PIOGA Pennsylvania Independent Oil & Gas Association

JUST THE FACTS

Gov. Wolf's Severance Tax Proposal: Seven Years Later Still a Bad Idea

Members and staff of the Pennsylvania Independent Oil & Gas Association have spent the past six years fighting Gov. Tom Wolf and certain members of the state legislature in their desire to impose a severance tax on unconventional natural gas production in the Commonwealth. This budget year is no different, with Wolf proposing to tax the industry as part of a "Back to Work PA" COVID-response effort and Rep. Christopher Quinn (R-Delaware County) introducing legislation (HB 1242) last month calling for a variable-rate tax on natural gas production.

These bipartisan efforts, typically proposed by elected officials far from the state's energy-producing areas, are clear evidence this fight is not over. It is imperative for us to continue to present the facts about the negative impact any additional tax on our industry would have on jobs, economic growth and energy production in the Commonwealth in the weeks ahead, leading up to the passage of a state budget. PIOGA encourages members to contact legislators and colleagues to encourage them to oppose additional energy taxes. Here are some facts on this important issue.

Pennsylvania's Tax Burden

Pennsylvania has among the highest cumulative tax burdens of the 50 states — as ranked by numerous independent sources — making the Commonwealth's tax structure a detriment to business. Natural gas producers in Pennsylvania pay all applicable taxes, along with an Impact Fee not imposed on any other industry. Among the facts:

- According to the Tax Foundation, Pennsylvania has the second-highest Corporate Net Income Tax in the nation, at 9.99 percent, trailing only New Jersey.
- Pennsylvania's Impact Fee, imposed on natural gas production from most unconventional wells, is in reality a severance tax by another name and is comparative with other states' severance taxes. The current effective rate of the Impact Fee is approximately 3.3 percent.
- MarketWatch ranks Pennsylvania's cumulative tax burden as the fifth-worse in the country, ahead of only Connecticut, New Jersey, New York and Illinois.
- U.S. News & World Report ranked Pennsylvania 42nd in its 2021 list U.S. Economy Rankings, a measure of each state's economic stability and potential.

Comparisons with Energy Producing States

Proponents continue to claim that Pennsylvania "is the only natural gas-producing state without a severance tax." This ignores the Impact Fee's $2 billion contribution to the state since 2012 as well as the details of other states' severance and full tax structures, making simple comparisons meaningless. A few examples:

- Texas imposes a severance tax on "high-cost" unconventional wells, but it is imposed at a reduced tax rate either for its first 10 years or until the well accumulates a tax savings of 50 percent of the actual drilling and completion costs for the well. The specific amount of the tax relief in Texas depends on drilling costs upon completion. This effectively allows for the well's highest years of production to be taxed at a considerably reduced rate.
- While West Virginia imposes a severance tax on unconventional natural gas production, the state also has an exemption on the payment of state sales tax for any service or equipment used on the well pad itself, from site preparation to drilling and completion. That amounts to a $600,000 savings on a $6 million unconventional well.

• The independent Tax Foundation placed Pennsylvania 16th highest in its 2019 ranking among the 50 states for its total state and local burden, at 10.4 percent. West Virginia was 26th, at 9.9 percent, and Oklahoma and Texas were 46th (8.2 percent) and 47th (8.0 percent), respectively. There are other states, including just about all with natural gas reserves, with better tax climates than Pennsylvania.

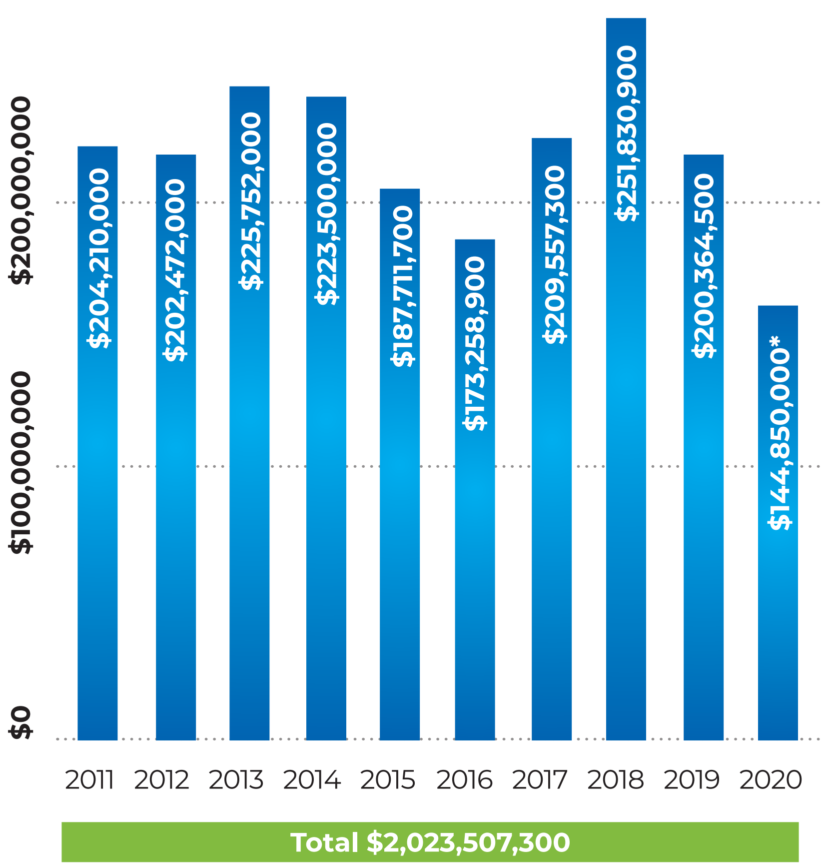
The Facts

Gov. Wolf's proposed severance tax has been a bad idea in all of the seven years he has pushed it in his annual spending plans. It is a particularly bad idea in 2021, as Pennsylvania emerges from a global pandemic and fights to put people back to work.

Pennsylvania's natural gas producers pay more than their fair share of taxes, with the vast majority of unconventional wells paying what's called an Impact Fee that has generated more than $2 billion in state and local revenue in its first nine years. What rankles most severance tax proponents is that the majority of Impact Fee revenue goes directly to local and county governments rather than to Harrisburg.

Energy production in Pennsylvania is already struggling, due to years of low commodity prices, high regulatory and compliance costs and infrastructure bottlenecks that reduce the actual value of natural gas at Pennsylvania's three transmission hubs between 16-29 percent below Henry Hub prices (as of late April 2021). An average of only 40 unconventional wells have been spudded monthly between October 2020-March 2021, with fewer than 20 drilling rigs currently in operation in the state.

Disbursement by Year



**Estimated amount*

Source: PA Public Utility Commission

While Impact Fee distributions have totaled more than $2 billion in the program's 10 years, the trend of those payments has been inconsistent in the past several years, including a significant decrease anticipated for 2020. The one-year spike in 2018 can be attributed to a court case involving payments from lower-volume unconventional wells and a period where gathering line construction allowed a number of wells to be brought online. Placing a severance tax on top of the current Impact Fee will only exacerbate this trend, resulting in reduced payments to the Commonwealth, less capital spending on new wells and the job and economic losses that would accompany that reduction.

A severance tax on the natural gas industry, in addition to current taxes, regulatory costs and pricing pressures, would make energy production harder, leading to reduced economic growth and fewer jobs in Pennsylvania. It's time to remind our leaders in Harrisburg of these facts. To find out how to contact your elected officials, go to pioga.org/news-resources/get-involved.

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