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Jon Hummell, Interim Director

Division of the Budget

Sam Brownback, Governor

April 25, 2014

The Honorable Richard Carlson, Chairperson
House Committee on Taxation
Statehouse, Room 185-N
Topeka, Kansas 66612

Dear Representative Carlson:

SUBJECT: Fiscal Note for HB 2735 by House Committee on Taxation

In accordance with KSA 75-3715a, the following fiscal note concerning HB 2735 is respectfully submitted to your committee.

HB 2735 would create a refundable income tax credit for the costs of drilling qualifying vertical or horizontal oil wells. The bill would provide a 10.0 percent refundable income tax credit for 10.0 percent of the indirect and direct costs for the completion of a vertical or horizontal oil well. The amount of the credit is limited to $50,000 for a vertical well and $200,000 for a horizontal well. The bill would allow 300 vertical wells to qualify for the income tax credit if they are drilled by February 15, 2015. The bill would allow that if the full 300 vertical wells qualify for the income tax credit by February 15, 2015, then an additional 300 vertical wells could qualify for the income tax credit if drilled by February 15, 2016. The maximum number of horizontal wells that could qualify for the income tax credit is limited to 105.

The bill would create seven crude oil production areas and would limit the number of vertical oil wells that would qualify for the income tax credit within each area, and would create four crude oil production zones and would limit the number of horizontal oil wells that would qualify for the income tax credit within each zone. All severance tax revenue generated from the qualifying oil wells would be deposited in the State General Fund. The Kansas Corporation Commission would be required to publish on a monthly basis on its website the number of qualifying vertical and horizontal oil wells that remain available and eligible for the income tax credit for each crude oil production area and crude oil production zone. The Kansas Corporation Commission would have the authority to write rules and regulations to administer this program. To qualify for the income tax credit, a business would be required to apply to the Department of Revenue after receiving a letter from the Kansas Corporation Commission that the business is in compliance with all applicable statutes and rules and regulations. The income tax credit could be claimed in either tax year 2015 or tax year 2016.

Estimated State Fiscal Effect				
	FY 2014 SGF	FY 2014 All Funds	FY 2015 SGF	FY 2015 All Funds
Revenue	--	--	$8,600,000	$8,600,000
Expenditure	--	--	$552,040	$552,040
FTE Pos.	--	--	--	--

The Department of Revenue estimates that HB 2735 would increase State General Fund revenues by $8.6 million in FY 2015 and would reduce State General Fund revenues by $28.6 million in FY 2016. The increase in revenues and how the April 17, 2014 consensus revenue estimate for FY 2015 would be affected are shown in the following table:

Effect on FY 2015 Consensus Revenue Estimates
(Dollars in Thousands)

Receipt Description	Consensus Revenue Estimates (April 17, 2014)	Change in Revenue FY 2015	Proposed Adjusted CRE FY 2015
Motor Carrier	$ 24,000	$ --	$ 24,000
Income Taxes:			
Individual	2,525,000	--	2,525,000
Corporate	425,000	--	425,000
Financial Institutions	38,000	--	38,000
Excise Taxes:			
Retail Sales	2,170,000	--	2,170,000
Compensating Use	360,000	--	360,000
Cigarette	89,000	--	89,000
Severance	136,200	8,600	144,800
All Other Excise Taxes	111,000	--	111,000
Other Taxes	172,000	--	172,000
Total Taxes	$6,050,200	$ 8,600	$6,058,800
Other Revenues:			
Interest	$ 10,000	$ --	$ 10,000
Transfers	(119,700)	--	(119,700)
Agency Earnings	50,900	--	50,900
Total Other Revenues	($ 58,800)	$ --	($ 58,800)
Total Receipts	$5,991,400	$ 8,600	$6,000,000

To formulate these estimates, the Department of Revenue reviewed data on oil drilling activity and severance tax collections. The Department assumes that 150 vertical wells and the full 105 horizontal oil wells would begin oil production in FY 2015. The bill would increase severance tax collections by $8.6 million in FY 2015 and would continue to increase severance tax collections as additional vertical wells are completed. Severance tax collections are estimated to increase to $22.2 million in FY 2016 and $27.2 million in FY 2017. The Department assumes that the maximum 600 vertical wells and 105 horizontal wells would be completed and would claim the income tax credit in tax year 2016. Because the income tax credit is refundable, income tax receipts are estimated to decrease by a total of $51.0 million in tax year 2016, with $30.0 million (600 vertical wells x $50,000) attributed to vertical oil wells and $21.0 million (105 horizontal wells x $200,000) attributed to horizontal wells. The Department of Revenue indicates that State General Fund revenues would increase by $8.6 million in FY 2015 (all from additional severance tax collections), decrease by $28.8 million in FY 2016 ($51.0 million decrease in income taxes and $22.2 million increase in severance taxes), and increase by $27.2 million in FY 2017 (all from additional severance tax collections).

The Department indicates that it would require $552,040 from the State General Fund in FY 2015 to implement the bill and to modify the automated tax system. The computer programming for this bill would require outside contract programmer services. The Department would also be required to create new forms and instructions for the new income tax credit.

The Kansas Corporation Commission indicates that it would need to develop and maintain a database to track all the qualifying oil wells in each crude oil production area and crude oil production zone. The number of qualifying vertical and horizontal oil wells that remain available and eligible for the income tax credit for each area and zone must be published on the Commission website on a monthly basis. The Commission would also be required to issue a letter certifying that each business applying for the income tax credit is in compliance with all applicable statutes and rules and regulations. The requirements of the bill have the potential to increase costs from the Commission's Conservation Fee Fund; however, a precise fiscal effect cannot be determined. In any case, the fiscal effect would most likely be absorbed within existing resources and staff levels. Any fiscal effect associated with HB 2735 is not reflected in *The FY 2015 Governor's Budget Report*.

Sincerely,

Jon Hummell

Jon Hummell,
Interim Director of the Budget

cc: Steve Neske, Revenue
Tom Day, KCC