Fact Check on Severance Taxes and the Marcellus Shale

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The Pennsylvania General Assembly has taken steps to enact a severance tax on natural gas drilled in the Marcellus Shale, a rich natural gas formation that underlies much of Pennsylvania.

State lawmakers made a commitment in the 2010-11 budget agreement to enact a tax by October 1 that would go into effect in January 2011. On September 29, the Pennsylvania House of Representatives passed a bill (SB 1155) to impose a tax, while the Senate has taken no action but may consider a bill when it reconvenes on October 12.

The oil and gas industry is waging a fierce fight to block the tax, with extensive lobbying in Harrisburg and radio and TV advertisements across the Commonwealth. The Pennsylvania Budget and Policy Center has examined severance taxes and the potential impacts, both good and bad, of drilling in the Marcellus Shale for almost two years. The following is a fact check on claims made by the industry:

Is Pennsylvania's proposed tax higher than other states?

No. Pennsylvania's proposed tax is comparable to other gas-producing states. The House-passed bill sets a rate of 39 cents per thousand cubic feet (MCF) of gas and exempts wells that produce less than 60 MCF per day. The effective tax rate, after factoring in tax breaks and local property taxes assessed in other states, is lower than Montana (7.9%), New Mexico (8.4%) and Wyoming (10.2%). Pennsylvania's effective tax rate of 7.3% would be higher than West Virginia's rate of 5.8%.

The Marcellus Shale Coalition plan has an effective tax rate of 2.3%, well below most gas-producing states.[1]

Will a severance tax on oil and gas companies increase taxes for individuals?

No. In an attempt to capitalize on the current anti-tax climate, TV ads run by the oil industry claim that higher energy taxes will increase taxes on individuals. It is difficult to find any basis for this claim.

In 2008, Pennsylvania imported 74% of its natural gas, all of it from states that already impose severance taxes, so Pennsylvanians are paying taxes to Texas, Wyoming, New Mexico and Louisiana.

Gas produced in Pennsylvania will be very inexpensive to transport over such short distances. Since transportation accounts for nearly half of the final cost, Pennsylvania gas consumers will be paying less for gas overall.

Will a Severance Tax Cost Jobs?

No. A severance tax on Marcellus Shale gas will increase employment, even when factoring in higher production costs for industry. Many economic models look at the impact of taxes on the cost of production and jobs, but not at jobs created with new tax revenue. A September report by the Penn State Institute for Research in Training & Development found that every $100 million in severance tax revenue will create a net gain of between 1,100 and 1,900 jobs. Between a quarter and a third of the jobs would be in the private sector and the rest in state and local

[1] The effective Pennsylvania tax rates are based on an estimated total well production of 2.8 billion cubic feet (BCF) at a price of $5 per MCF. The U.S. Energy Information Administration (EIA) forecasts natural gas prices will be $4.90 per MCF next year. Over the past decade, Henry Hub natural gas spot prices have fluctuated from $2.26 per MCF to $13.83 per MCF.

government. The severance tax would also have a net positive effect on gross state product (a measure of the state's total economic activity) and on disposable personal income.

Is drilling activity higher in Pennsylvania because it does not impose a severance tax?

No. Gas drilling activity has continued across the nation, despite the recession. From 2004 to 2008, natural gas production has grown by an average of 5.4% in the 14 largest gas-producing states (Pennsylvania ranked 15th in 2008). There is a natural gas rush in the Marcellus Shale in West Virginia in spite of its tax. More Marcellus Shale wells were drilled in West Virginia than in Pennsylvania through the end of 2009.

Aren't companies already paying Pennsylvania's high corporate income tax rate?

No. The majority of wells, 70% by 2009, were owned by companies that incorporate as partnerships or limited liability companies (LLCs). Individual investors in the partnership or LLC pay the 3.07% personal income tax rate on profits, rather than the 9.99% corporate net income tax rate. Most states impose both corporate taxes and severance taxes; all of the top 14 producers except Wyoming have a corporate income/franchise or gross receipts tax as well as a severance tax.

Isn't the industry paying hundreds of millions in taxes already?

No. In 2008, oil and gas income tax revenue accounted for $38.8 million, according to the Pennsylvania Department of Revenue. Much of the equipment and supplies purchased by the industry are exempt from sales tax under Pennsylvania's manufacturing exemption, and companies don't pay property taxes on gas reserves. The industry is even trying to get an exemption from hotel taxes on rooms it rents for out-of-state workers.

Shouldn't companies get tax breaks to recover capital costs?

No. Studies from Wyoming, Utah and other gas-producing states show that tax breaks create huge windfalls for gas companies, but do little to stimulate additional production and have little impact on jobs. Producers expect returns on investment of 60% or more per well, without tax breaks.

Is the Arkansas tax model right for Pennsylvania?

No. The two states aren't comparable. Arkansas competes with gas giants − neighboring Texas, Louisiana and Oklahoma. Pennsylvania is 1,000 miles from all of them, and a thousand miles closer to lucrative natural gas markets in the northeast. Pennsylvania's gas wells are richer than many other gas fields. Average lifetime production in Pennsylvania is estimated at 2.8 billion MCF − three times that of Barnett Shale wells in Texas.

Won't the industry just pack up and leave if we enact a severance tax, further hurting our economy?

No. Companies base their business decisions on long-term economics – not short-term tax changes. They operate in the 14 states with greater production than Pennsylvania, all of which have a severance tax or production fee. In fact, 96% of the natural gas produced in the United States comes from states with severance taxes. The gas producers are in Pennsylvania because the Marcellus Shale is highly profitable: wells are cheaper to drill than in other shale formations, the reserves are larger and Pennsylvania is closer to northeastern markets than competitor states.

The Bottom Line: Pennsylvania can benefit from its natural gas reserves in the Marcellus Shale if drilling is conducted responsibly. A natural gas severance tax ensures drillers rather than taxpayers foot the bill for environmental monitoring and enforcement as well as for the real costs to host communities. The revenue will

support public education, colleges and universities, and other investments that will sustain economic growth throughout the Commonwealth.