County Commissioners Association of Ohio

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TO: **MEMBERS OF HOUSE WAYS AND MEANS SUBCOMMITTEE**

FROM: **JOSH HAHN, SENIOR POLICY ANALYST**

SUBJECT: **TESTIMONY ON THE SEVERANCE TAX PROPOSAL (AS PART OF HB 59, THE BIENNIAL APPROPRIATIONS BILL)**

The County Commissioners Association of Ohio (CCAO) appreciates the opportunity to provide testimony on the Governor's proposal to increase the severance tax. I hope you'll grant me the opportunity to speak briefly to the ad valorem tax as well as the impact fee proposal the Administration has put forward.

Last year CCAO adopted the following policy with respect to the Administration's proposal to increase severance taxes on the production of oil and gas:

1. The severance tax rate on oil and gas companies should be increased beyond what the Administration is proposing to a more appropriate rate, and this can be done without discouraging the industry from locating in Ohio.

2. Revenue from increased severance taxes on oil and gas companies should be used minimally for income tax cuts. Some revenue should be used to restore local government funding cuts or to provide property tax relief. Special emphasis should be given to impacted counties.

As you know, the Governor's proposal establishes a two-tiered basic structure for the severance tax with natural gas taxed at 1.0% of market value and NGLs, oil, and condensate taxed at 4.0% of market value.

However, for the first year of production from horizontal wells, while producers are recovering the cost of the original investment, a lower tax rate of 1.5% will apply to oil, condensate, and NGLs.

The tax structure on the products of conventional vertical wells also changes, in a way that gives tax reductions to the owners of those wells.

The effective tax on natural gas, which is currently $0.03 per MCF, is changed to be the lesser of 1% of market value or $0.03 per MCF. At prices below $3 per MCF (which was the case for much of 2012), this would result in a tax reduction relative to the current $0.03 per MCF tax rate.

Finally, gas wells where the average production is less than 10 MCF per day based on a daily average per quarter would be exempt completely from the Ohio severance tax. This will exempt the output of nearly 45,000 conventional vertical gas wells in Ohio.

Product	Conventional Wells	High-Volume Horizontal Wells ("Shale" Wells)
Crude Oil	20 cents per barrel (unchanged)	1.5% for first year, 4% following years (*Initial 1.5% rate can be extended for one additional year only if initial costs to drill the well are not yet recovered.)*
Natural Gas	0 for well <10MCF/ day, 1% for wells>10MCF/day capped at 3 cents/MCF	1%
Natural Gas Liquids	0 (*Currently no separate tax is applied, and that will remain*.)	1.5% for first year, 4% following years (*Initial 1.5% rate can be extended for one additional year only if initial costs to drill the well are not yet recovered.*)

As you know, the disposition of tax revenue generated from the new horizontal wells is also different than from the conventional vertical wells. Whereas for the conventional vertical wells the tax revenue goes to regulatory funds within the Ohio Department of Natural Resources (ODNR), for the horizontal wells the tax revenue will go to the state GRF, and in effect be used to offset some of the cost of the Governor's proposed income tax reductions.

As noted above, while CCAO believes revenue from increased severance taxes on oil and gas companies should be used minimally for income tax cuts, some revenue should be used to restore local government funding cuts or to provide property tax relief. Special emphasis should be given to impacted counties.

These dual goals of local relief to impacted counties and statewide income cuts can be achieved by modestly increasing the Administration's proposed rates. Even at the Administration's proposed severance tax rates on horizontal well output, an Ernst & Young (E&Y) study for the Ohio Business Roundtable found that Ohio's overall taxes, including taxes other than severance, would still rank lowest among the eight states included in the study in terms of overall effective tax rates.

The E&Y study examined all major state and local taxes, for two types of wells: wells producing both dry natural gas and NGLs, and wells producing dry natural gas and oil. The seven comparison states in the study were Ohio's resource-extracting neighbors, Michigan, Pennsylvania, and West Virginia, and four other oil and gas dependent states: Arkansas, North Dakota, Oklahoma, and Texas. All seven of those states either already have substantial horizontal well extraction or are expected to have such extraction in the near future. The E&Y study found that Ohio's overall effective tax rate (ETR) on the output from the two types of wells would be 40% or 48% below the average ETR in the other 7 states, depending on the type of well output.

By modestly increasing the rate, but maintaining a competitive edge, the General Assembly can assist those impacted counties whose services and infrastructure may be impacted by such welcome but challenging development.

In addition, CCAO believes the property and Ad-Valorem tax formula in state law needs to be revised to provide local communities with more revenue from property taxes than they are expected to receive under the current tax structure.

Further, the Administration's impact fee proposal of $25,000 per well for local communities with 100% of the money returned to the well owner as a credit on future property taxes would be an administrative burden on the county and other local governments with little benefit to the impacted communities. CCAO recommends that the impact fee provision be eliminated as proposed by the Administration.

In its place there should be a recognition that there will be impacts on county and township roads and bridges as a result of the development of oil and gas resources. A specific impact fee should be adopted or authorized by the General Assembly. While Road Use Maintenance Agreements can help with road damage and our policy continues to ask that these agreements be required before a drilling permit is issued, the real solution to this problem is to recognize that the continual wear and tear on roads and bridges should be recognized and some type of impact fee should be allowed in recognition of this fact.

This could be accomplished in one of two ways. First, the General Assembly could provide that a surcharge be added to current or proposed severance taxes to be collected by the state and distributed to the county budget commission who would redistribute the surcharge on the basis of relative need considering the actual degree of impacts on county and township roads in the county. Second, authority could be granted to allow counties and townships to enact a permissive surcharge.

I thank you for the opportunity to speak before you today and will attempt to answer any questions you may have.