Ohio Legislative Service Commission

Bill Analysis

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H.B. 212

130th General Assembly
(As Introduced)

Reps. R. Hagan, Foley, Patterson, Boyd

BILL SUMMARY

- Levies a severance tax at a rate of 7.5% of the spot price market value of oil, condensate, and gas ("hydrocarbons") produced by horizontal wells, with adjustments to reflect the heat energy of natural gas liquids.
- Distributes revenue from the new severance tax to fund environmental and oil and gas regulatory purposes, local governments, and a state custodial trust fund to promote economic development.
- Earmarks 67% of the new severance tax revenue to counties, townships, and municipal corporations based on each subdivision's population, road miles, and workers employed in hydrocarbon production.
- Requires hydrocarbon severers to annually report the locations of the counties, municipal corporations, and townships in which each of the severer's production employees reside.
- Creates the custodial Severance Tax Trust Fund funded by 13% of horizontal well severance tax revenue.
- Creates a compensated Severance Tax Trust Board to manage and invest the money in the Severance Tax Trust Fund.
- Authorizes the General Assembly, beginning in fiscal year 2020, to appropriate up to a certain amount of money from the Severance Tax Trust Fund to fund economic diversification projects, education, or workforce development or to use to obtain federal matching grants.

- Creates the Severance Tax Trust Fund as a custodial account consisting of a portion of the moneys received from the tax levied by the bill on the severance of oil, condensate, or gas through the use of a horizontal well.

- Requires moneys in the Fund to be appropriated for specified purposes in amounts determined by a formula established by the bill.

- Creates the Severance Tax Trust Board for the purpose of administering, managing, and investing moneys in the Severance Tax Trust Fund, and specifies the Board's duties.

- Creates the Severance Tax Trust Administration Fund as a custodial account consisting of a portion of the moneys received from the tax levied by the bill on the severance of oil, condensate, or gas severed through the use of a horizontal well, and requires money in the Fund to be used to pay the administrative expenses of the Board.

CONTENT AND OPERATION

Horizontal well severance taxes

Overview

Continuing law levies a tax on any person that severs oil or natural gas in Ohio. The tax equals 10¢ per barrel of oil and 2½¢ per MCF (1,000 cubic feet) of natural gas.[1] Additionally, continuing law imposes a separate "cost recovery assessment" in the additional amount of 10¢ per barrel of oil and ½¢ per MCF of natural gas for all oil and natural gas wells, except very low volume wells.[2] Revenue from this tax and assessment funds the activities of the Department of Natural Resources' Division of Oil and Gas Resources Management and Division of Geological Survey.

The bill distinguishes between "horizontal" wells and "non-horizontal" wells for severance tax purposes. The bill maintains continuing law's severance tax and cost recovery assessment on oil and natural gas extracted by use of either type of well, but, beginning October 1, 2013, levies a new tax on hydrocarbons extracted through use of a horizontal well. Unlike continuing law's severance tax, the new horizontal well tax is not levied on the basis of the volume of natural resources extracted, but rather on the basis of the value of extracted hydrocarbons. Revenue from the new horizontal well tax

[1] R.C. 5749.02(A)(5) and (6).

[2] R.C. 1509.50, not in bill.

is distributed differently than revenue from continuing law's severance tax and cost recovery assessment (see "**Horizontal well severance tax proceeds**," below).

Horizontal wells are wells drilled to produce oil or gas with a wellbore that reaches a horizontal or near horizontal position in the Point Pleasant, Utica, or Marcellus formation and that is stimulated to produce. (Stimulation is defined as a "process of enhancing well productivity, including hydraulic fracturing operations.")[3]

Taxable resources

The new horizontal well tax applies to "gas" (as compared to the current "natural gas"), which is defined as hydrocarbons in a gaseous state at normal temperature and pressure. It is not clear if gas differs from the natural gas that continuing law measures for severance tax purposes because natural gas is not specifically defined for purposes of that severance tax. But the bill also taxes condensates as a separate category of taxable natural resource if severed by a horizontal well. Condensate is defined as liquid hydrocarbons that were originally in the gaseous phase in the reservoir. The principal distinction between condensate and gas appears to be that condensate in its extracted form is liquid that is measured in barrels while gas in its extracted form is gaseous and measured in MCF.[4]

Horizontal well severance tax rates

Beginning October 1, 2013, the severance of hydrocarbons from a horizontal well is taxed at new rates. The bill levies the tax on oil and condensate extracted from a horizontal well at a rate of 7½% of the spot market value – i.e. the metered value of the oil or condensate in the quarter multiplied by the average of the daily closing oil and condensate spot "West Texas Intermediate" prices for that quarter listed on the New York Mercantile Exchange.

The rate of the tax on gas extracted from a horizontal well varies according to the BTU value of the gas extracted. (BTU is a per cubic foot measurement of the amount of heat energy required to raise the temperature of one pound of water by one degree Fahrenheit.) If the BTU of gas measures less than or equal to 1,050 BTU, the rate equals 7½% of the metered value of such gas in the quarter multiplied by the average of the daily closing gas spot prices for that quarter reported on the New York Mercantile Exchange. If the gas exceeds 1,050 BTU, then the gas is taxed according to the following formulas, the result of which is multiplied by the quantity of each BTU category of gas

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[3] R.C. 1509.01(Z) and (GG), not in bill, and 5749.01(D).

[4] R.C. 5749.01(K) and (L).

extracted by the well for that quarter. The spot price for natural gas liquids (NGLs) is the average daily spot price for the quarter reported on the "Mont Belvieu NGL" index.[5]

Gas BTU Measurement	Rate Formula
>1050-1200 BTU	(Gas Spot Price × 7½% × 0.9329) + (NGL Spot Price × 7½% × 2½)
>1200-1350 BTU	(Gas Spot Price × 7½% × 0.8232) + (NGL Spot Price × 7½% × 5½)
>1350 BTU	(Gas Spot Price × 7½% × 0.7366) + (NGL Spot Price × 7½% × 8½)

The Tax Commissioner is required to post quarterly spot prices for oil, gas, condensate, and NGLs and the quarterly tax rate for gas extracted from horizontal wells on the Department of Taxation's web site no later than 15 days after the end of each calendar quarter.[6]

Horizontal well severance tax proceeds

Severance tax revenue collected from the new horizontal well severance is credited as follows:[7]

Percentage of Revenue	Fund Receiving Revenue	Use of Revenue
47%	Impacted Subdivision Fund	Current expenses and permanent improvements of counties, townships, and municipal corporations (see "**Funding for local governments**," below).
20%	Nonimpacted Subdivision Fund	Current expenses and permanent improvements of counties, townships, and municipal corporations (see "**Funding for local governments**," below).
11.7%	Severance Tax Trust Fund	Economic diversification, workforce development, and education (see "**Severance Tax Trust Fund**," below).
9%	Immediate Removal Fund	Used by the Director of Environmental Protection to pay costs of investigating or abating unauthorized discharge of material that requires emergency action to protect public health or safety or the environment or conducting remedial actions *(R.C. 3745.12, not in bill)*.

[5] R.C. 5749.02(A)(10) and (11) and (E); Sections 3 and 4.

[6] R.C. 5749.02(D). NGL is not defined in the bill, but is defined elsewhere in the Revised Code as hydrocarbons contained in natural gas that are generally extracted in a gas processing plant and liquefied, and include mixtures of ethane, propane, and butane. See R.C. 4906.01.

[7] R.C. 5749.02(B).

Percentage of Revenue	Fund Receiving Revenue	Use of Revenue
7%	Well Inspection Fund	Used by the Chief of the Division of Oil and Gas Resources Management to pay costs associated with oil and gas well inspection *(R.C. 1509.074)*.
4%	Oil and Gas Well Fund	Used by the Chief of the Division of Oil and Gas Resources Management to plug idled and orphaned wells and restore land affected by drilling or extraction and to take corrective actions against imminent health or safety risks at an orphaned or idled well or at a well for which the owner cannot be contacted. (Idled and orphaned wells are wells that have been abandoned or for which the bond has been forfeited.) *(R.C. 1509.02 and 1509.071.)*
1.3%	Severance Tax Trust Fund Administrative Fund	See "**Severance Tax Trust Fund Administrative Fund**," below.

Funding for local governments

More than one-half the revenue collected from the new horizontal well severance tax is used to provide funding for counties, townships, and municipal corporations ("subdivisions"). Of the revenue dedicated to this purpose, roughly 70% is used by the Tax Commissioner to provide funding to subdivisions that are or will be major producers of oil and gas from horizontal wells ("impacted subdivisions"), as certified by the Chief of the Division of Oil and Gas Resources Management before August 1 of each year. The remaining 30% is used to provide funding for other subdivisions ("nonimpacted subdivisions").[8]

The bill requires the Commissioner to adopt rules to administer the distribution of revenue to subdivisions.[9]

Impacted subdivisions

After the Chief compiles a list of impacted subdivisions, the Tax Commissioner is required, before September 1 of each year, to distribute revenue from the Impacted Subdivision Fund to impacted counties and municipal corporations based on a formula that takes into account the following three factors:

[8] R.C. 5749.02(B) and 5749.18(B).

[9] R.C. 5749.18(H).

(1) The proportion of employees who are employed in hydrocarbon production who reside in the county's unincorporated territory or in the municipal corporation compared to the total number of those employees residing in the entire county.

(2) The proportion of the population of the county's unincorporated territory or of the municipal corporation compared to the total population of the entire county.

(3) The proportion of miles of roads in the county's unincorporated territory or in the municipal corporation compared to the total road miles in the entire county.[10]

The Commissioner is required to adopt rules to assign a weight to each of the three factors relative to one another. The assigned weights apply uniformly among both impacted and nonimpacted subdivisions.[11]

Of the proportion to be distributed to each impacted county, 50% is retained by the county and the remaining 50% is divided among each impacted township in the county, applying the same three-factor formula described above, except each factor compares the employment, population, and road miles for the unincorporated territory of each impacted township to those for the unincorporated area of the entire county.[12]

Nonimpacted subdivisions

The Tax Commissioner is required, before September 1 of each year, to distribute revenue from the Nonimpacted Subdivision Fund to nonimpacted counties and municipal corporations, employing the three-factor formula described above. Similar to the distribution among impacted subdivisions, 50% of a nonimpacted county's distribution is reserved for nonimpacted townships in that county.[13]

Use of funds

To facilitate the receipt of funds, the bill requires each county, township, and municipal corporation to create a fund in the subdivision's treasury to which the Tax Commissioner will credit revenue from the Impacted and Nonimpacted Subdivision Funds. Any funds credited to a subdivision must be used to pay the subdivision's current operating expenses or permanent improvements.[14]

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[10] R.C. 5749.18(C)(2).

[11] R.C. 5749.18(H).

[12] R.C. 5749.18(C)(2).

[13] R.C. 5749.18(D).

[14] R.C. 5749.18(E) and (G).

Severer report of employees' residence

The bill requires, before March 1 of each year, that each severer subject to an oil or gas severance tax submit a form provided by the Commissioner on which the severer must report the number of its employees employed in production operations and the counties and municipal corporations or townships in which each of those employees resides. The severer is not required to use the form provided by the Tax Commissioner to submit this information as long as the required information is reported adequately on another form.[15]

Severance Tax Trust Fund

The bill creates the Severance Tax Trust Fund as a custodial fund. The Fund consists of 11.7% of the money received from the tax levied by the bill on the severance of oil, condensate, or gas through the use of a horizontal well (see "**Horizontal well severance tax proceeds**," above).[16]

Beginning in fiscal year 2020, money in the Fund may be appropriated to provide funding for economic diversification projects, education, workforce development, federal matching grants, and higher education. The amount appropriated in each fiscal year cannot exceed amounts equal to the following:

(1) For fiscal year 2020, 1% of the investment earnings of the Fund in the preceding fiscal year;

(2) For fiscal year 2021, 2% of the investment earnings of the Fund in the preceding two fiscal years, divided by two;

(3) For fiscal year 2022, 3% of the investment earnings of the Fund in the preceding three fiscal years, divided by three;

(4) For fiscal year 2023, 4% of the investment earnings of the Fund in the preceding four fiscal years, divided by four; and

(5) For fiscal year 2024 and every fiscal year thereafter, 5% of the investment earnings of the Fund in the preceding five fiscal years, divided by five.[17]

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[15] R.C. 5749.18(F).

[16] R.C. 190.01.

[17] R.C. 190.04.

Except for the purposes discussed above, the General Assembly cannot appropriate money in the Fund except upon approval of ⅘ of the membership of the House of Representatives and of the Senate. Money so appropriated may be used for any purpose.[18]

Severance Tax Trust Board

The bill creates the Severance Tax Trust Board for the purpose of administering, managing, and investing moneys in the Severance Tax Trust Fund.[19] The Board and the Board's staff, in managing and investing the assets of the Fund, must exercise the judgment and care under the circumstances then prevailing that an institutional investor of ordinary prudence, discretion, and intelligence exercises in the designation and management of large investments entrusted to it, not in regard to speculation, but in regard to the permanent disposition of funds, considering preservation of the purchasing power of the Fund over time while maximizing the expected total return from both income and the appreciation of capital.[20]

Duties

Not later than one year after the bill's effective date, the Board must do each of the following:

(1) Establish a statement of investment policies and guidelines, including the Board's overall investment philosophy and other related policies as necessary for the effective management and investment of the assets of the Severance Tax Trust Fund;

(2) Establish a framework or process for the management of the investment risk of the Fund;

(3) Approve the long-term or strategic asset allocation of the Fund in terms of the proportion of total assets to be invested on average over time in the various asset classes or risk categories as well as the minimum-maximum range within which the assets can be allocated at any point in time; and

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[18] R.C. 190.01.

[19] R.C. 190.02(A).

[20] R.C. 190.03(A).

(4) Establish an investment management structure for the Fund and proportion of assets in an asset class to be managed by external investment managers versus the Board's staff.[21]

Additionally, on or before December 1 each year, the Board must submit to the Governor, the Speaker and Minority Leader of the House of Representatives, and the President and Minority Leader of the Senate recommendations for legislation to improve the Severance Tax Trust Fund.[22]

Membership, organization, and compensation

The Severance Tax Trust Board is composed of the following members:

(1) The Treasurer of State;

(2) One member of the public who is a representative of the oil and gas industry;

(3) One member of the public who is a representative of a statewide environmental organization; and

(4) Six members of the public, each of whom must have direct experience in the management, analysis, supervision, or investment of financial assets.[23]

All of the public members are to be appointed by the Governor with the advice and consent of the Senate. The bill provides for staggered four-year terms and establishes standard appointment procedures. The public members are to be compensated for their service in accordance with state law, and all members must be reimbursed for their necessary expenses incurred in the performance of their work as members.[24]

The Board may hire staff to assist it in the conduct of its duties; staff members are in the unclassified service. The Director of Administrative Services is required to fix the compensation of the staff.[25]

At the first meeting, which must occur not later than one year after the bill's effective date, members of the Board must elect a chair. The Board must meet annually

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[21] R.C. 190.03(B).

[22] R.C. 190.05.

[23] R.C. 190.02(A).

[24] R.C. 120.02(B) and (E).

[25] R.C. 190.02(D).

or more frequently at the call of the chair. A majority of the Board constitutes a quorum. The Board is a public body for purposes of the Public Meetings Law, and records of the Board are public records.[26]

Finally, the Board must prepare and submit an operating budget for each fiscal year. Administrative expenses incurred by the Board must be paid from the Severance Tax Trust Administrative Fund created by the bill (see "**Severance Tax Trust Administrative Fund**," below).[27]

Severance Tax Trust Administrative Fund

The bill also creates the Severance Tax Trust Administrative Fund as a custodial fund. The Fund consists of 1.3% of the moneys received from the tax levied by the bill on the severance of oil, condensate, or gas through the use of a horizontal well (see above). Money in the Fund must be used to pay the administrative expenses of the Severance Tax Trust Board. Before the end of each fiscal year, the Board must transfer any money in the Fund in excess of that included in the Board's operating budget for that fiscal year to the Severance Tax Trust Fund. The bill precludes the Board from appropriating or encumbering money in the Severance Tax Trust Fund.[28]

HISTORY

ACTION	DATE
Introduced	06-18-13

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[26] R.C. 190.02(C).

[27] R.C. 190.02(F).

[28] R.C. 190.02(G).