



Modernizing an Antiquated Tax System

Understanding the Severance Tax

Governor Ed Rendell has proposed a tax on the removal, or “severance,” of natural gas from the ground in Pennsylvania. The tax would be paid by companies who lease land to extract the gas located deep underneath it. The tax rate is proposed at 5% of the price of the natural gas at the wellhead and \$0.047 per thousand cubic feet, the same as the tax rate currently imposed in West Virginia. The tax would take effect on October 1, 2009 and is expected to generate \$107 million for the General Fund in fiscal year 2009-10 and grow to \$632 million in 2013-14.

Pennsylvania Is the Only Mineral Rich State Without a Severance Tax.

Most states that have significant mineral wealth, including Texas, Arkansas, Oklahoma, Alaska, Wyoming, and West Virginia, impose a tax on the extraction of minerals or other natural resources. Pennsylvania is the only mineral rich state that does not have this tax.

Interest in the severance tax has been stirred by a 21st Century gold rush in the Marcellus Shale, a deep geologic formation that spans West Virginia, Ohio, New York, and most of Western Pennsylvania. New drilling techniques and rising natural gas prices have made it both economically feasible and potentially highly profitable to exploit the vast gas reserves.

Why Impose a Severance Tax on Natural Gas?

A severance tax can help alleviate the economic disconnect between profits reaped by the industry and the costs incurred by government, by giving the state a share of the proceeds from every cubic foot of gas sold. It also compensates the state and its citizens for removal of this non-renewable resource. Finally, it is an important source of state revenue that can contribute to the Commonwealth’s long-term ability to provide public education, affordable higher education, senior services, and health care.

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

The Commonwealth is already facing new permitting, monitoring, and compliance costs to handle the new industry. As the drilling process has great potential to contaminate both surface and groundwater, water usage and treatment will have to be monitored for many years. Counties and townships will need to build or upgrade roads to accommodate heavy truck traffic and upgrade first-responder capacity to respond to the emergency demands of this often dangerous enterprise. Development will attract new workers to the region, many with families and children, creating new demands for schools and other public services. 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. State and local taxpayers will bear most of these costs.

Natural gas producers are allowed to reap substantial economic benefits without paying their

fair share of taxes. Many out-of-state drillers coming in to extract the gas will pay the personal income tax rate, rather than the higher corporate tax rate. These enterprises pay virtually no tax to compensate for their costs to local governments, as oil and gas wells are **exempt from property tax** – a benefit not afforded to other mining businesses, or residential and commercial taxpayers.

Key Facts.

A severance tax is not unique:

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

The severance tax is an important source of revenue for state and local governments:

- Severance taxes provide substantial revenue for programs that protect the environment, help offset current service costs, and support education, health care, and other vital services.

The severance tax will not make Pennsylvania less competitive:

- The rate being proposed in Pennsylvania is the same as in neighboring West Virginia.
- Pennsylvania's proposed severance tax rate is lower than the top four producers of natural gas: Texas, Wyoming, Oklahoma, and New Mexico.
- Numerous studies have shown that increasing a state's severance tax has little to no effect on production or employment.
- Natural gas produced in Pennsylvania will have a natural price advantage over Western states in the lucrative Northeastern market – even with a severance tax – due to significantly lower transportation costs than competitors. Fully 48% of the price paid by consumers for natural gas is due to transportation and distribution costs – not the resource itself.

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.
- Imposing the severance tax on coal and other mining would increase state tax revenues – as these industries are more established in Pennsylvania.

Local governments need additional tax revenue to compensate for additional costs:

- Oil and gas reserves, like other minerals, were subject to property taxes until a 2002 court case. Assessment practices used in Pennsylvania prior to the court ruling are widely accepted and used by large producing states like Texas and Oklahoma.
- Allowing counties to assess oil and gas reserves for property tax purposes would add significant resources for largely rural counties, municipalities, and school districts.