

Taxing Fracking

Proposals for boosting Ohio's severance tax

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The Kasich Administration has proposed strengthening the severance tax, but the General Assembly won't have the debate. Job losses mount and local economies falter as the effect of billions cut in the state budget sink in. There is urgent need to raise revenues to restore jobs and services and help impacted communities with up-front costs of drilling. Every day the oil and gas extracted from Ohio's land will never be replaced, and legislators are not even talking about keeping a share of that value to build opportunity for Ohio's future.

Current severance tax

Ohio's severance taxes are among the lowest of all energy states. Regardless of the price for a barrel of oil, the driller pays a dime per barrel for the severance tax and another dime in a conservation fee. Whether oil is selling for \$35 or \$150 per barrel, Ohio is getting just 20 cents. The severance tax on natural gas is also low, at 3 cents (including a half-cent conservation fee) per thousand cubic feet (mcf). Whether natural gas is selling for \$10.00 or \$2.28 per mcf, Ohio is getting just 3 cents.

Kasich's proposal

Gov. John Kasich proposes raising rates on fracked oil and natural gas liquids to 4 percent with a loophole that takes it down to 1.5 percent for up to 24 months. Fracked dry gas would be taxed at 1 percent. A small share of the revenues – no more than what would be raised at today's low severance tax rates – would be used for oversight and regulation of the industry. The rest would be given back in income tax cuts.

Rates should be higher

Kasich's proposal could raise up to a billion dollars over four years. A 5 percent severance tax rate, without loopholes, on all production out of the well – dry gas, wet gas or oil – could generate up to \$1.8 billion over the same time period. An additional 2.5 percent could raise another \$900 million. None of this is enough to restore the nearly \$2 billion cut from Ohio's K-12 schools and the \$1 billion cut from communities for services ranging from pothole repair to senior centers. But a severance tax at 5 percent or 7.5 percent could start to restore jobs and local investment in Ohio.

Tax loopholes should be eliminated

Kasich's proposal includes tax loopholes that allow frackers to recover the costs of drilling. The tax break lowers the severance tax rate on oil and natural gas liquids for the first year, and up to another

Key findings

- Kasich administration proposes a fracking tax, but would use it for tax cuts that favor the wealthy.
- Kasich proposal includes a loophole worth up to \$603 million to frackers.
- Ohio should impose a severance tax of 5 percent, with an additional permanent fund fee of 2.5 percent, on oil and gas drilling in Ohio.

12 months, from 4 percent to 1.5 percent. This is an expensive loophole, costing as much as \$603 million over four years.

Tax cuts are the wrong use

The state has lost 275,000 jobs since 2005, when the Ohio legislature cut the state income tax by more than 20 percent. Kasich proposes using severance tax revenues for further income tax cuts, an approach that has not created jobs in the past. Furthermore, most families won't benefit from Kasich's proposed tax cuts, which would average only \$42 for median-income Ohioans, but would give \$2,300 to the top 1 percent, those averaging incomes of \$321,000 a year. Revenues should be used instead to keep cops on the beat, firehouses open, teachers in the classroom and to maintain vital services that families depend on, like senior centers, community mental health, trash pick-up, clean water and pothole repair.

Local communities impacted by drilling face a treadmill of costs

The Kasich proposal for local impact fees would require well owners to make an up-front payment of \$25,000 (based on estimates of needs related to roads) but would require that fee to be paid back. This ignores not only many costs associated with drilling activity, which range from roads to health care, schools, emergency services, and waste disposal, but also the recurrence of drilling impacts related to repeated well stimulation. Horizontal drilling has unusual costs that recur as the well is stimulated over and over: swarms of workers, truckloads of supplies, well preparation, wastewater disposal or recycling. The "treadmill" of drilling and fracking activity means heightened and more continuous industrial impacts on rural infrastructure and stress on community services. As a result, communities impacted by drilling will need resources on an ongoing basis. The severance tax is the tool of public finance used to assist impacted communities in states with significant energy production. For example, Colorado provides 63 percent of its severance tax to local government. Montana provides 39 percent; North Dakota, 11 percent; Wyoming, 35 percent.

Drillers are going to drill if the resource is there

The oil and gas industry is vociferous in opposition to Kasich's proposal. But imposition of the tax won't discourage oil companies that have spent billions on land leases. The leases already create a contractual obligation to drill. Leases expire after three to five years and although they may be renewed, there is a cost to renewal.

Recommendations

- **The tax rate on all oil and gas needs to be higher than 4 percent.** A 5 percent severance tax rate would help restore local jobs, schools and services and assist impacted communities. An additional 2.5 percent should be used to create a permanent fund dedicated to economic recovery from the drilling and to provide for environmental risk.
- **There should be no tax breaks.** Loopholes for cost recovery such as those in Kasich's proposal were first used as horizontal drilling and pressurized extraction were under development. Other states have such breaks, but they reflect legislative fights that oil company lobbyists won. There is no reason to adopt the outcomes of those battles in a new tax structure in Ohio.
- **All production from the well – dry gas, wet gas and oil – should be taxed at the same rate.** Natural gas may be low in cost now, but it has been high in the recent past. The proposed severance tax fee is based on percentage, so when taxation falls with market value.
- **Funds should not be used for tax cuts.** Revenues should be used to restore services, help local communities drilling costs and start building a diversified economy when wells run dry.