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PENNSYLVANIA LAWMAKERS FAIL TO ADDRESS PRESSING NEEDS REGARDING NATURAL GAS INDUSTRY IN 2011–12 BUDGET

Francis A. Muracca, II
Pittsburgh
1.412.394.7939
famuracca@jonesday.com

Editor's Note - Pennsylvania continues to evaluate alternatives of budgetary funding from the natural gas resources in the Marcellus Shale Formation against possible loss of jobs from adding taxes and fees. Many thanks to Fran Muracca for sharing this insightful commentary.

On June 29, 2011, for the first time in eight years, the Pennsylvania General Assembly, confronted with deep budgetary and economic challenges, passed a balanced budget before the June 30 deadline with no broad-based tax increases and a property tax reform measure. Legislators from both parties sought to fill a portion of the 2011–12 budget gap with a new severance tax or impact fee on natural gas producers, but at the risk of having the budget vetoed, lawmakers voted against including either one in the budget. The $27.15 billion General Fund budget, which passed largely along party lines and was signed into law by newly elected governor Tom Corbett, is also the first Pennsylvania budget since 1970 to significantly reduce spending from the previous year, representing a decrease of $1.17 billion, or 4.1 percent, from 2010–11.

According to Governor Corbett, the 2011–12 budget consolidates and streamlines economic development programs to focus on job creation and attracting businesses to Pennsylvania. The budget maintains important tax credit programs at 2010–11 levels, including the Job Creation and Film Production Tax Credits, and increases the cap on the Research and Development Tax Credit from $40 million to $55 million. The budget also reinstates the phaseout of Pennsylvania's corporate Capital Stock and Franchise Tax, which will be eliminated in 2014. Additionally, lawmakers did not seek to amend Pennsylvania's Corporate Net Income Tax or impose combined reporting on business corporations.

In a last-minute legislative measure, Governor Corbett also sought a series of changes to Pennsylvania's property tax reform law, which will now give taxpayers greater control over local property tax increases through the referendum process. School districts are now restricted from raising property taxes above an index determined by Pennsylvania's Department of Education, with two exceptions: districts now may increase property taxes above the state index without a voter referendum only to fund special education and pension liabilities. The legislature is now out of session until September.

The Marcellus Shale Formation, which principally extends across West Virginia and the Appalachian Basin to northwestern Pennsylvania, represents an important source of energy for the Midwest and the northeastern United States that is projected to last several decades. Geologists estimate that nearly 500 trillion cubic feet of natural gas could be recovered from the formation. Whether to impose a severance tax or an impact fee on natural gas production has been the focus of vigorous debate among lawmakers, economists, producers, local governments, and the general public. Pennsylvania remains the largest natural-gas-producing state without a severance tax.

Shortly after taking office, Governor Corbett created an executive Marcellus Shale Advisory Commission (the "Commission") principally comprised of industry leaders and members of the Corbett administration to study the impact of natural gas drilling on Pennsylvania. The Commission, headed by Lieutenant Governor James Cawley, is due to submit its final report on July 22. The Commission was charged with the responsibility for developing a comprehensive strategic proposal for the responsible and environmentally sound development of the Marcellus Shale resources.

Impact Fee as an Alternative to a Severance Tax

While the debate over the natural gas industry's contribution to Pennsylvania's economy and infrastructure needs is in its third year, the concept of an impact fee on natural gas producers is relatively new. The states where impact fees are most common are concentrated in the South and West, especially Washington, Oregon, California, Arizona, Colorado and Florida.[1] Unlike the severance tax, the possibility of an impact fee has not been flatly rejected by Governor Corbett, who has stated that he would consider a fee to support local communities as long as the money was not collected into the General Fund. However, the governor and legislative leaders have insisted that drilling tax revenue will not offset planned budget cuts for public schools, health care, services for the vulnerable, or public universities or fund other core functions of state government. Governor Corbett's agenda over the coming months is to have the Commission conclude its work before lawmakers move to pass any bill or the governor agrees to any fee structure.

[1] National Impact Fee Survey: 2009; Clancy Mullen, Duncan Associates, Austin, Texas; December 20, 2009.

State enabling legislation governs the kind of impact fees that local governments may enact. Impact fees have historically been imposed by local governments on developers to fund infrastructure improvements and public services associated with specific projects. In most states, local governments have the authority to impose fees for water and wastewater facilities. Similar fees have also been used to compensate municipalities for negative social or environmental risks. In Pennsylvania, traffic-related impact fees are authorized by statute. In 1990, Pennsylvania enacted legislation under its Municipalities Planning Code that allowed local governments to levy impact fees on developers to cover the costs of new roads, water lines, and sewer systems in the vicinity of a new development. A municipality that chooses to adopt a transportation impact-fee ordinance must complete a series of independent studies and receive public comment. Often the cost of, and timeline for, justfying a transportation fee is affordable only for the most affluent municipalities. The various Marcellus Shale impact-fee proposals authored by Pennsylvania lawmakers seek to eliminate the requirement for municipalities to demonstrate the need for an impact fee, bypassing the hiring of independent consultants and preparing studies. The Pennsylvania Builders Association has long opposed impact fees and successfully lobbied against their enactment.

The leading impact-fee proposal currently in the Pennsylvania General Assembly is Senate Bill 1100 (the "Bill"), originally authored by Senator Joseph Scarnati. As originally drafted, the Bill proposed a base fee of $10,000 per year for any well that produces an average of at least 90,000 cubic feet of gas per day. The fee would increase with increased gas production or an increase in the price of natural gas, up to a possible maximum of $100,000 or more per well if the price of gas increased substantially.

On May 16, 2011, the Bill was sent to the Senate Environmental Resources and Energy Committee, chaired by Senator Mary Jo White. Senator White offered an amendment that significantly changed the way the fee was calculated. Senator White argued that since the local impact on the community from any single well would not increase with an increase in the price of gas, a fee with such an increase was more like a tax than an impact fee. As an alternative, she proposed a flat fee of $40,000 per well for the first year, followed by a $10,000 reduction per year for Years 2 through 4, with a continuing fee of $10,000 for Years 5 through 10.

Because of the production curve of a typical horizontal natural gas well, Senator White's amendment produces roughly the same fee as Senator Scarnati's original proposal for a typical well at the current price of natural gas. However, because Senator White's amendment does not adjust the fee in accordance with the price of gas, her amended fee would remain the same despite potential future increases in gas prices. Also, the amended Bill would no longer charge a fee after 10 years of production, while the original Bill imposed the fee for the life of the well as long as it produced an average of at least 90,000 cubic feet of gas per day. Additionally, under Senator White's amendment, natural gas producers could obtain a credit of up to 30 percent of the fee for donations to approved county affordable-housing projects.

Senator White's amendment also made changes to the distribution of the collected fees, although the general structure of the outlays, unlike the fee itself, remained intact. Under the amended Bill, none of the collected fees would be deposited in the General Fund; instead, a separate Shale Impact Account would be established. From this fund, an initial amount ranging from $2.5 million to $7.5 million per year would be distributed to county conservation districts. Beginning in 2012, an additional $1 million would be distributed off the top to the state fire commissioner for the training of first responders to Marcellus Shale emergencies. After these two amounts are paid, 60 percent of the remaining fund would be distributed to counties and municipalities where Marcellus Shale drilling is ongoing. The final 40 percent of the fund would be distributed for environmental grants, the Motor License Fund, and the Hazardous Sites Cleanup Fund.

On June 14, 2011, the Environmental Resources and Energy Committee approved the Bill as amended by Senator White with a unanimous vote, including an affirmative vote by Senator Scarnati. It is not clear when the Bill may receive a vote from the entire Senate. Given Senator Scarnati's position as the Senate's President Pro Tempore, it seems likely that he will be able to push for a vote on his Bill in the fall.

The Pennsylvania Budget and Policy Center opposes the governor's position that a substantial portion of any drilling impact-fee revenues should go only to the local counties where drilling is conducted. While sales, income, and corporate taxes are collected from across the state, then pooled in the state's General Fund and largely redistributed across the state to local governments, impact fees are structured to fund the foreseen and unforeseen needs of areas directly impacted by a particular activity. However, Pennsylvania lawmakers point to the governor's "no tax" pledge as the driving force behind the adoption of an impact fee rather than a severance tax. An impact fee allows the governor and his constituents to depart from standard practice for the distribution of tax revenues while assuring Pennsylvanians that responsible and environmentally safe drilling will be conducted in the state. Arguably, Pennsylvania would be one of the first gas-producing states to deviate from the severance tax norm. By comparison, former governor Ed Rendell used gaming tax revenues to support statewide property tax reductions. Approximately 88 percent of the revenues from table games goes directly into the state's General Fund. The Pennsylvania Budget and Policy Center fails to recognize a distinction between statewide sanctioned gaming activities designed to increase the state's lottery revenues specifically supporting senior citizens and the capital improvements needed to support the extraction of natural resources in specific counties promoting economic growth.

Impact Fee on Natural Gas—Unique in the United States

If Senate Bill 1100 is passed, Pennsylvania would be the first state to impose an impact fee on natural gas production, although under similar circumstances, several other states, including Montana, Washington, and Wisconsin, have permitted impact fees for wind energy production. In other areas, impact fees are common across the United States. In most cases these fees are directed to new development and purport to offset the cost to the community associated with the development by providing funds for such activities as building new schools, maintaining roadways, and supplementing emergency and other municipal services.

The only impact fee on natural gas drilling that has been passed to date was a fee imposed by the County of Rio Blanco, Colorado. Rio Blanco is a rural county where unconventional natural-gas-drilling techniques have led to a recent drilling boom. Using a state statute permitting local governments to impose impact fees on "construction and building materials," the Board of County Commissioners of Rio Blanco imposed an impact fee on various equipment and materials used for natural gas drilling. When Rio Blanco issued a notice of deficiency to ExxonMobil for $748,400, ExxonMobil countered that it did not owe the fee since its materials were not "construction and building materials" as required by the statute. The case eventually made its way to the Colorado court of appeals, which held in favor of ExxonMobil and barred the county from imposing the impact fee on natural-gas-drilling companies.[2] To date, this overturned county impact fee is the only effort to exact an impact fee from natural gas operations in the United States that has been enacted or tested in the courts.

Analysis of a Potential Natural Gas Impact Fee

While a complete economic analysis of the amended Bill has not yet been published, Dr. Rose Baker and Dr. David Passmore of Penn State's Institute for Research in Training and Development did review the potential economic impact of Senator Scarnati's original impact-fee proposal, along with several more traditional severance tax bills.[3] According to Drs. Baker and Passmore, Senate Bill 1100 would generate fees of between $103 million and $172 million per year between 2011 and 2015. These fees alone are too small to have a significant impact on the Pennsylvania economy or the natural gas industry. Drs. Baker and Passmore estimate that the fee would reduce employment by 290 jobs compared to the estimated 7.1 million Pennsylvania jobs in 2011 and that the fee could reduce Pennsylvania's 2011 estimated gross state product of $519 billion by roughly $24 million. The Pennsylvania Budget and Policy Center has also stated that Senator White's amendment drastically reduces the effective tax rate of the Bill to 1 percent from the 3.1 percent proposed by Senator Scarnati.[4] Since the above numbers are based on the original text of the Bill, the current amended version should be even less significant.

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[2] *Bd. of County Comm'rs of Rio Blanco v. ExxonMobil Oil Corp.*, 192 P.3d 582, 590–91 (Colo. Ct. App. 2008).

[3] Dr. Rose M. Baker and Dr. David L. Passmore, "Potential Pennsylvania Economic Impact of Four Natural Gas Severance Tax/Fee Proposals," Presented at Regional Economic Models, Inc., Seminar: *Evaluating Fiscal Impacts: The Example of an Oil and Gas Severance Tax* (May 18, 2011).

[4] *A Turn for the Worse: Sen. Scarnati's Amended Marcellus Shale Fee Plan*, http://www.pennbpc.org/turn-worse-sen-scarnatis-amended-marcellus-shale-fee-plan (June 20, 2011) (web sites herein last visited July 15, 2011).

A June 2011 Quinnipiac University poll[5] showed that 69 percent of Pennsylvanians and 59 percent of Pennsylvania Republicans support some type of severance tax on natural gas. Senate Bill 1100 is poised to balance the support of a severance tax against the anti-tax national sentiment that helped Governor Corbett and the Republicans win election in 2010. On July 15, the governor's Marcellus Shale Advisory Commission voted to include the adoption of a local impact fee on drillers in its final recommendations to the Legislature and executive branch set for release on July 22. Commission members stressed that their recommendations are only "the end of the beginning." Lt. Governor Cawley has warned that the Commission's recommendations will likely undergo significant modification during the legislative process. Pennsylvania residents, the governor and the General Assembly are anxiously awaiting the presentation of the Commission's formal report on July 22, which will serve as a platform to resume debate in September when lawmakers return to Harrisburg.

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[5] *Big Gender Gap Keeps Pennsylvania Gov's Approval Low, Quinnipiac University Poll Finds; Voters Support Natural Gas Drilling 2-1*, http://www.quinnipiac.edu/x1327.xml?ReleaseID=1610 (June 14, 2011).