HB 803

Department of Legislative Services

Maryland General Assembly
2009 Session

FISCAL AND POLICY NOTE
Revised

House Bill 803 (Delegate Beitzel)

Ways and Means Budget and Taxation

Garrett County - Code of Ordinances - Natural Gas

This bill alters various provisions of law regarding natural gas production in Garrett County. The tax rate on natural gas production is reduced and the distribution of tax revenues is altered.

Fiscal Summary

State Effect: None.

Local Effect: Garrett County revenues from natural gas severance taxes may decrease annually by a significant amount. Distribution of revenues is altered, providing additional revenue to the county general fund and less revenues to specific purposes. Revenues increase in certain municipalities and decrease in others. Local expenditures are not affected.

Small Business Effect: Meaningful benefit to natural gas producers in Garrett County.

Analysis

Bill Summary: The bill decreases the tax rate on natural gas produced in Garrett County from 7% to 5.5% of the wholesale market value at the well head. The bill also changes the distribution requirements of the tax revenues, specifying that one-eleventh of the revenues be distributed to municipalities in the county on a per-capita basis and the rest be distributed to the county general fund.

The bill removes the requirement that the purchaser pay a portion of the natural gas production tax, specifying that the full tax liability is to be paid by the producer and is due by the fifteenth day of each month, instead of quarterly. The bill also removes provisions allowing the tax liability to be borne ratably by all interested parties, which may include the royalty interest and the lessor's interest.

Current Law: Natural gas produced and saved for commercial purposes in Garrett County is subject to a 7% tax of the wholesale market value. The tax is not applicable to gas injected into a reservoir for storage, gas produced from oil wells with oil and lawfully vented or flared, or gas used for lifting oil, unless sold for such purposes.

The producer of natural gas is liable for 60% of the tax levied and the first purchaser is liable for 40% of the tax levied. The lax liability of the producer is deducted from the price paid by the purchaser and the purchaser must pay the full tax liability to the county by the last day of April, July, October, and January.

Tax revenues from natural gas production in Garrett County must be credited to the county's Natural Gas Fund. Disbursements from the fund must be as follows:

- 15% of the receipts collected within a municipality must be paid to the corporate officials of that town;
- the first $50,000 must be used towards liquidation of the indebtedness of Garrett County for public school building purposes;
- the next $25,000 of receipts from the tax must be used towards the payment of the expenses of maintenance and operation of the Garrett County Memorial Hospital; and
- the balance of the funds must be dedicated to a New School Building Repair and/or Addition Fund and spent as approved by the State Superintendant of Schools.

Background: Over the past two years, energy companies have shown considerable interest in locating natural gas from a geologic formation known as the Marcellus Shale, which spans Garrett and Allegany counties in Maryland. The Marcellus Shale was not targeted for gas exploration in the past due to high anticipated drilling costs. However, new cost-effective drilling techniques are currently being used in the Marcellus Shale formation in Pennsylvania (and to a lesser extent in West Virginia) and are anticipated in New York and Maryland. Energy companies have begun to contact Garrett County land and mineral rights owners about leasing lands for drilling.

Garrett and Allegany counties are the only gas producing counties in Maryland. As shown in **Exhibit 1**, natural gas severance tax revenues in Garrett County have been minimal in recent years. Allegany County does not impose a severance tax on natural gas.

Exhibit 1
Garrett County Natural Gas Severance Tax

Fiscal Year	Revenues
2005	$512
2006	3,649
2007	2,537
2008	777

Major oil-producing states such as Texas and Oklahoma have severance taxes on natural gas at rates between 7.5% and 8%, respectively. Natural gas exploration of the Marcellus Shale formation is still in its early stages and Pennsylvania has seen the most active development. Pennsylvania does not impose a severance tax on natural gas, but recently a statewide severance tax on natural gas at a rate of $0.047 per 1,000 cubic feet of gas produced has been proposed in the state legislature.

Local Fiscal Effect:

Reduction of the Natural Gas Tax Rate

The fiscal impact of reducing the severance tax rate on natural gas production depends on the number of active natural gas wells in the county. At current production levels, the impact is minimal; however, a substantial increase in the number of natural gas wells is anticipated in the near future. Assuming a wholesale price at $6 per thousand cubic feet, a natural gas well producing 2.4 million cubic-feet per day will generate $367,920 in county severance taxes at the current 7% rate. If the rate is reduced to 5.5%, the same well will generate $289,080 in county severance taxes, a difference of $78,840. In the event that five new wells are drilled, Garrett County tax revenues would decrease by $394,200 annually.

Reducing the tax rate may possibly result in more natural gas exploration in the county, as a lower severance tax results in additional profits for natural gas producers.

Allocation of Natural Gas Tax Revenues

As advised by Garrett County, expansion of natural gas wells in the county will increase the cost of road maintenance in certain areas due to increased truck traffic. Revisions to natural gas tax distribution requirements, as provided in the bill, allocate 91% of revenues to the county general fund, making the revenues available to offset the negative externalities of natural gas exploration in the county.

Revisions to distribution requirements also reduce required natural gas tax disbursements to the Garrett County Memorial Hospital by $25,000 annually, and to the county New School Building Repair and/or Addition Fund by an undetermined amount (the balance of the fund). Revenues from natural gas severance taxes increase in municipalities that do not have natural gas production within their corporate limits; however, revenues decrease for municipalities that have natural gas production within their corporate limits.

Small Business Effect: Reducing the severance tax rate on natural gas provides a meaningful benefit for companies that operate natural gas wells in the county.

Additional Information

Prior Introductions: None.

Cross File: SB 651 (Senator Edwards) - Budget and Taxation.

Information Source(s): Department of Legislative Services

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