CRAIN'S CLEVELAND BUSINESS

ENERGY GUEST BLOG -- JIM SAMUEL

The state of the state's severance tax debate

4:30 am, March 28, 2014

What will come of an Ohio Severance Tax increase?

It's been said (regardless of whom you credit with the quote) that insanity as doing the same thing over and over again and expecting a different result.

Casual observers of the Statehouse severance tax debate might think they are watching the adage in action, as we are looking at a likely sixth version of a severance tax in 18 months, depending on how you are counting at home.

At a cursory glance, the tax rates being debated appear pretty close; the rates being debated vary by less than half of a percentage point. But look a little deeper and the proposals do have different features — most notably the inclusion of a House-backed proposal that initially had support from industry advocates who have previously been most vocally opposed to any changes in severance tax.

Severance taxes are levied in at least 36 states on extracted or mined natural resources like oil, gas, coal, talc, salt and other minerals. In Ohio, natural gas and oil are taxed volumetrically — 20 cents on a barrel of oil and 3 cents per thousand cubic feet (MCF) of natural gas. There is no specific tax on natural gas liquids.

Ohio is in the midst of an important debate over how and whether to change its severance tax structure. The two current proposals up for debate are House Bill 375, introduced in December, and the governor's Mid-Biennium Review (MBR), which was introduced on March 11 and includes significant tax reform, including a hike in severance taxes.

The details

House Bill 375 received industry support upon its introduction, and after significant amendments is now technically called Substitute House Bill 375 (Sub HB 375). It includes a severance tax rate for horizontal shale wells of 1% on gross receipts for the first two years of production, then 2.25% thereafter.

Smaller, conventional vertical wells would not be taxed for the first three years and then see a low rate of a quarter percent (O.25%). Certain horizontal well owners would also be able to deduct what they pay in increased severance taxes from their obligations under the commercial activities tax (CAT) and portions of the personal income tax, but only if they are subject to the Ohio income tax, which typically applies only to smaller companies and not to large corporations.

The first $21 million in revenue in each fiscal year will go to regulatory and mapping programs in the Ohio Department of Natural Resources, with funds primarily dedicated to the plugging of what are called orphan wells. Another 10% of the funds will be dedicated to local governments, with any amount remaining dedicated to income tax cuts for Ohioans.

Gov. John Kasich's latest plan, originally contained within the MBR, has a top tax rate of 2.75% of gross receipts on horizontal shale wells. A provision for cost-recovery during drilling startup exempts $8 million of gross receipts per well from taxation during the first three years. Small, conventional gas producers with vertical wells would pay no severance tax at all.

The governor's plan pays for some expanded regulatory programs at ODNR and dedicates about 20% of the tax revenue to local governments in counties with drilling activity to assist with infrastructure and other associated costs, and to create a legacy fund for future economic development in the region where drilling is taking place.

But the vast majority of revenue in the Governor's proposal is devoted to an across the board reduction in Ohio's income tax. Combined with other tax changes in the MBR, the plan would cut the Ohio income tax rate to below 5%. The Governor's proposal estimates an annual base of about $450 million in severance tax by 2017, with roughly $100 million going to local governments and regulatory costs and the rest dedicated to income tax reduction.

Originally, the Governor's severance tax was contained in the 1,620 pages of the MBR called House Bill 472. However, the House has split the Governor's MBR into more than a dozen bills to be heard in specialized committees. The Governor's severance tax proposal is before the same house committee hearing Sub HB 375 and the House intends to deal with this issue in one unified piece of legislation.

So what's the bottom line?

While some optimistically predict a compromise by the legislature's summer break, I do not see likely agreement, and thus resolution, until the fall at the earliest. There are difficult policy and budgeting issues to wrestle with, most notably the estimated level of revenue generation from the severance tax. And of course, it must be noted that most members of the General Assembly will be on the ballot in November.

While in public debate and rhetoric the differences between the opposing players appear vast, the deliberations have come far in the past 18 months. An increase in the rate appears likely, resulting in greater regulatory funding, support for local impacts and some level of tax relief for all Ohioans. And at less than 3%, an Ohio severance tax rate would remain well below most states.

In a recent regulatory presentation, it was estimated that $20 billion to $24 billion has been invested in Ohio in the last few years in the form of wells, pipelines, processing plants and land leases. Ohio's capacity for gas processing is projected to double as liquids processing triples in the coming year. And it was forecasted that eastern Ohio could support 19,000 new natural gas and gas liquids wells in the next two decades.

There is little debate that shale development is supporting growth and investment, making Ohio a key region in the national and international energy debate.

Rather than an exercise in repetitive insanity, I prefer to liken the severance tax debate to the movie “Groundhog Day.” While the movie has become an iconic reference for people doing the same thing over and over again, they miss the fact that Bill Murray's character tries to perfect the day throughout countless renditions. I think that is what we are doing in this debate.

seeing in this debate.

Let's hope that in this context the Bill Murray metaphor carries the day and our repeated attempts to wrestle with this difficult piece of public policy produces an outcome that supports growth responsibly and builds Ohio's economy for future generations.

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