



Fair Compensation for Pennsylvanians

Understanding the Natural Gas Severance Tax

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Pennsylvania is on cusp of a 21st Century natural gas “gold rush” in the Marcellus Shale, a deep geologic formation that spans West Virginia, Ohio, New York, and most of Pennsylvania. The thickest and most promising portion of the shale formation underlies northeastern Pennsylvania. New drilling techniques and rising natural gas prices have made it economically feasible and potentially highly profitable to exploit the vast gas reserves.

Pennsylvania has been through this before, during the coal mining, oil, and timber booms of the 19th and early 20th Centuries. While the harvesting of natural resources has built great fortunes for some and helped Pennsylvania grow and develop into the state we are today, some of the negative effects, like acid mine drainage and loss of wildlife, continue to linger.

Natural gas extraction poses similar challenges. Some landowners and drilling company shareholders will receive a hefty bounty, but Pennsylvanians could be left with the tab for inevitable environmental damage, water supply issues, road damage, housing and social issues, and changes to the way of life in rural Pennsylvania.

Natural Gas Production Will Create New Costs for State and Local Governments.

The Commonwealth and its municipalities are already facing new costs related to the natural gas industry that will be borne by state and local taxpayers:

- Environmental Monitoring and Protection: The drilling process has great potential to contaminate both surface and groundwater. Water usage and treatment will have to be monitored for many years.
- Infrastructure Costs: Counties and townships will need to build or upgrade roads to handle heavy truck traffic and expand first-responder units to meet the emergency demands of this often dangerous enterprise.
- Demand for Services: Development will attract new workers to the region, many with families and children, creating new demands for schools and other public services.
- Land Reclamation: Disrupted habitats will need to be rehabilitated, developed sites will need to be remediated, and local economies will have to be repositioned after the natural gas and developers are gone.

The gas industry already enjoys special tax preferences.

The Commonwealth’s current tax system allows natural gas producers to reap substantial economic benefits without paying their fair share of taxes. Federal tax policies substantially reduce drillers’ taxable income – lowering their state income taxes. Many out-of-state drillers take advantage of state tax laws allowing them to pay the personal income tax rate, rather than the higher corporate tax rate.

Oil and gas wells are exempt from paying property taxes in Pennsylvania. As a result, gas companies pay virtually no tax to compensate local governments for their expenditures. This benefit is not afforded to other mining businesses, or residential and commercial taxpayers.

A Severance Tax Can Help Compensate Pennsylvanians for the Loss of this Non-renewable Resource.

Every other major energy-producing state, including Texas, Arkansas, Oklahoma, Alaska, Wyoming, and West Virginia, imposes a tax on natural resource extraction. Pennsylvania is the only mineral-rich state without this tax.

Governor Ed Rendell has proposed a tax on the removal, or “severance,” of natural gas from the ground in Pennsylvania. The proposed tax, modeled on neighboring West Virginia’s severance tax rate, would take effect July 1, 2010 and is expected to generate \$177 million in the first year and grow to \$528 million within four years.

A natural gas severance tax will benefit Pennsylvanians:

- It will ensure gas companies contribute to the cost of their activities rather than leaving state and local taxpayers to foot the bill for additional environmental, infrastructure and public safety costs.
- It will compensate Pennsylvanians for removal of this non-renewable resource.
- Finally, it will contribute to the Commonwealth's long-term ability to provide education, senior services, environmental protection, and health care, as well as help reimburse local governments for service costs imposed by drilling activity.

Without the tax, Pennsylvania loses much of the benefit of drilling:

- Federal domestic energy production incentives reduce drillers state income tax payments.
- 70% of drillers in Pennsylvania pay the 3.07% personal income tax rather than the 9.99% corporate net income tax, creating a further windfall.
- Gas producers no longer pay local property taxes on reserves, due to a 2002 court-created loophole. Consequently, other property taxpayers must pick up the tab for industry-related costs in largely rural counties, municipalities, and school districts hosting drilling activity.

Severance taxes are the norm in energy-producing and mineral-rich states:

- Pennsylvania is the only mineral-rich state that doesn't levy any kind of severance tax.
- Thirty-five states levy some kind of severance or extraction tax on the removal of natural resources.
- Twenty-seven states levy a severance tax on the extraction of natural gas. Twenty-three of those states also have corporate income or other corporate taxes.

Natural gas production in the Marcellus Shale will create jobs, but the industry is still small:

- In 2008, the industry directly employed 10,300 people, according to the U.S. Bureau of Labor Statistics, and the state estimates that number will grow to 12,400 by 2016. By comparison, Wal-Mart employed 48,800 people in Pennsylvania as of January 2010.

The severance tax will not make Pennsylvania less competitive:

- Drilling decisions are based on the location of the reserves and the expected price of natural gas – not severance tax rates.
- Almost half of the price of natural gas to consumers is due to transportation and distribution costs. Due to its proximity to the lucrative Northeast market, Pennsylvania has a natural price advantage over competing states.
- Numerous studies have shown that increasing a state's severance tax has little to no effect on production or employment.
- The rate being proposed in Pennsylvania is the same as in neighboring West Virginia, eliminating any possible tax incentive to drill in one state or the other.
- All states with greater natural gas production than Pennsylvania currently have severance taxes or fees on its extraction.

Imposing a severance tax will not increase utility costs for Pennsylvania consumers:

- Pennsylvanians currently import four times more gas than we produce. We already pay tax on the gas we import from Texas, Wyoming, Oklahoma, and New Mexico.
- Most of the gas that will be produced in Pennsylvania over the next 20 years will likely be exported to other Northeastern states.

"The industry will probably hate me for saying this, but as far it goes in my world of spreadsheets, the severance tax is not a deal-breaker. I don't believe it will have a huge impact on drilling. It's not that large."

— Subash Chandra, oil and gas industry analyst, Jefferies & Co. Inc., *The Philadelphia Inquirer*, May 2, 2010