

MARCELLUS SHALE TAX ISSUES AND OPPORTUNITIES

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As we reported in a previous edition of this newsletter, Act 46 of 2010, more commonly known as Pennsylvania's 2010-2011 budget bill, contained a commitment by the General Assembly to pass a natural gas severance tax by October 1, 2010, with an effective date of no later than January 1, 2011. Despite much posturing and negotiating, the Democrats and Republicans were not able to come to an agreement on the final form of a severance tax. Therefore, we find ourselves in the midst of an administration transition, in which incoming Governor Corbett has pledged not to enact any new taxes or tax increases. At this point the likelihood the enactment of a severance tax seems remote. Still, there are rumblings from the Democratic leadership in the House that the severance tax may not be totally dead.

One of the main sticking points with the negotiations of last summer and fall was where the revenue from a severance tax would go. Each of the several competing bills and ideas sliced the revenue pie up in a different way, with the General Fund often being the main beneficiary. We understand that the current Democratic leadership is prepared to alter the content in what was last session's H.B. 1489 and introduce a new bill that would devote all of the revenue to: (1) paying for local costs stemming from drilling; (2) providing environmental safeguards; and (3) infrastructure. The new proposal would be a volume-based tax, set at .30 per thousand cubic feet of gas extracted (MCF). H.B. 1489 would have imposed tax at .35/MCF. Even with these changes, any severance tax proposal faces a huge and likely insurmountable hurdle—at least in the short term—given Governor-elect Corbett's no new taxes pledge.

The severance tax isn't the only tax issue on the table with respect to Marcellus Shale. Last session's H.B. 10 would have subjected oil and gas interests to real estate property taxation. Currently, oil and gas interests are not subject to property taxation under the Pennsylvania Supreme Court's holding in *Independent Oil & Gas Association v. Board of Assessment of Fayette County*, 572 Pa. 240, 814 A.2d 180 (2002) ("*IOGA*"). Prior to the Supreme Court's decision in *IOGA*, many counties assessed such oil and gas interests as part of the property tax base. In *IOGA*, however, the Court determined that the assessment statutes do not provide for the taxation of oil and gas interests because they are not "lands" or any physical improvement "permanently affixed" to the ground. *Id.* H.B. 10 specifically would have included "rights held pursuant to a lease or other agreement" regarding natural gas and oil as being subject to taxation as real estate. Given the views of some legislators with respect to the impact of drilling on local governments, reintroduction of a bill similar to H.B. 10 is likely.

The Marcellus Shale has created a boom in economic activity over large portions of Pennsylvania. Excavators, engineers, transportation companies and the hospitality industry are reaping the benefits of the extraction of natural gas. Those involved in the Marcellus Shale industry should make sure they are taking full advantage of the tax exemptions available to them and understand the implications of their activities with respect to Pennsylvania taxes. For instance, those who contract with drilling companies to erect extraction equipment or prepare drilling sites, may qualify for the sales and use tax manufacturing exemption. Out of state companies who send employees or contractors into Pennsylvania for work in the industry, should understand that they will likely have nexus with Pennsylvania for corporate net income and foreign franchise taxes, and may incur additional obligations with respect to local earned income and business privilege taxes.

Along the same lines, those property owners who have royalty rights as a result of the leasing of land for drilling, may find themselves with personal income tax issues or the need for estate planning services. If you have any questions with respect

to the Pennsylvania tax consequences of Marcellus Shale activities, please feel free to contact any member of the McNees SALT Group.

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