TASK FORCE REPORT

The Future of Severance Taxes and Water Funding

Executive Summary

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Executive Summary

Challenges to Using Severance Tax Revenue for Long-Term Project Funding

- Year-over-year revenue volatility
- Transfers of severance tax revenues to the general fund
- The state's Taxpayer's Bill of Rights (TABOR) constraints
- Potential decline in severance tax revenue

To vew the complete report, scan the QR code or visit https://watercenter.colostate.edu

Water is a critical resource that provides a wide range of public and private benefits to residents and visitors of Colorado. Given the public nature of these benefits, water projects often depend critically on a mix of federal, state, and local funds. Colorado severance tax—a tax on oil, gas, and mineral extraction—is a primary example of state funding that supports water projects and local governments. While it is difficult to estimate a precise number, study results demonstrate that Colorado's water project and local government funding needs are in the billions of dollars, span every county in the state, and exceed existing state and federal funding sources. The state plays an important partner role in meeting funding needs in this landscape, especially given the uncertainty and trends in federal funding and the limited feasible options for local governments.

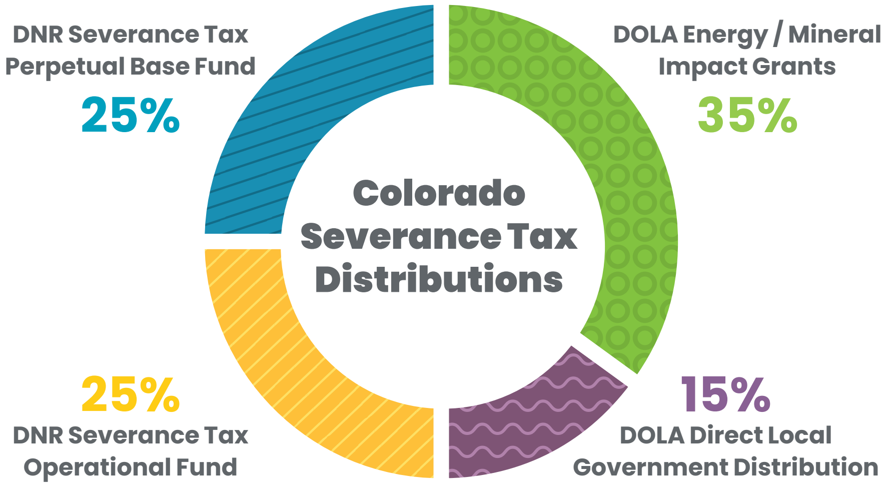
Two state agencies, the Department of Natural Resources (DNR) and the Department of Local Affairs (DOLA), manage severance tax revenue, which support a wide range of projects to benefit communities across the state and maintain specific programs and operations. However, several challenges limit the reliability of severance tax revenue as a long-term funding source. These include year-over-year volatility driven by commodity prices and the ad valorem tax credit; the increasingly common transfer of severance tax revenues to the general fund (also called a "sweep"); constraints on new revenue under the state's Taxpayer's Bill of Rights (TABOR); and the potential decline in severance tax revenue as the energy sector evolves in response to global markets and policy shifts.

Senate Bill 25-040 (Colorado General Assembly, 2025) established the Future of Severance Taxes and Water Funding Task Force to examine the long-term sustainability of Colorado's severance tax system, including past and future sweeps of funds, and its ability to support water projects and local governments. The Colorado Water Center at Colorado State University was designated as the independent third-party research entity responsible for conducting the technical analysis underlying this report, with the task force providing guidance and expertise on its development. While previous efforts have examined specific aspects of severance tax structure and policy, this report focuses on 1) describing the broader picture of water and local government funding needs, and 2) presenting a menu of alternative funding options to address those needs going forward and backfill past sweeps.

The report's findings are based on interviews with task force members, additional experts, and stakeholders as well as existing data. The findings also draw upon an examination of severance tax history and structure in Colorado and examples of how other states approach severance tax structures and water project funding.

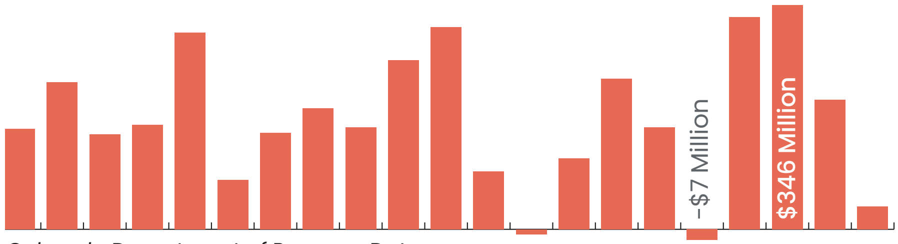
Photograph of Chimney Hollow Dam construction courtesy of Northern Water.

Colorado Severance Tax Distributions



Severance Tax Annual Net Collections

FY 04-05 to FY 24-25



Colorado Department of Revenue Data

Severance Tax Alternative Funding Options

Preventing Future Sweeps and Other Considerations

- Preventing Future Sweeps:
  - Incremental Severance Fund Stability Reforms
  - Constitutional Dedication of Revenue
- Other current or potential sources of existing revenue streams

New and Diversified Sources

- Optional Utility Bill Programs
- New Taxes on Current Industries Related to Water
- Taxes or Fees on Emerging Sectors
- Renewable Energy Production Fee to Fund a Permanent Trust

Discussion and Conclusions

Severance tax revenues are one source of funding in a complex landscape, which local governments often combine with other sources to finance their water project and infrastructure needs. Severance tax does not just support water projects; local governments in energy-impacted communities depend on the revenue for a wide range of public facilities and services, and critical DNR operational programs, from oil and gas regulation to avalanche forecasting to species conservation, also historically rely on severance tax funding. Any strategy to diversify or replace severance tax revenue must account for this full range of current beneficiaries, not only the water project funding needs that are the primary focus of this report.

For reasons mentioned earlier, severance taxes do not provide a reliable and long-term funding source for these critical and significant needs, and the future of sustainable, stable water and local government funding will require sources beyond the current landscape. Without adequate state and federal support, a larger share of project costs would fall directly on municipal ratepayers, agricultural producers, and other local users, many of whom may not have the capacity to absorb the full cost of needed projects. This creates a risk that essential water infrastructure and water security projects are delayed, scaled back, or not implemented.

The report presents alternative funding options ranging from changing the current severance tax structure to establishing new revenue streams. The options vary in implementation complexity, revenue potential, sweep protection, and whether they require voter approval, necessitating varying levels of additional groundwork before they could be pursued. Legal questions around TABOR classification, the feasibility of enterprise structures, and the design of a permanent trust all warrant further analysis. Ideas involving partnerships with emerging industries, including renewable energy, data centers, and expanded gambling, require early engagement with those sectors before legislative or ballot pathways can be evaluated. Given the significant funding needs and variety of funding recipients, no single mechanism is likely to be sufficient to replace severance tax revenue. A diversified approach will likely be more effective than any single policy change or replacement for severance tax revenue.

About the Task Force

Senate Bill 25-040 established the Future of Severance Taxes and Water Funding Task Force and specified appointments.

The Future of Severance Taxes and Water Funding Task Force

- **Lauren Ris,** *Director, Colorado Water Conservation Board*
- **Carly Jacobs,** *Chief Financial Officer, Department of Natural Resources*
- **Robert Sakata,** *Agriculture Water Policy Advisor, Colorado Department of Agriculture*
- **Eric Bergman,** *Director of the Division of Local Government, Department of Local Affairs*
- **Brian Jackson,** *Director of Western Water, Environmental Defense Fund*
- **Doug Dennison,** *Director of Oil and Gas Services, EcoPoint Incorporated*
- **Steve Wolff,** *General Manager, Southwestern Water Conservation District*
- **Shawn Bolton,** *Agriculture Representative*
- **Jim Yahn,** *County Commissioner, Logan County*
- **Elyse Ackerman Casselberry,** *City Manager, Delta*

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