Legislative Budget and Finance Committee

A Study Pursuant to HR 131:
An Examination of Natural Gas Tax Structures

<u>Report Presentation by Stephen Fickes, MPA, Deputy Executive Director</u>
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Good morning, Madam Chair and members of the Committee. I am pleased to be here today to discuss the results of our study pursuant to House Resolution 131 (HR 131). Because of the multiple items on today's agenda, my testimony will be brief and highlight just a few items about this study.

HR 131 requested a review of the natural gas impact fees and severance taxes among the top five producing states. Based on total natural gas production, those states are: Texas, Pennsylvania, Louisiana, West Virginia, and New Mexico. Among these states, Pennsylvania is unique in that it assesses an "impact fee" on natural gas development. The other states all use some form of a severance tax, which is based either on the volume of gas produced or market value.

Although there are definitional differences between a fee and a tax, in the end, each is intended to raise revenue from natural gas exploration within the state's borders. Because HR 131 does not ask for a distinction between an impact fee and a severance tax, for comparative purposes, we treat them as the same.

When comparing fees and taxes between states, it is important to note that such comparisons are not "apples-to-apples." We highlight some distinctions in the report, but what fee or tax works in one state is likely created under conditions that do not exist elsewhere. As such, we urge caution in comparing one state's fee or tax as a basis for what another state's fee or tax should be. For example, in many of the states we reviewed, the severance taxes were created decades ago, with vastly different circumstances, whereas Pennsylvania's impact fee is relatively new and was created specifically in response to the growth of unconventional drilling and the impacts created from that activity on local communities.

Pennsylvania's impact fee is a complex assessment based on the average annual price of gas in the year the well is drilled. The impact fee process is more intricate than I can explain here, but our report describes it in detail in Section II. Since enacting its impact fee, Pennsylvania has collected more than $2.5 billion in revenue. The collected fees ranged from $146 million in 2021 to $279 million in 2023, averaging about $212 million annually.

The distribution of these funds is equally complex and varies by each state's financial and statutory requirements. Pennsylvania distributes 60 percent of its impact fee funds back to local governments based, at least in part, on the number or percentage of wells located in each county or municipality. Louisiana and West Virginia distribute a much smaller percentage of severance tax revenue than Pennsylvania to local governments. Texas and New Mexico allocate severance tax revenue to specific state budget categories and do not distribute funds to local governments.

In section III of the report, we discuss other business climate conditions which were outlined in HR 131. These include permitting requirements, geological conditions, geographical considerations, and climate conditions. As might be expected, no two states are alike, and each factor can significantly influence drilling operations. For example, Pennsylvania generally has abundant water sources. However, this fact also introduces challenges in crossing waterways with pipelines, which adds unique permitting requirements that other competitive states with fewer waterways do not experience. From a climate perspective, every resident is familiar with Pennsylvania's numerous freeze-thaw cycles. In our analysis, Pennsylvania had the lowest mean temperature of any peer state. Freezing temperatures can lead to freeze-offs in the flow of natural gas, which in turn impacts operations. We outline many more of these differences, such as miles of pipelines, roadway miles, and the complexity of the geological formations. As directed by HR 131, we also include a detailed discussion on the historical pricing of natural gas at the national level and as compared to the state-specific prices.

In conclusion, this report shows the contextual differences between the top natural gas-producing states. These comparisons highlight the fact that whether an impact fee or a severance tax is used - each mechanism is specific to the unique needs found within the state. Finally, I would like to thank our staff who worked on this project, including analysts David Beaudoin and Anthony Choi. I would also like to acknowledge the cooperation we received from numerous state and federal resources, who helped contribute to this report. I would be happy to answer any questions you may have.