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Lawmakers Shouldn't 'Give Away the Store' With Industry-Friendly Severance Tax Exemptions

HARRISBURG, PA (June 24, 2010) – If the Pennsylvania General Assembly listens to the natural gas industry, two-thirds of the gas extracted from a typical Marcellus Shale well will be exempted from a state severance tax, a Pennsylvania think tank warned today.

In a new report, the Pennsylvania Budget and Policy Center examines severance tax policies in Texas and Arkansas as the gas industry ramps up efforts to include exemptions in Pennsylvania's severance tax.

Center Director Sharon Ward was joined by Representative Dave Levdansky and other lawmakers to release the report at a Capitol press conference today. Representative Levdansky is the main sponsor of legislation to enact a severance tax in Pennsylvania (HB 2443).

"Citing tax policies in Texas and Arkansas, the industry is making the case for much more generous severance tax exemptions in Pennsylvania than either of those states offer," Ward said. "And these are states that already have the most generous severance tax exemptions in the country."

"We need to close corporate loopholes, not create new ones," said Representative Levdansky. "Our forests, farmlands and other rural areas are producing a phenomenal amount of natural gas which is certain to proliferate into the future. We need the revenue from a severance tax to protect our environment and help local governments with the costs they incur by hosting drilling sites."

One Exemption Is Not Enough

The gas industry has successfully lobbied Pennsylvania officials to include an exemption for low-producing wells in recent severance tax proposals. The exemption would be for existing shallow, or "stripper," wells – in addition to Marcellus Shale wells in their later years of production.

More recently, the industry has been making the case for a tax exemption during the first three years of Marcellus Shale well production to recover capital costs. If both front- and back-end exemptions are included, a typical Marcellus Shale well would be taxed for only nine years of its 40-year life span.

"Pennsylvania doesn't need to offer tax breaks to attract gas producers," Ward said. "We're close to lucrative natural gas markets in the Northeast, and studies in other states have found tax breaks do little to spur production. Pennsylvania could end up leaving millions of dollars on the table without much to show for it."

"The rich gas reserves in the Marcellus Shale are already bringing big oil and gas companies like ExxonMobil and Shell into our state," said Representative Levdansky. "They will continue to drill Pennsylvania natural gas wells with or without a severance tax. We don't need to offer them tax breaks. We need to ensure that they do not leave a legacy of devastation for future generations."

Pennsylvania Is Not Texas

While the industry cites Texas and Arkansas as models, neither state offers exemptions for all gas wells at the beginning or end of production. Texas, for instance, provides a rate reduction for “high-cost” wells based on the actual costs of drilling. Only in extreme cases will the tax rate be reduced to zero and only until half of capital costs are recovered. Unlike in Pennsylvania, Texas drillers also pay billions each year in property taxes on gas reserves.

The Budget and Policy Center paper recommends that lawmakers reject an upfront severance tax exemption for Marcellus Shale wells and that any exemption for low-producing wells be conditioned on gas prices dropping below a certain level – the same way a rate reduction is triggered for shallow wells in Texas.

“Pennsylvania taxes are already very favorable to the gas industry,” Ward said. “Further tax breaks will drain revenue for core services like health care, education, and environmental cleanup. Communities across Pennsylvania are already feeling the impact of Marcellus Shale drilling. Lawmakers need to act now to put a properly structured severance tax in place.”

The Pennsylvania Budget and Policy Center is a non-partisan policy research project that provides independent, credible analysis on state tax, budget and related policy matters, with attention to the impact of current or proposed policies on working families. To learn more, go to www.pennbpc.org.