State and Local Tax Alert: Changes to the Ohio Severance Tax Proposed

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On December 4, 2013, House Bill 375 (the Bill) was introduced in the Ohio General Assembly. If enacted, the Bill would make several significant changes to Ohio's existing oil and gas severance tax laws. The most significant proposed changes in the Bill are summarized in this alert.

Severance Tax Rate

Summary of Current Law

Under current law, the severance tax rate for oil and natural gas severed through both horizontal and conventional wells is equal to 3 cents per MCF of natural gas severed and 20 cents per barrel of oil severed, which includes an administrative fee of .50 cents per MCF of natural gas and 10 cents per barrel of oil.

Rate For Conventional Wells Under the Bill

Under the Bill, the administrative fee would be eliminated, and the base rate for natural gas would be reduced from 2.5 cents per MCF to 1.5 cents per MCF for conventional wells. Thus, the total severance tax rate for oil and gas severed through conventional wells would be equal to 1.5 cents per MCF of natural gas and 10 cents per barrel of oil.

Rate For Horizontal Wells Under the Bill

For oil and gas severed through horizontal wells, the severance tax would be based on a percentage of the net proceeds received, and would be equal to 2% of the net proceeds received, with a 1% capital recovery rate in effect for five years. In other words, the rate would be 1% of the net proceeds received by the owner for five years, and 2% thereafter. In addition, for horizontal wells that produce less than 100 MCF per day of natural gas, the rate would be 1% for that natural gas. Similarly, for horizontal wells that produce fewer than 17 barrels of oil per day, the rate would be 1% for that oil. The net proceeds received would be self-reported by the owner of the horizontal well, and would be equal to the gross receipts from the severance of oil and gas less any post-production costs related to the sale of the oil and gas (i.e., costs related to gathering, processing, transporting, fractionation of, and delivery for sale of oil and natural gas, and any related adjustment accounting for shrinkage).

Payment of Horizontal Well Tax

Under the Bill, the owner of the horizontal well would be responsible for reporting and paying severance tax on a quarterly basis in a similar manner as required under current law. An owner, however, may designate a severer to pay the severance tax on behalf of the owner. If the owner does make that designation, the Bill allows the severer to recoup the amount of taxes paid from the owner, but only to the extent that the severer does not claim a tax credit equal to the amount of horizontal well severance tax paid (as described in detail later in this alert).

Non-Refundable Personal Income Tax Credit and Commercial Activity Tax Exclusion

The Bill would provide for a non-refundable personal income tax credit equal to the amount of severance tax paid with respect to horizontal wells for a taxable year. The credit would be available to the well owner or severer, depending on who paid the severance tax. The tax credit would be non-refundable, but able to carried forward for up to seven years. A taxpayer that is a direct or indirect investor in a pass-through entity that paid a horizontal well severance tax may claim a distributive or proportionate share of the tax credit. The Bill also would allow the owner or severer who paid the severance tax to designate another person with a working interest or royalty interest in the well to claim the tax credit for horizontal well severance tax paid. That designation would need to be made in writing and included with the quarterly severance tax return filed by the owner or severer. Finally, the Bill would exclude from commercial activity tax liability gross receipts realized from the sale of oil or natural gas by a severer or owner that paid a horizontal well severance tax on the basis of that oil or natural gas.

Vorys will continue to track the progress of the Bill and will provide updates as appropriate. In the meantime, if you have any questions about any of the proposed amendments discussed in this Alert, please contact your Vorys attorney or Scott J. Ziance at sjziance@vorys.com or 614.464.8287; Chris L. Connelly at clconnelly@vorys.com or 614.464.8244; or John S. Petzinger at jspetzinger@vorys.com or 614.464.5696.