

Severance Taxes: Preliminary Report Findings

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Sean O'Leary
Policy Analyst
304.720.8682
soleary@wvpolicy.org
www.wvpolicy.org

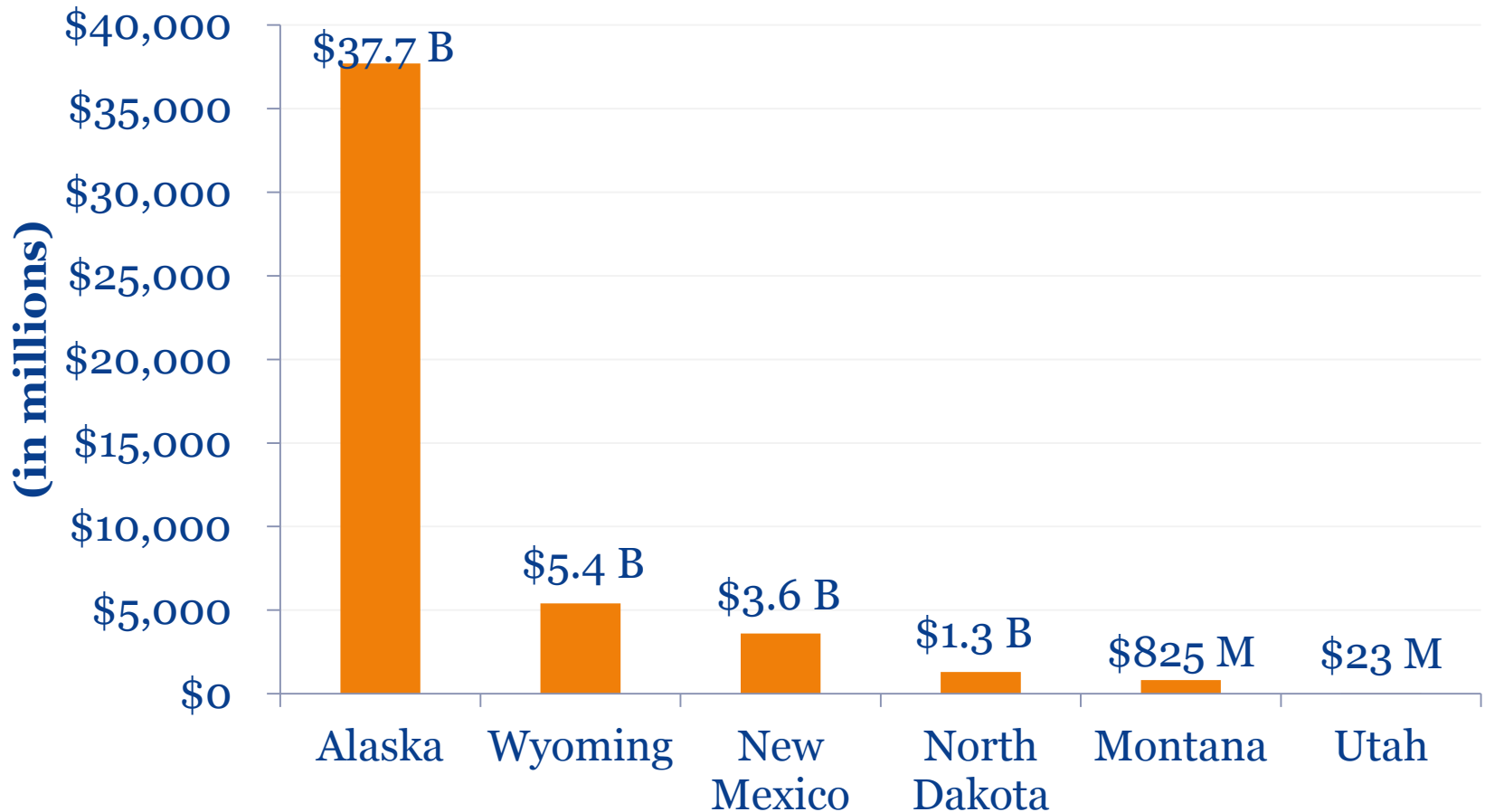
Severance Taxes

- A severance tax is a tax on the privilege of extracting natural resources.
- Revenues are used for various purposes, ranging from education, infrastructure, local government support, to remediation.
- Severance taxes are a significant source of revenue in states where extractive industries play a prominent role in the economy, including West Virginia.

State	Severance Tax Share of Total State Tax Revenue
Alaska	74%
North Dakota	43%
Wyoming	34%
New Mexico	15%
Montana	12%
Oklahoma	11%
West Virginia	9%
Louisiana	9%
Texas	4%
Kentucky	3%

Source: U.S. Census Bureau, 2010 Annual Survey of State Government Tax Collections

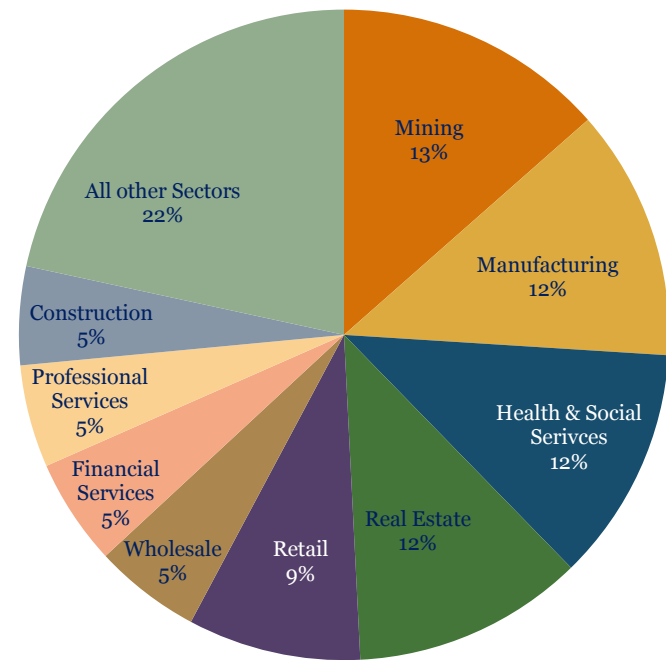
States with Severance Tax Trust Funds



More important than ever

- Severance taxes are important to natural resource states.
- In 2010, the mining industry became the largest contributor to private sector GDP in West Virginia, surpassing manufacturing.
- Severance taxes are the most direct way our most dominant industry provides its share of support to the state.

Share of Private Sector GDP, 2010



Source: U.S. Bureau of Economic Analysis

Why do we have a severance tax?

- Thirty-eight states tax natural resource extraction.
- Severance taxes allow the maximization of the public benefit of natural resources while they exist.
- Natural resources, like coal and natural gas, are a source of wealth while they exist, but will disappear sometime in the future, leaving expensive cleanup and struggling economies behind.
- Severance taxes provide resources for environmental clean-up, as well as a potential resource to alleviate the volatility associated with energy focused economies.

Effective vs. Statutory Rates

- West Virginia's statutory severance tax on coal, oil, and natural gas is 5% of the gross value.
- However, effective rates are often lower than statutory rates.
- The effective rate is the end result after you adjust for deductions, limits and credits.
- For example, West Virginia has a reduced rate for thin seam coal, which saved the coal industry \$74.9 million in 2010.
- These limits and credits lower the severance tax rate below the statutory rate.

How does West Virginia's effective rate compare?

- Table 1 calculates effective severance tax rates by dividing total severance taxes paid by the total value of shipments and receipts for services for the extractive industry.
- West Virginia's overall effective rate is lower than the rate in several other highly productive energy states.

State	Effective Severance Tax Rate
Alaska	11.2%
North Dakota	9.6%
Montana	7.5%
New Mexico	5.4%
Kentucky	3.6%
Wyoming	3.6%
West Virginia	3.2%
Oklahoma	2.8%
Texas	2.7%
Louisiana	2.1%

Source: U.S. Census Bureau, 2007 Economic Census

Do severance taxes affect production?

- Studies of severance taxes in other states have shown tax rates have little effect on production.
- Studies in Wyoming¹ and Utah² have found that even significant changes in in severance tax rates had little impact on industry production, but had a large impact on government revenues.
- There is also little evidence of different effective rates leading to more or less investment from state to state.³
- The coal, oil, and gas industries are guided by the location of reserves, access to markets, and technology and are less able to relocate than industries with mobile capital resources.

1 – Shelby Gerking, et al , *Mineral Tax Incentives, Mineral Production and the Wyoming Economy*, December 2000.

2- Gabriel Lozada and Michael Hogue, *The effect of Proposed 2009 Tax Changes on Utah's Oil and Gas Industry*, University of Utah, December 18, 2008.

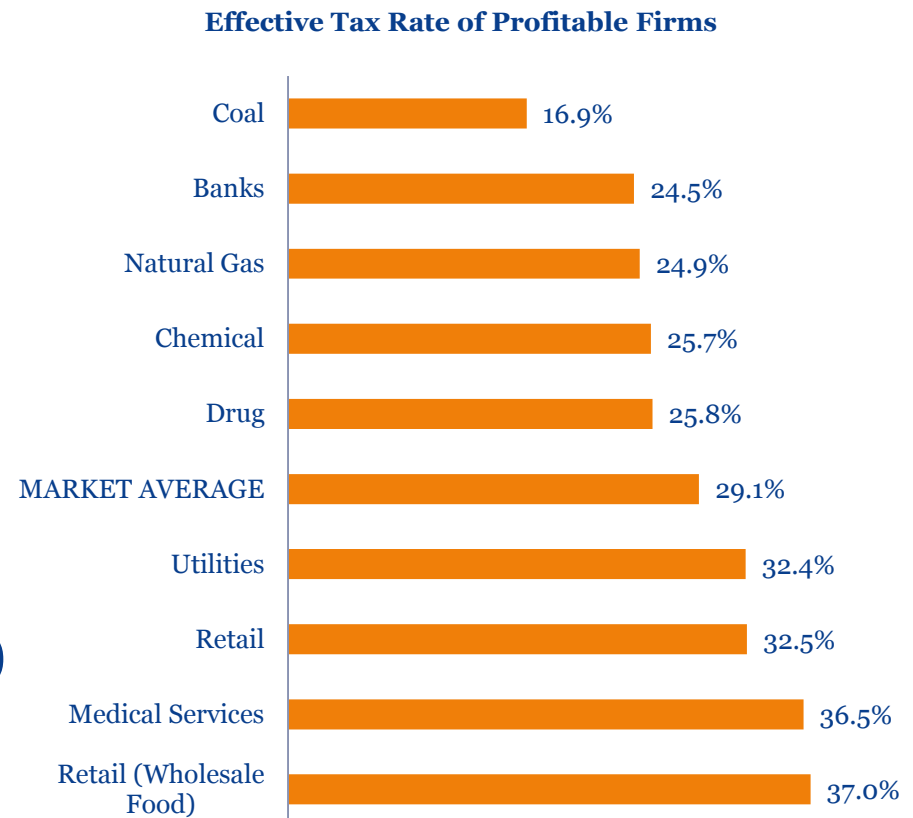
3- Headwaters Economics, *Energy Revenues in the Intermountain West*, October 2008.

Severance Tax Burden

- Severance taxes are highly exportable, particularly for energy producing states.
- Resources extracted in the state are used to produce energy that is largely consumed out of state.
- This allows severance taxes to be passed through to out of state energy consumers.
- In addition, mining industries in West Virginia can deduct their state severance tax payments from their federal corporate income tax, further reducing the burden of the severance tax.

Severance Tax Burden

- The deductibility of the severance tax greatly lowers the corporate tax burden for the coal and natural gas industries.
- Both the coal and natural gas industries have lower than average effective tax rates (local, state, and federal taxes) for profitable industries.



Source: Aswath Damodaran, NYU

Severance Taxes and Local Governments

- In FY2011, \$45.8 million in severance tax revenue was distributed to local governments in West Virginia.
- The revenue is first distributed to the coal and natural gas producing counties and municipalities, then again to all local governments.
- Coal severance revenue is deposited into a special “coal revenue fund” for the local governments.
- County governments have budgeted \$41 million in expenditures from their coal revenue funds for FY2011-2012

Source	Local Dedication
Coal	\$37,742,774
Natural Gas	\$5,680,981
Oil	\$412,030
Coalbed Methane	\$1,255,405
Waste Coal	\$754,463

Source: West Virginia State Tax Department, Severance Tax Disaggregation FY 2011

Severance Taxes and Local Governments

- 46 counties used a total of \$15.9 million of their coal severance tax funds for general government expenditures.
- 27 counties used \$8.1 million for public safety.
- 22 counties used \$5.4 million for health and sanitation.
- 20 counties used \$3.3 million for culture and recreation.
- 15 counties used \$7.4 million for capital projects.
- 14 counties used \$820,620 for social services.

Severance Taxes and Local Government

Most Popular Line Items

Item	Number of Counties
County Commission	24
Courthouse	19
Economic Development	14
Regional Jail	12
Library	12

Largest Total Line Items

Item	Total Expenditures
Courthouse – Capital Project	\$4,932,415
County Commission	\$4,337,154
Regional Jail	\$3,745,153
Courthouse	\$3,177,606
Water	\$2,348,869

Source: West Virginia State Auditor's Office, Local Government Levy Estimates/Budget 2011-2012

Future of West Virginia's Severance Tax

- In 2011, \$449.8 million or 88% of West Virginia's severance tax revenues came from coal, while \$51.5 million or 10% came from natural gas.
- Projected changes in coal and natural gas production will have a significant effect on the state's finances.
- While revenue from coal is expected to decline, revenue from natural gas is expected to boom with the development of the Marcellus Shale.

Projected Severance Tax Revenue (millions of dollars)

Year	Coal	Natural Gas
2010	\$401.9	\$55.6
2015	\$290.6	\$100.5
2020	\$302.8	\$144.8
2025	\$303.7	\$205.5
2030	\$299.7	\$257.1
2035	\$303.8	\$306.4

Source: WVCBP analysis of Energy Information Administration Annual Energy Outlook data