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Governor Kasich Proposes Significant Severance Tax Increase

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On February 11, 2015, Representative Ryan Smith introduced Ohio House Bill 64 (the Bill), the governor's proposed 2016-2017 biennial budget bill. As Governor John Kasich previously announced, the Bill contains a number of Ohio tax proposals, including reform of Ohio's severance taxes. The Bill would make a number of significant changes aimed at raising additional revenue from the extraction of oil and gas through horizontal wells. Severance tax provisions affecting traditional wells would remain largely unchanged. The administration estimates the Bill would raise additional severance tax revenue of approximately $325 million during the biennium.

The new tax rates on oil and gas products severed by a horizontal well would vary. The tax on oil would be 6.5% of the value of the oil severed. For gas entering the natural gas distribution system without further processing, the rate would be 6.5% of the value of the gas severed. For all other gas, the rate would be 4.5% of the value of the gas after processing, regardless of where the processing facility is located. For condensate collected at a point other than the wellhead and separated from oil or gas severed by a horizontal well, regardless of where title passes, the rate would be 6.5% of the value of the condensate collected. For natural gas liquids collected at a point other than the wellhead and separated from oil or gas severed by a horizontal well, regardless of where title is transferred, the rate would be 4.5% of the value of natural gas liquids collected. Natural gas liquids would now include ethane, whether it is being rejected or sold.

The value of the severed products would be determined by multiplying the volume severed, processed or collected as the case may be (i.e., barrels of oil, MCF of gas, barrels of Marcellus-Utica condensate, and one million BTUs of natural gas liquids) by the average spot price for the particular product during the calendar quarter that is two calendar quarters prior to the calendar quarter in which the product was severed, processed or collected. The tax commissioner would determine these prices from a publicly available source determined by the tax commissioner, and would be required to certify and post such prices on the tax commissioner's website no later than the last day of the first month of each calendar quarter.

For purposes of ensuring compliance with these new taxes, the Bill would give the tax commissioner specific authority to inspect the books, accounts, records and memoranda, and examine under oath, “any person involved in” the sale, transportation, or other disposition of oil, gas, condensate, or natural gas liquids. This provision seemingly expands the tax commissioner’s existing audit authority beyond the books and records of the severer, to include third parties (e.g., marketers).

The Bill would eliminate the severance tax on gas from a traditional well if such well’s production does not exceed 910,000 cubic feet in a quarter for a severer filing on a quarterly basis or 3,640,000 cubic feet for a severer filing on an annual basis. The Bill would also exempt production from an exempt domestic well, generally meaning a well owned by the owner of the land and used primarily to provide gas for the owner’s domestic use.

The Bill would require each severer to register for the severance tax with the tax commissioner before severing any natural resource (not just oil and gas products).

This Bill would represent a major change in the way Ohio severers are taxed. If you questions or concerns about how this Bill may affect your business please contact your Vorys attorney, Scott Ziance, (614) 464-8287, sjziance@vorys.com or John S. Petzinger, (614) 464-3022, jspetzinger@vorys.com.