HOUSE
RESEARCH
ORGANIZATION bill digest 5/6/2011

HB 889
Lewis, et al.
(CSHB 889 by Hilderbran)

SUBJECT: Future income method of appraisal of oil or gas interests

COMMITTEE: Ways and Means — committee substitute recommended

VOTE: 10 ayes — Hilderbran, Otto, Elkins, Gonzalez, Lyne, Martinez Fischer, Murphy, Ritter, Villarreal, Woolley

0 nays

1 absent — Christian

WITNESSES: (*On original bill:*)
For — Jim Allison, County Judges and Commissioners Association of Texas; Paul Kenworthy, Permian Basin Petroleum Assn; Kerry Knorpp, Historic Texas Ranches; John Valenza, Texas Oil and Gas Association; (*Registered, but did not testify:* Adrian Acevedo, Anadarko Petroleum; Charlie Bradley, Schleicher County; Teddy Carter, Texas Independent Producers and Royalty Owner Assn.; Tricia Davis, Texas Royalty Council; Joe English; Aurora Flores, Texas Assn. of Counties; Donald Lee, Texas Conference of Urban Counties; Howard Limmer, Scurry County; Jim Robinson, Texas Association of Appraisal Districts; Keith Schroeder, Burleson County; Brent South, Hunt County Appraisal District; Terry Williams, Scurry County; Monty Wynn, Texas Municipal League)

Against — (*Registered, but did not testify:* Lindsey Baker, City of Denton)

On — Tim Wooten, Texas Comptroller of Public Accounts

BACKGROUND: Oil and gas interests may be appraised using the future-income method. This method involves converting the future value of an income stream to its present day value. Determining the value of an oil or gas interest's future production must take into account assumptions of the price of oil or gas in every year the interest is expected to produce into the future.

In Texas, the method for appraising the future income of an oil or gas interest is set in statute. Tax Code, sec. 23.175 requires that if an oil or gas interest is appraised using the future income method, the method must use the average price of the oil or gas from the interest for the preceding calendar year multiplied by a market condition factor. That factor is the price at which the oil or gas produced from the interest is projected to be sold in the current year of the appraisal. The average price for the preceding calendar year is calculated by dividing the sum of the monthly average prices for which oil and gas from the interest was selling during each month of the preceding calendar year by 12. The Texas comptroller of public accounts calculates the market condition factor by dividing the comptroller's current calendar year statewide average price for oil or gas, as appropriate, as forecasted for budget revenue estimating purposes by the preceding calendar year's actual statewide average price for oil or gas, as appropriate.

The price for the oil or gas interest's future production used in the second or a subsequent calendar year of the appraisal reflects the same percentage rate increase or decrease in the price of oil or gas, as appropriate, as projected for that calendar year by the comptroller for revenue estimating purposes.

DIGEST:

CSHB 889 would change the way oil and gas interests are appraised under the future-income method. Under the bill, the market condition factor that is applied to the average price of oil or gas would be replaced with a price-adjustment factor. Local chief appraisers would calculate the price-adjustment factor by dividing, by the price of the same goods for the preceding calendar year, the price of imported low-sulfur light crude oil in nominal dollars or the spot price of natural gas at the Henry Hub in nominal dollars, as appropriate, as projected for the current calendar year by the federal Energy Information Administration.

The price for the oil or gas interest's output used in the second through sixth calendar years of the appraisal could not reflect an annual escalation or de-escalation rate of oil or gas that exceeded the average annual percentage change from 1982 to the most recent year for which the information was available in the producer price index for domestically produced petroleum or natural gas, as appropriate. The price for the interest used in the sixth calendar year of the appraisal would have to be used in each subsequent year of the appraisal.

The bill would take effect on January 1, 2012, and would apply only to the appraisal of an oil or gas interest on or after the effective date.

NOTES:

According to the LBB's fiscal note, CSHB 889 would either be revenue neutral or would produce a slight gain of revenue for the state and local governments. The bill would produce a property tax revenue gain because forecast of future prices would be higher than the forecast used under current law. That expected gain would be partially offset by the more conservative price escalation method in CSHB 889.

The bill as filed would have had a negative fiscal impact on the state of $235 million in fiscal 2012-13. This would have been the result of using different escalation factors and periods, continuing to use the comptroller's price forecast rather than one provided by the Energy Information Administration, and using a two-year average price rather than a one-year average.