HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: CS/HB 515 Oil and Gas Production Taxes
SPONSOR(S): General Government Policy Committee, 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	16 Y, 0 N, As CS	Keating	Hamby
3)	Finance & Tax Council	14 Y, 0 N	Shaw	Langston
4)				
5)				

SUMMARY ANALYSIS

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

- 5% of gross value for oil with a value of $100 or more per barrel
- 3% of gross value for oil with a value of between $60 and $100 per barrel
- 1% of gross value for oil with a value of 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 on or after July 1, 2009, from certain new wells and certain shut-in or temporarily abandoned wells returned to service. The bill provides that each of these exemptions will be repealed on June 30, 2019.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 new future oil and gas production in Florida from the excise tax.

The Revenue Estimating Conference estimates that the tiered tax rates for tertiary oil will have no fiscal impact to the state or local governments for FY 2009-2010 and FY 2010-2011, a negative fiscal impact to the state of $800,000 for FY 2011-2012, and a negative fiscal impact to local governments of $200,000 for FY 2011-2012. The Revenue Estimating Conference estimates that the new exemptions will have no fiscal impact to the state or local governments for FY 2009-2010 and FY 2010-2011, a negative impact to the state of $1.4 million for FY 2011-2012, and a negative impact to local governments of $300,000 for FY 2011-2012.

[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

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[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.

Section 211.06, F.S., specifies the distribution of proceeds from the tax imposed under s. 211.02, F.S.

Effect of Proposed Changes

CS/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 value of the oil, as follows:

- 5% of gross value for oil with a value of $100 or more per barrel
- 3% of gross value for oil with a value of between $60 and $100 per barrel
- 1% of gross value for oil with a value of 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

[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

current operating costs but remain below $100 per barrel, the tax rate applicable under the proposed 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.

The bill amends cross-references to Section 211.06, F.S., which specifies the distribution of proceeds from the tax imposed under s. 211.02, F.S., to conform to the tertiary oil tax structure changes.

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 on or 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 on or 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 on or 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 on or after July 1, 2009, from any new horizontal well or any new 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.

These exemptions 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. DEP has issued permits for an additional 10 horizontal or deep wells that may be eligible for an exemption. Assuming that none of the temporarily abandoned wells are reactivated, it appears that at least 59 wells are potentially eligible for one of the exemptions. This total does not include wells for which permit applications may subsequently be filed.

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[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

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 new 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. Amends s. 211.06, F.S., to conform cross-references.

Section 4. Provides an effective date of July 1, 2009.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues

The Revenue Estimating Conference estimates that the tiered tax rates for tertiary oil will have the following fiscal impact on state government:

	FY 2009-2010	FY 2010-2011	FY 2011-2012
General Revenue	0	0	($0.7 m)
State Trust	0	0	($0.1 m)
Total	0	0	($0.8 m)

The Revenue Estimating Conference estimates that the exemptions for specified on-shore production will have the following fiscal impact on state government:

	FY 2009-2010	FY 2010-2011	FY 2011-2012
General Revenue	0	0	($1.2 m)
General Revenue SC	0	0	0
State Trust	0	0	($0.2 m)
Total	0	0	($1.4 m)

2. Expenditures:

None

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

The Revenue Estimating Conference estimates that the tiered tax rates for tertiary oil will have the following fiscal impact on local governments:

	FY 2009-2010	FY 2010-2011	FY 2011-2012
Total	0	0	($0.2 m)

The Revenue Estimating Conference estimates that the exemptions for specified on-shore production will have the following fiscal impact on local governments:

	FY 2009-2010	FY 2010-2011	FY 2011-2012
Total	0	0	($0.3 m)

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 excise tax collected on oil and gas production in Florida is placed in the Oil and Gas Tax Trust Fund. 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

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 new future oil and gas production in Florida from the excise tax.

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 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

On March 10, 2009, the General Government Policy Committee adopted a strike-all amendment to HB 515 and reported the bill favorably as a council substitute. The strike-all amendment:

- Provides that the tax on tertiary oil is based on the value of the oil produced;
- Clarifies the language establishing the exemptions; and
- Provides that the exemption for production from horizontal wells and wells with a total measured depth in excess of 15,000 feet applies only to new wells.