Section 211.025, F.S.
[7] Presentation by Quantum Resources to the Florida Department of Revenue, December 2008. In its presentation, Quantum Resources also indicated that it is pursuing other means of reducing its current operating costs.
[8] http://tonto.eia.doe.gov/dnav/pet/hist/wtotusaw.htm
[9] http://www.eia.doe.gov/oiaf/forecasting.html

structure may make tertiary oil production more profitable than it otherwise would be under the existing 5% rate.

The bill also amends the definition of tertiary oil in s. 211.02(3)(a), F.S., to update and correct a reference to federal law. The bill provides that the term "tertiary oil" means oil produced through use of a tertiary recovery method in a qualified "enhanced oil" recovery project (rather than a qualified "tertiary" recovery project). The current term, "qualified tertiary recovery project" is defined in Florida law as a project that meets the requirements of s. 4993(c), Internal Revenue Code of 1954, as amended, or substantially similar requirements. That provision of the Internal Revenue Code was repealed. Thus, the bill replaces this obsolete reference with an updated reference to 26 U.S.C. s. 43(c)(2), which defines a "qualified enhanced oil recovery project." The new reference does not appear to change the scope of projects that would be deemed to produce tertiary oil subject to the Florida excise tax.

Exemptions for On-Shore Oil and Gas Production

The bill amends s. 211.027, F.S., to create exemptions from the excise tax for the following on-shore oil and gas production (not limited to tertiary oil):

- Production from a new field well completed after July 1, 2009, for a period of 60 months after completion.
- Production after July 1, 2009, from a new producing well in a field established by DEP before July 1, 2009, for a period of 48 months after completion.
- Production after July 1, 2009, from a shut-in well that has been out of service for a period of at least 24 months prior to July 1, 2009, but has been returned to commercial production, for a period of 48 months after completion.
- Production after July 1, 2009, from a temporarily abandoned well or wellbore that has been out of service for a period of at least 24 months prior to July 1, 2009, but has been brought into commercial production, for a period of 48 months after completion.
- Production after July 1, 2009, from any horizontal well or any well in excess of 15,000 feet in total measured depth, for a period of 60 months after completion.

The bill provides that each of these exemptions will be repealed June 30, 2019.

The first four exemptions listed above apply to production from wells that are not yet completed or are not currently operational. Whether any eligible well will be completed and become operational will likely depend on operating costs and current and forecast market conditions. Because these exemptions help to lower operating costs, the bill could encourage additional oil and gas production from eligible wells in Florida.

According to DEP, seven new wells have received permits and could be completed after July 1, 2009, and two additional new wells with pending permit applications could be completed after July 1, 2009. As of year-end 2008, 67 Florida wells were in shut-in status.[10] According to DEP, between 40 and 45 of these wells were shut-in at least 24 months prior to July 1, 2009. As of year-end 2008, eight Florida wells were listed as temporarily abandoned.[11] According to DEP, these wells were taken out of service at least 24 months prior to July 1, 2009, but are less likely to be reactivated than shut-in wells because they are already partially plugged. Assuming that none of the temporarily abandoned wells are reactivated, it appears that at least 49 wells are potentially eligible for one of the first four exemptions. This total does not include wells for which permit applications may subsequently be filed.

The last exemption listed above (for horizontal wells and wells in excess of 15,000 feet deep) applies to production after July 1, 2009, from both existing eligible wells and eligible wells that become completed and operational. According to DEP, two existing wells eligible for this exemption have been completed

[10] Florida Oil and Gas Production Annual Report for 2008, at http://www.dep.state.fl.us/water/mines/oil_gas/index.htm
[11] Florida Oil and Gas Production Annual Report for 2008, at http://www.dep.state.fl.us/water/mines/oil_gas/index.htm

within the last 60 months, but both have since been shut down along with the Jay field. DEP has issued permits for an additional 10 eligible wells that have not been completed. Whether any eligible well will be completed or reactivated will likely depend on operating costs and current and forecast market conditions. Because these exemptions help to lower operating costs, the bill could encourage additional oil and gas production from eligible wells in Florida.

DEP asserts that the bulk of Florida oil and gas production occurs within the first 48 to 60 months from a well's completion. If this is accurate, the exemptions proposed could exempt a large portion of the potential future oil and gas production in Florida from the excise tax.

B. SECTION DIRECTORY:

Section 1. Amends s. 211.02(1), F.S., relating to the excise tax on oil and gas production.

Section 2. Amends s. 211.027, F.S., providing exemptions to the excise tax on oil and gas production.

Section 3. Provides an effective date of July 1, 2009.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues

The excise tax collected on oil and gas production in Florida is placed in the Oil and Gas Tax Trust Fund.[12] Pursuant to s. 211.06, F.S., the proceeds in this fund are credited as follows:

- General Revenue Fund of the state
  - 67.5% of proceeds from tax on small well oil and tertiary oil
  - 75.0% of proceeds from tax on all other oil production
  - 67.5% of proceeds from tax on gas
- General Revenue Fund of the board of county commissioners in county where produced
  - 20.0% of proceeds from tax on small well oil and tertiary oil
  - 12.5% of proceeds from tax on all other oil production
  - 20.0% of proceeds from tax on gas
- Minerals Trust Fund (DEP)
  - 12.5% of proceeds from tax on small well oil and tertiary oil
  - 12.5% of proceeds from tax on all other oil production
  - 12.5% of proceeds from tax on gas

According to DEP, the total excise tax collections for oil and gas production over the past five years were $46.45 million, with annual revenue ranging from $6.084 to $13.386 million and average annual distributions to the state as follows:

- General Revenue Fund $6.889 million
- Producing Counties $1.240 million
- Minerals Trust Fund $1.076 million

DEP estimates that recurring revenues distributed to the General Revenue Fund and the Minerals Trust Fund would decrease by approximately 20% as a result of the exemption for existing horizontal or deep wells completed within the last 60 months. DEP estimates that such revenues would decrease further (up to approximately 55%) as a result of applying the tiered tax structure to tertiary oil.

[12] Section 211.06, F.S.

This bill was discussed at the February 27, 2009, Revenue Estimating Conference, but is under continued review for a consensus estimate of impacts.

2. Expenditures:

None

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

Based on DEP's estimates of the bill's impact on revenues to the state, recurring revenues to the counties in which oil and gas are produced would decrease proportionately.

This bill was discussed at the February 27, 2009, Revenue Estimating Conference, but is under continued review for a consensus estimate of impacts.

2. Expenditures:

None

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The bill reduces overall tax costs for producers of tertiary oil until the delivered price of oil reaches $100 per barrel or higher. The bill also reduces overall tax costs for producers of oil and gas with production after July 1, 2009, from wells eligible for an exemption.

D. FISCAL COMMENTS:

The fiscal and economic impacts of this bill will likely depend on oil and gas producers' operating costs and current and forecast market conditions for oil and gas. Because the bill helps to lower operating costs, the bill could encourage additional oil and gas production in Florida. The bill could also exempt a large portion of the potential future oil and gas production in Florida from the excise tax, reducing potential revenues to the state's General Revenue Fund, the producing counties' general revenue funds, and the Minerals Trust Fund.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Not applicable. This bill does not appear to: require counties or municipalities to spend funds or take an action requiring the expenditure of funds; reduce the authority that counties or municipalities have to raise revenues in the aggregate; or reduce the percentage of a state tax shared with counties or municipalities.

2. Other:

None

B. RULE-MAKING AUTHORITY:

Not applicable.

C. DRAFTING ISSUES OR OTHER COMMENTS:

The bill establishes that the taxable value of tertiary oil shall be adjusted for the "delivered price" of the oil. Section 211.075(1), F.S., provides that the tax on oil production is due on or before the 25th day of the month following the month of production. This creates a potential implementation issue because

delivery may not take place prior to the date the tax is due, resulting in overpayments or underpayments and the potential for producers to face penalties and interest and the requirement to file revised returns.

The bill provides exemptions for oil and gas produced from reactivated shut-in wells and temporarily abandoned wells that have been out of service for a period of at least 24 months prior to July 1, 2009. These provisions are open to interpretation as to whether or not the 24-month period includes any 24-month period prior to July 1, 2009, or only the 24-months immediately prior to July 1, 2009.

The Department of Revenue has raised a concern that the proposed effective date may not provide enough time for modifications to systems and forms for taxpayers.

IV. AMENDMENTS/COUNCIL OR COMMITTEE SUBSTITUTE CHANGES