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OIL AND GAS IMPACTS AND THE NEED FOR LOCAL REVENUE

HOUSE FINANCE COMMITTEE

Harrisburg, Pennsylvania

Presented By
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Good afternoon. I am Douglas E. Hill, Executive Director of the County Commissioners Association of Pennsylvania (CCAP). The CCAP is a non-profit, non-partisan association providing legislative and regulatory representation, education, research, insurance, technology, and other services on behalf of all of the Commonwealth's 67 counties. I am pleased be here today to offer testimony in support of House Bill 10, and to give the Committee background on litigation and the surrounding issues that necessitate this legislation.

Although CCAP members have been involved in a wide variety of issues related to oil and gas development, including economic development, infrastructure, environmental and emergency preparedness concerns, the Association's initial and longer-term focus has been on local revenue from oil and gas production. This is because, until 2002, oil and gas, like coal and other minerals, were assessable for real property tax purposes.

Counties are responsible to maintain the assessment rolls, and in doing so assess all categories of property, including residential, commercial, tax exempt and mineral property. In 2002, the Pennsylvania Supreme Court, in *Independent Oil and Gas et al v. Fayette County Board of Assessment Appeals,* found that for oil and gas to be assessable they had to be specifically enumerated in law. Since that time, oil and gas interests have been escaping county, municipal, and school property taxation. The ruling flies in the face of language in the General County Assessment law which states that all property is taxable unless specifically exempted from taxation by the General Assembly.

Importantly, the Court's decision was not based on constitutional or equity grounds, but simply on the lack of specific statutory authority. As a result of this ruling, our *Pennsylvania County Platform* was amended to support authorization to assess oil and gas. Representative DeWeese has introduced House Bill 10, which includes our preferred language to correct the court's decision.

Counties have sought legislation like HB 10 to reverse the Supreme Court ruling from the time of the court decision. However, the matter now takes on new urgency as oil and gas development rapidly expands. The industry brings economic development and jobs, and represents an area of potential growth in a time of economic slowdown. Counties are excited about the opportunities, but these benefits are also no different from what small local businesses and large corporations from inside and outside Pennsylvania bring to the state's overall economy. What *is* different is that all of these other business interests pay a share of the property tax, whereas the oil and gas industry does not because the Supreme Court has created a legal loophole that currently allows them to be exempt from this responsibility.

To summarize our members' position in a very basic way, counties believe oil and gas producers ought to pay their fair share just like producers of other minerals and all other taxpayers currently do. The intent of HB 10 is to restore equity, both among mineral producers and among property tax payers generally. Any time one segment of property is excluded from taxation, the burden of provision of local government services falls to the remainder of the taxpayers, and in fact our proposal also provides for property tax relief for other residents by including language that would shift any windfall increase in revenues to general property tax relief in the first year of implementation.

CCAP argues that the Supreme Court's decision is unfair to residential and commercial property owners, as well as developers of other minerals including coal and limestone, all of which contribute a share to the local property tax base. Local residents and businesses, including farmers who already bear a large share of the property tax burden, should not be forced to shoulder an inequitable portion of the tax burden due to what counties believe to be an errant court ruling.

Restoration of the ability to assess oil and gas truly is just that - a restoration. Based on prior case law, we know that counties were actively assessing oil and gas for property tax purposes as far back as 1910, and until the Supreme Court decision in 2002.

We should also be clear that when we talk about assessing oil and gas, we are talking about property taxes on the producer's interest, not the landowner's. The subsurface mineral rights are assessed as a separate parcel of property from the surface rights, because the landowner has transferred the mineral right to the producer either by virtue of the lease, or transfer of deed, allowing exclusive access to exhaust all of the gas present. The company that severs the mineral interest through deed or lease has capacity for production, so the lease is evidence of potential for extraction, and thus acquires value. Because the oil or gas interests are severable, the entity that owns the oil or gas interest in the lease pays the tax, not the surface property owner.

In responding to the introduction of HB 10, the industry called property tax assessment unnecessary, and claimed that the industry has no impact on county government. To the contrary, there are various levels of impact. Oil and gas development clearly has impacts on local roads and bridges which are owned by counties, townships, and boroughs. Drilling horizontal wells means that high volumes of frac fluids must be used, and often these are hauled to and away from sites in heavy trucks. Responsible operators have been demonstrating willingness to repair the roads they damage, sometimes restoring them to higher standards than existed when they came. But local governments and our constituents have no guarantees under the existing system. If irresponsible operators don't fix the messes they leave behind, or roads deteriorate more rapidly with new traffic, the rest of property tax payers have to foot the bill with no contributions from the oil and gas companies due to the Supreme Court decision.

Counties are involved in human services provision, and commissioners are beginning to share stories from their home counties where crews are actively exploring and drilling which indicate that out-of-state workers will have impacts on our social services system. The child welfare system and the drug and alcohol system, as well our county courts and county jails are the first to feel the impacts in Pennsylvania. And an out-of-state worker who may be on probation or parole in his or her home state falls, by interstate agreement, under Pennsylvania county or state supervision. Any impacts will come at the expense of local citizens because oil and gas is currently not subject to the property tax assessment.

There are other impacts at the county level, as counties are responsible for emergency preparedness and response coordination. Counties also support the industry in providing facilities through the recorder of deeds office to investigate and verify deeds for lease transactions. Many counties contribute to the operations of conservation districts, which are also involved in environmental protection efforts alongside DEP and the river basin commissions.

But all that aside, the fundamental basis of the property tax system is that everyone who owns property – whether an individual, a store, a mineral producer, a power plant, a factory – is a member of the community and derives benefit, directly or indirectly, from that community. Property taxes are one mechanism to share the fiscal cost of providing core community services, in some nomimal proportion of ability to pay. It is not a service fee and so is imposed without regard to the level of use of any of those services, but it nonetheless recognizes the strong interrelatedness of all members of the community.

The industry has argued that few counties were assessing oil and gas prior to the court's 2002 decision, and that the actual income derived from property taxes on oil and gas was minimal at that time.We concede the point, but we also remind the legislature that the context of the late 1900's and early 2000s was one of an industry in decline, with active wells in fewer than half of the counties and, within those counties, outdated mineral assessment methodologies. That said, when the court decision was issued, our counties were in the process of implementing improved assessment methodologies for oil and gas that more accurately reflected the value of the resource. At the time of the litigation, about half of the affected counties had implemented these methodologies and most of the remainder were in the process of doing so.

The state of the industry is drastically different today, and so the prior performance of the tax is not an accurate indicator of anticipated revenue. We candidly have no means to estimate what restoration of assessability would yield. The Marcellus play adds a new swath of counties to the mix, and the nature and volume of the extraction is different, so it is not accurate to compare number of counties implementing the assessment prior to the court's decision with numbers that would likely exist today.

In the past, company representatives have made allegations that assessment of oil and gas is extremely expensive for counties themselves. In checking with our neighboring state of West Virginia, we know that the cost of assessing 59,000 wells for local property taxes and the statewide severance tax is approximately $250,000 per year. The property tax assessment alone costs roughly $4 per well with the average well valued at roughly $100,000. But the cost is not the issue; counties have the obligation to maintain assessed values on all properties, which might include hiring specialty assessors to assess an industrial facility or a power plant, and we even have to pay for developing assessed values for tax exempt property.

We are cognizant of the importance this industry has played in the economy of many counties in the western part of the state, and the growing importance it will play throughout the Marcellus region. Counties are supportive of development of this resource, and want to see it done responsibly. However, counties do not believe that restoration of the property tax assessment will cause the industry to pull out of Pennsylvania. In many other states where oil and gas are currently being developed, the industry pays both a state and local tax. In fact, we have heard anecdotally from commissioners that companies beginning to work in Pennsylvania for the first time are surprised that they don't have to pay a local tax, and have indicated that their business models include a certain margin presuming local taxation. In some cases, they are looking for other ways to make donations to the local community.

Moreover, unlike locating a factory or a retail center, the natural gas resource is fixed to its location. While a car manufacturer can bid among states to find who will make the best tax and incentive offer for their facility, resource extraction, even with horizontal wells, is location-specific. So the question then becomes whether the assessment against the industry – in our case the local property tax – is fair or is uncompetitive. We know that almost all states with active wells have property taxes, severance taxes, or, most frequently a combination of the two. Instead, the industry's prioritization for extraction is based on accessibility, either the physical and geologic terrain or, as is the case in Pennsylvania, the duration of the permit process.

We have also seen arguments raised by industry that they pay taxes already, including corporate taxes and the income taxes paid by their employees. Again, these are all taxes common to other employers in the Commonwealth, and the only difference is that they are not also paying the property tax. We note as well that there are provisions in Act 511 regarding the school and municipal income tax that if there are

reciprocity agreements with another state then the primacy for income tax on those earnings goes to the home state; since a large number of Marcellus employees are out-of-state residents, the tax collections in their host municipalities may be reduced and the industry's argued local tax contribution is even less.

One of the legitimate concerns of the industry, particularly for smaller producers which are the Pennsylvania-based companies that have been here for the history of shallow well drilling, is special considerations for wells with smaller profit margins, typically the older wells nearing the end of the production life which the industry calls stripper wells. Although not clearly defined, our understanding is that stripper wells are found in the traditional oil and gas regions of Pennsylvania, and are typically vertical wells with low production rates. New taxation on these wells could negatively impact parts of the industry, as well as local economies in the western part of the state. We are willing to discuss exemptions based production levels to protect those wells that have only marginal profitability.

Let me now turn briefly to the separate but related issue of severance taxes. While we do not know the details of the severance tax proposal the Governor will offer in the budget address next week, we note that in the past his proposal has not included any revenue share for local governments. We have not taken a position on the severance tax, but if it receives active consideration, we would support a local share, as well as defined separate allocations from the tax for environmental purposes such as the local conservation districts, the Environmental Stewardship Fund or Growing Greener.

However, a severance tax share is not a substitute for restoring counties' ability to assess oil and gas, nor is House Bill 10 a substitute for a share from the severance tax. House Bill 10 is needed to address an existing inequity in the assessment of minerals that was created by the 2002 *IOGA* decision. Other states with vibrant industry to have both a local property tax and a state severance tax. In West Virginia, not only do local governments have a property tax assessment, but the state also dedicates ten percent of its severance tax for counties and municipalities. Of that ten percent, 75 percent is distributed to producing counties, and 25 percent is distributed all counties and municipalities based on population.

As noted, other high producing states have revenue sources from oil and gas extraction for local governments. Texas has both local and state taxation on gas produced and stored with special provisions for high and low producing wells. Wyoming has a severance tax of 6 percent which is shared with local governments. New York has a local property tax, and is considering implementing a state severance tax.

In summary, counties are committed to working with the industry to achieve the proper balance in developing the resource to the benefit of Pennsylvania today, while minimizing negative impacts on future generations. To deal with the issue here and now, and to prepare for the future, however, local revenue will be necessary. In fact, we believe local government revenue and equity in taxation should be placed as a priority, and no state revenue source should be considered unless in conjunction with local revenue. We look forward to working with interested parties to assure that this happens.

I would be happy to answer your questions at this time.