Shared Costs, Shared Resources
State Distribution of Severance Tax Revenues
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Thirty-five states levy severance taxes on the extraction of natural resources. Most commonly, states impose these taxes on the extraction of non-renewable energy resources, including oil, natural gas, or coal, depending on which resources are present in the state. Pennsylvania is the only state with substantial mineral wealth that does not levy a severance tax or fee on the extraction of this finite, natural bounty. In his 2009-10 Budget, Governor Ed Rendell has proposed enacting a severance tax on the extraction of natural gas. The proposed tax would use the same rate as neighboring West Virginia to limit any market distortions of the tax. As currently proposed, the proceeds of the tax would go into the state's General Fund.

The experience of other states shows that drilling for natural gas brings economic benefits but also imposes substantial costs on state and local government and the environment. These costs include road maintenance and repair, police and emergency services, and environmental protection and compliance. Severance taxes are a means to insure that the public costs of resource extraction are paid by producers rather than state and local taxpayers. This brief examines how selected other states distribute the proceeds of their severance tax to help affected entities provide the public goods and services demanded by the resource extraction.

MOST SEVERANCE TAX REVENUE STAYS IN GENERAL FUND

In most states, the largest share of severance tax revenue goes into the general fund or is used for general government purposes. Many states with severance taxes share a portion of their collected severance taxes with local governments or set aside a portion of the tax for specific purposes, such as conservation projects or a permanent fund. Many states do all three.

Fifteen states share a portion of their collected severance taxes with local governments. Those states are Colorado, Florida, Kansas, Kentucky, Louisiana, Mississippi, Montana, New Mexico, North Dakota, Oklahoma, Oregon, South Dakota, Tennessee, West Virginia, and Wyoming.[1]

Ten states earmark in statute severance tax revenue for environmental cleanup or conservation. These states include California, Colorado, Florida, Louisiana, Montana, New Mexico, Ohio, Oklahoma, West Virginia, and Wyoming.[2] In some cases the earmarking is done through the general fund; in other cases, a separate fund is established.

Several western states put a portion of their severance tax revenues into a permanent fund, including Alaska, New Mexico, and Wyoming. Permanent funds are special accounts where severance tax dollars can be saved to invest for the future. The funds are called "permanent" because in most cases, only the interest earned by the fund can be spent, leaving the principal intact for future needs. States often redirect a portion of the earnings of permanent funds back into their general funds to help augment regular tax revenues. This extra revenue helps reduce the demand for sales and income taxes to support public services. In theory, as the balances in the permanent funds grow over time, the earnings can help offset declining severance tax revenues that the states use to balance their budgets. In most states that have mineral extraction industries, these businesses also pay

[1] Judy Zelio and Lisa Houlihan, *State Energy Revenues Update*, National Conference of State Legislatures, June 2008, http://www.ncsl.org/programs/fiscal/severtax.htm.
[2] Judy Zelio and Lisa Houlihan, *State Energy Revenues Update*, National Conference of State Legislatures, June 2008, http://www.ncsl.org/programs/fiscal/severtax.htm.

property taxes, either on buildings and equipment, deposits and production, or both. This was the case, too, in Pennsylvania until 2002 when the state Supreme Court ruled that oil and gas reserves are not subject to local property taxes.

MANY STATES SHARE FUNDS WITH LOCAL GOVERNMENTS

PBPC's recent paper, *Responsible Growth: Protecting the Public Interest with a Natural Gas Severance Tax*, recommends that Pennsylvania structure its severance tax to allocate some revenue to local governments and to the environment. Examples of state specific allocations approaches are listed below.

West Virginia transfers more than 6% of its total severance tax collections to counties and municipalities.[3] Seventy-five percent of this amount goes to coal- or oil- and gas-producing counties, and the remaining 25% is divided between counties and municipalities based on population across the state.[4] The Division of Forestry receives 0.3% of the state's total severance tax revenue.[5] These funds come from the state's severance tax on timber.[6] In FY 2008, West Virginia collected $524 million in severance taxes and returned $35 million to local governments.

Louisiana's Constitution stipulates that parishes receive one-fifth of severance tax collections from oil and natural gas. The tax is distributed based on the parish of production.[7] In 2007 parishes received only about 3% of the state's severance tax collection−$32 million in total−because of a per-parish cap of less than $1 million.[8] After distributing funds to the state's parishes and paying for debt, a portion of the state's oil and gas revenue, including the severance tax, is deposited in the Louisiana's Coastal Protection and Restoration Fund.[9] The amount transferred to the restoration fund ranges from $7 million to $25 million, depending on total oil and gas revenue received by the state.[10]

Montana imposes a complex set of taxes on oil and gas production and distributes tax revenue to state and local governments in an equally complex manner. In 2009, it is estimated that 45% of the oil and gas production tax revenue will go to the state's general fund, while 48% is split among counties and school districts.[11] A small portion of the state's severance taxes is used specifically for environmental projects. One of the many earmarks of the state's coal severance tax is for state park land acquisition (1.27% of the total tax) and 0.7% of the oil and gas production tax is set aside for natural resource projects.[12]

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[3] Beth Gorczyca Ryan, "Coal Taxes Support Communities Across West Virginia," *The State Journal*, Charleston, West Virginia, February 22, 2007, http://www.statejournal.com/story.cfm?func=viewstory&storyid=20383.

[4] West Virginia State Treasury, *Tax Distribution Site*, http://www.wvsto.com/Tax+Distribution/DefaultTD.htm.

[5] Governor's FY 2010 Executive Budget, Volume I, West Virginia State Budget Office, http://www.wvbudget.gov/BudDocs/WVBudget_FY2010_Vol%201_Report.pdf.

[6] Sandy Fisher, Collecting the Timber Severance Tax: Are We Getting Cheated? The Timber Reform Research Project: West Virginia Highlands Conservancy, January 2002, http://www.wvhighlands.org/PDFs/TimberSeveranceReport.pdf.

[7] Louisiana State Constitution of 1974, as amended, Article VII. Revenue and Finance. http://senate.legis.state.la.us/Documents/Constitution/Article7.htm#%C2%A74.%20Income%20Tax;%20Severance%20Tax;%20Political%20Subdivisions.

[8] Tammy Sharp, "PJAL endorses Amendment 4 at meeting," *Leesville Daily Leader*, October 27, 2008, http://www.la-par.org/PAR%20News%20Files/leesville%20daily%20leader_10.27.2008.pdf.

[9] Coastal Protection and Restoration Authority of Louisiana, CPRA statute, http://www.lacpra.org/index.cfm?md=pagebuilder&tmp=home&nid=28&pnid=4&pid=10&fmid=0&catid=0&elid=0.

[10] Scott Angelle and Robert Harper, FY 09-10 Executive Budget Review: Natural Resources, presentation before the Louisiana House Committee on Appropriations, http://house.legis.state.la.us/housefiscal/Publications/Appropriations%20Meetings%20April%202009/Natural%20Resources%20-%20HB%201%20FY%2010%20Format.ppt.

[11] North Dakota Legislative Council staff for the Taxation Committee, "Oil-producing States' Funding Allocation to Political Subdivision," October 2008.

[12] Montana Department of Revenue, Biennial Report, July 1, 2006 to June 30, 2008, http://mt.gov/revenue/publicationsreports/biennialreports/Corrected_2007-2008_Biennial_Report.pdf.

Colorado splits its severance tax collections evenly between its Department of Local Affairs and Department of Natural Resources. The Department of Local Affairs distributes funds to local governments via a formula and competitive grants. The Department of Natural Resources uses half of its severance tax proceeds to fund oil and gas regulation efforts, low-income energy assistance programs, and wildlife conservation.[13] The other half is allocated to a permanent fund that supports water conservation projects. Colorado allows most companies to deduct 87.5% of local property taxes paid from state severance tax liability. The property tax offset does not apply to low-producing wells.

State	General Fund	Local Governments	Environment	Permanent Fund	Other	Property Tax
Arkansas[14]	75%	25%	0%	0%	0%	Yes
Colorado	0%	50%	25%	25%[15]	0%	Yes
Kentucky[16]	50%	50%	0%	0%	0%	Yes
Louisiana	90%	3%	3%	0%	4%	Yes
Michigan	100%	0%	0%	0%	0%	Yes
Montana[17]	46%	48%	5%	0%	1%	Yes
New Mexico[18]	60%	5%	0.2%	4%	31%	Yes
North Dakota[19]	17%	8%	10%	65%	0%	No
Ohio	0%	0%	100%	0%	0%	Yes
Oklahoma[20]	84%	16%	0%	0%	0%	Yes
Texas[21]	93%	0%	7%	0%	0%	Yes
West Virginia[22]	65%	7%	0.3%	0%	28%	Yes
Wyoming[23]	24%	3%	4%	41%	29%	Yes

[13] Marc Carey and Jason Schrock, *Overview of Mineral Taxes in Colorado: State severance tax and federal mineral lease revenue*, Colorado Legislative Council Staff, February 25, 2009 http://www.leg.state.co.us/Clics/Clics2009A/commsumm.nsf/b4a3962433b52fa787256e5f00670a71/27a301726aa5ebf787257568006a52bd/$FILE/09JointFin0225AttachB.pdf.

[14] This is the distribution of Arkansas' severance tax on oil and gas.

[15] Colorado's Perpetual Fund provides loans for water conservation projects in the state.

[16] This is the distribution of Kentucky's coal tax, that state's primary severance tax.

[17] Distribution of Montana's oil and gas production tax in FY 2008. Property taxes on oil and gas are levied by the state.

[18] Figures represent the distribution of New Mexico's emergency school tax, severance tax, conservation tax, natural gas processors tax, and production ad valorem tax in FY 2008. The state's Severance Tax Permanent Fund distributes 4.7% of the 5-year market average return of the fund back to the General Fund each year. This transfer is not included in the distribution percentages listed in the table. "Other" includes debt service on General Obligation debt and school bonds.

[19] Distribution of the state's oil extraction and oil and gas gross production taxes under current law using estimated collections from the 2009-11 Biennium. Funds earmarked for basic education included in the General Fund totals. Table excludes transfers to the General Fund from the Permanent Oil Tax Trust Fund as these vary each biennium. In the 2007-09 Biennium, the state transferred $115 million to the General Fund. Local governments receive a portion of production taxes in lieu of property taxes, but the amounts are capped.

[20] Table figures show apportionment of the state's severance tax on natural gas (their main source of severance tax revenue) from fiscal year FY 2005-2006.

[21] This is the statutory distribution of Texas' gas production tax. 0.5% of the state's 7.5% rate is earmarked for monitoring and enforcement activities and is classified as "environment" in this table. The portion of the tax allocated for the state's Foundation School Fund, which provides the state's subsidy for public education, is included in the "general fund" category.

[22] This is the distribution of all severance taxes collected by West Virginia in 2008. Included in the "other" category are payments to the Worker's Compensation Debt Reduction Fund and the State Infrastructure Fund.

[23]The Wyoming distribution represents all mineral excise taxes in 2006. Taxes earmarked for the state highway fund and the Budget Reserve Account are classified as "other." The Permanent Wyoming Mineral Trust Fund provided $124 million to the General Fund in 2006, but is not included in this distribution.