Taxes and the Marcellus Shale

This column is presented weekly by the Public Education sub-committee of the Clinton County Natural Gas Task Force in an effort to provide accurate, up-to-date information on activities surrounding the Marcellus Shale formation and the natural gas exploration industry.

Much of the recent public debate in Pennsylvania about Marcellus Shale has been focused on a Severance Tax on natural gas production, including whether to levy such a tax, and if so, where should the new tax dollars go. Last week, the state House of Representatives approved a bill that would levy such a tax and laid out a formula for distribution, and this is now being considered by the state Senate.

Part of the controversy over the Severance Tax is that it potentially bridges both local and state government, something that typically isn't done with most taxes in the Commonwealth. As proposed, the Severance Tax would be a state-level tax, but with a set percentage of the revenues redistributed directly to local governments being affected by Marcellus development. Much of the debate in Harrisburg revolves around how many of these dollars should remain at the state level and how many should go to local governments.

Adding to the debate is that it currently isn't clear how Marcellus development is affecting local government services and costs, and thus how development may affect local taxpayers. There is much anecdotal evidence that such impacts are occurring, such as road damage, rising and changing demand for police and emergency services, and increased time commitments for municipal and county-level officials. But as yet there isn't definitive information about how widespread or costly these impacts will be, and thus how many more dollars local governments will need to cover these costs.

The Commonwealth currently does receive some tax revenue from Marcellus activity through its existing tax structure. Mineral right owners owe state income tax on their leasing and royalty dollars, as do workers related to the industry on their wages and salaries. Gas companies pay the corporate or other state tax on their revenues, depending upon their corporate structure. New spending by mineral right owners and gas-related workers is subject to the sales tax, just like spending by other residents and workers. The heavy use of trucks, and thus large purchases of diesel fuel, likewise affects liquid fuels tax collections by the state.

Local governments, in contrast, have fewer taxes that are affected by Marcellus development. The earned income tax, one of the two most important local taxes, only taxes earnings and wages of residents who live within the jurisdiction, and exempts leasing and royalty income. Thus local governments will receive no new tax dollars from mineral right owners, and their earned income tax collections will increase only if the workers in the industry happen to live within their jurisdiction. The latter is particularly a concern for small rural townships, who are experiencing the impacts of gas development but yet are not the chosen residence for gas-related workers.

The real property tax, the other important local tax, similarly will not be immediately responsive to Marcellus development. Rising property values resulting from Marcellus development will not increase assessed values, and thus tax collections, due to the way Pennsylvania assesses property (assessed values only increase through reassessment, which typically happens very infrequently). Only new construction or property improvements will immediately increase local real property tax collections. Natural gas deposits themselves are exempt from the real property tax, due to a 2002 Pennsylvania court decision. This is in contrast to other non-renewable resources, such as coal and limestone, which are subject to the tax (and are payable by the company physically extracting the resource, not the mineral right owner).

A Severance Tax is a tax on the value of production at the point of extraction, and it is widely used by other states. It can be administered on a percentage basis (like a sales tax), on a production basis (per unit of production), or a combination of both. The Pennsylvania debate is focused on levying the tax solely on natural gas, but in other states it typically is levied on several types of non-renewable resources (such as coal and limestone), rather than just natural gas.

The natural gas industry has argued against instituting the Severance Tax in Pennsylvania. They argue that Pennsylvania's tax structure is significantly different from other states, so comparisons with other states are inappropriate. They also suggest that the tax would hurt a 'fledgling industry', which needs tax breaks rather than taxes to thrive. They also argue that they want to be treated just like other industries, and that levying a Severance Tax solely on natural gas is unfair. Others have argued that the Severance Tax is simply a money grab by the state to balance the state budget, and that proposed distribution of dollars has little relation to the actual costs being created by Marcellus development.

Supporters of the Severance Tax similarly argue fairness, and argue that the industry should bear some of the costs they're creating. They suggest that the industry is not 'fledgling', but rather is very well established with deep pockets, and thus fully able to pay a Severance Tax without undue burden. They also note that Pennsylvania is competing with states who have severance taxes on natural gas, and we have a significant location advantage due to our closeness to the Northeast markets, and thus levying a Severance Tax would not put Pennsylvania gas producers at a competitive disadvantage. Some supporters also note that the industry says they just want to be treated like other industries with regard to a Severance Tax, but yet don't want to be treated the same with regard to the real property tax.

There are similar discussions about how dollars from a Severance Tax should be distributed, and particularly how much should go into the General Fund, how much should go local communities being affected by Marcellus development, and how much should go to environmental needs.

These political arguments are currently playing out in Harrisburg, and reflect the varied perspectives on Marcellus development, and on taxation. As the debate continues in the Capitol, it is important that citizens share their concerns (either pro- or con-) with their local legislators, so the decisions about the Severance Tax do reflect Pennsylvanians perspectives.

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