Crude Oil and Natural Gas Severance Tax
Policy Development 2014

Issue:

Over the past several years, drilling counties have been assessing "ad valorem" taxes to surface owners for oil and gas drilling on their property. By 2013, almost all of the drilling counties were beginning to assess this tax. Tennessee Code Annotated 60-1-301(c), which deals with the oil and gas severance tax, says that "No other tax shall be imposed on such gas and oil by the state, counties, or any other political subdivision of the state." The oil and gas industry maintains that the ad valorem tax equates to a second severance tax based on the fact that the tax is calculated using annual production reports.

In addition to a question of the legality of the ad valorem taxation, the oil and gas industry has the following concerns:
Severed Minerals - Landowners with severed mineral rights are receiving tax bills on the oil and gas produced on that land, despite the fact that they did not receive royalties on the product.
Unitization Issues - Wells that draw oil or gas from multiple mineral owners are having taxes assessed to the landowner on whose land the well is located creating an unfair disparity.
Calculation of Tax - The state is using annual well production reports to calculate the tax. The oil and gas industry contends that the tax would be more fairly assessed as a percentage of revenues, making it an income tax.

Questions:

Should Farm Bureau be involved in this issue?

Do you consider double taxation to be occurring in these situations?

What reforms would improve severance taxes?

Background:

Severance taxes are excise taxes on natural resources that are severed from the earth. The severance of coal, oil, gas, ores and other minerals is subject to tax in 34 states in the U.S. In some states, a tax is imposed on every person severing natural resources from the soil or water of the state. However, in the majority of states, the severance taxes are limited to certain specified industries, such as coal or iron mining, natural gas or oil production, etc. where the nature of each commodity is carefully specified. While the tax is usually payable by the severer or producer, a few states provide that payment is to be made by the first purchaser, unless the product is not sold within a specified period following severance, in which case the tax is to be paid by the producer. When the tax is imposed on the producer, the question sometimes arises as to what constitutes production. The statutes may provide definitions about production and define some acts necessary to separate, refine or finish a product as part of the production. If the production is carried on by more than one person, the tax will be allocated to the value of the product in each stage.

In the U.S. severance taxes usually are held to be excise taxes rather than property taxes. Therefore, they are not subject to constitutional restrictions applicable to property taxes and do not constitute double taxation when imposed in addition to ad valorem taxes.

Currently the state of Tennessee levies a tax on all gas and oil removed from the ground at a rate of three percent of the sales price. Property taxes vary, and are values derived from four components: the appraised value of the land, the assessment ratio (set at 25% of the appraised value for residential and farm land or 40% for commercial/industrial property), the assessed value, and the county tax rate. Within the past five years, severance taxes have accounted for an average 0.02 percent of the total tax revenue for Tennessee. In 2012, severance taxes included $2,450,000 out of the total $11.9 billion tax revenue. One-third of severance taxes are allocated to the producing county, while the remaining two-thirds is deposited into the state general fund.

Oil and gas companies, as well as landowners, have been fighting the taxation with litigation. The Coal Creek Company sought a summary judgment against the tax assessments of The Intervener, Division of Property Assessments, and Assessor of Property for Anderson, Campbell, and Morgan Counties. The State Board of Equalization ruled that: “the Assessors methodology for valuing the mineral components of subject parcels violates the prohibition in T.C.A. 60-1-301 against taxing oil and gas removed from the ground except for a severance tax…” This ruling was made on January 28, 2014 and has been appealed.

Farm Bureau Policy:

State and Local Taxes (Partial)

The Tennessee Legislature has a responsibility to adequately fund education, law enforcement and other primary roles of state government. For these services, all citizens should be responsible for paying some direct taxes to support government. The tax system funding these programs should be structured to ensure it contributes to maximum efficiency and economy in government.

We strongly oppose a statewide property tax and a property tax based on the value of a vehicle. Tax reform must not be used as a tool to increase taxes. We oppose all efforts to raise tax rates.

Since we cannot foresee all of the various combinations of taxes in an effort to reform our tax structure, the Tennessee Farm Bureau Federation’s Board of Directors should analyze the economic impact to Tennessee farmers of any proposal. The Board should adopt the position with the best long-term economic interest of Tennessee farmers.