



## Tall Tales about Deep Wells: Part 3 of a Series

# Severance Tax Proposal Won't "Crush" Natural Gas Industry

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The Pennsylvania House is considering a bill to enact a severance tax on natural gas at a fixed rate of \$0.39 per thousand cubic feet (MCF). The rate is not, as some have claimed, the highest in the nation. In fact, it is competitive with other energy-producing states.

When comparing effective tax rates, which account for reduced front- and back-end deductions and exclusions, the proposed rate in Pennsylvania is comparable to that of New Mexico and Montana.

Natural gas producers in many energy-producing states, including Montana, New Mexico, Oklahoma and Wyoming, must pay property taxes on gas reserves and equipment, while in Pennsylvania property taxes on oil and gas reserves are prohibited by a 2002 court ruling. Accounting for property taxes paid by drillers in other energy-producing states but not in Pennsylvania, the effective tax rate in the House bill is lower than that in Montana, New Mexico and Wyoming.

**Table 1. Effective Severance and Property Tax Rates**

State	Montana <sup>1</sup>	New Mexico <sup>1</sup>	Oklahoma <sup>2</sup>	Wyoming <sup>1</sup>	Pennsylvania House Bill (SB1155) <sup>3</sup>	Marcellus Shale Industry Plan <sup>3</sup>
Effective Severance Tax Rate	7.5%	7.3%	6.7%	5.1%	7.3%	2.3%
Effective Property and Severance Tax Rate	7.9%	8.4%	6.7%	10.2%	7.3%	2.3%

The Western energy-producing states have been able to assess reasonable tax rates, receive a fair return on the loss of non-renewable resources, and continue to be attractive places for gas producers to operate.

<sup>1</sup> Headwaters Economics, *Energy Revenue in the Intermountain West*, October 2008

[http://www.headwaterseconomics.org/energy/HeadwatersEconomics\\_EnergyRevenue.pdf](http://www.headwaterseconomics.org/energy/HeadwatersEconomics_EnergyRevenue.pdf).

<sup>2</sup> Marc Carey and Todd Herreid, Memorandum to Representative Kathleen Curry on Effective Severance Tax Rates, Colorado Legislative Council Staff, September 8, 2006.

<sup>3</sup> This is the effective tax rate on taxable wells only and excludes low-producing stripper wells, which are exempted from the proposed severance tax in Pennsylvania. If stripper wells were included, the effective tax rates of the House bill and industry proposal would be lower. The effective tax rates account for reduced front- and back-end deductions and exclusions and are based on an estimated total well production of 2.8 billion cubic feet and a natural gas price of \$5 per MCF.

## **Industry tax plan would be among the lowest in the U.S.**

The Marcellus Shale Coalition proposes a complicated plan in which production would be taxed at 1.5% for the first 5 years; 5% between Years 6 and 13; 1% for the next five years; and 0% below 90 MCF (Years 19 through 40).<sup>4</sup>

This proposal is far more generous than that in place in Arkansas, Texas, and Louisiana. Under this plan, Pennsylvania's tax would generate less than one-quarter of a comparable well in Wyoming or roughly 1/3 of what would be collected in Oklahoma.

A lower tax rate would boost the profits of drillers, which are already quite competitive. Range Resources, for example, expects a 60% rate of return on its Pennsylvania wells.<sup>5</sup> It would, however, leave Pennsylvania unprepared for the economic, social, and environmental costs of development.

## **A severance tax will have a net job creation benefit.**

A recent Penn State Institute for Research in Training & Development report found that every \$100 million raised in severance taxes from gas producers in Pennsylvania would result in a net gain of more than 1,100 jobs, even after factoring in higher production costs to the industry.<sup>6</sup>

These results are echoed by studies in Wyoming, Utah and the Intermountain West indicating that severance taxes have little impact on drilling decisions, but can have major implications for host states and local communities.

The economics, with or without a severance tax, are favorable for drilling in the Marcellus Shale. Pennsylvania is close to major markets, has relatively low drilling costs compared to other shale formations, and has a huge potential supply. Pittsburgh-based EQT, which actively drills in both Pennsylvania and West Virginia (which levies both property and severance taxes on production), has no preference to which state it operates.<sup>7</sup> This seems to indicate that the severance tax issue is not as large as industry groups claim.

As the October 1 deadline looms, state legislators can choose to protect the financial interests of the gas industry or enhance the common good for all Pennsylvanians.

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<sup>4</sup> Years of taxability varies based on the size of the well. This example assumes total well production of 2.8 billion cubic feet over 40 years.

<sup>5</sup> John H. Pinkerton and Jeffrey L. Ventura, 2Q '10 Shareholder Letter, Range Resources, <http://www.rangeresources.com/Our-Company/Shareholder-Letter.aspx>.

<sup>6</sup> Rose M. Baker and David Passmore, *Benchmarks for Assessing the Potential Impact of a Natural Gas Severance Tax on the Pennsylvania Economy*, September 13, 2010 <http://www.personal.psu.edu/dlp/remi2010/#/>.

<sup>7</sup> Sean Hamill, "Pennsylvania's tax level for shale drilling sparks debate," *Pittsburgh Post-Gazette*, September 27, 2010 <http://www.post-gazette.com/pg/10270/1090615-454.stm>.